INTERNATIONAL MONETARY FUND

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KENYA

July 2023

FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS AND REQUEST FOR A 20-MONTH ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY, REQUESTS FOR EXTENSION, REPHASING, AND AUGMENTATION OF ACCESS, MODIFICATION OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA AND WAIVER OF NONOBSERVANCE FOR A PERFORMANCE CRITERION, AND MONETARY POLICY CONSULTATION CLAUSE—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KENYA

In the context of the Fifth Reviews Under the Extended Fund Facility and Extended Credit Facility Arrangements and Request for a 20-Month Arrangement Under the Resilience and Sustainability Facility, Requests for Extension, Rephasing, and Augmentation of Access, Modification of a Performance Criterion, Waiver of Applicability for Performance Criteria and Waiver of Nonobservance for a Performance Criterion, and Monetary Policy Consultation Clause, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Acting Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 17, 2023, following discussions that ended on May 22, 2023, with the officials of Kenya on economic developments and policies underpinning the IMF arrangements under the Requests for Resilience and Sustainability Facility. Based on information available at the time of these discussions, the Staff Report was completed on June 30, 2023.
- **Supplements of the Staff Report** updating information on recent developments.
- **Statement by the Executive Director** for Kenya.

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

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PRESS RELEASE

PR23/265

IMF Executive Board Completed the Fifth Reviews of Kenya's Extended Fund Facility and Extended Credit Facility Arrangements and Approves Arrangement under the Resilience and Sustainability Facility

FOR IMMEDIATE RELEASE

- The IMF Executive Board completed the fifth reviews under EFF/ECF arrangements for Kenya, allowing for an immediate disbursement equivalent to SDR306.7 million (about US$415.4 million). This includes SDR81.4 million (about US$110.3 million) from augmentation of access.
- The Executive Board also approved a 20-month arrangement under the Resilience and Sustainability Facility (RSF) in an amount of SDR407.1 million (about US$551.4 million) to support Kenya's ambitious efforts to build resilience to climate change and catalyze further private climate financing.
- Key policy priorities of the program include reducing debt vulnerabilities through multi-year fiscal consolidation efforts. This will be done through raising tax revenues and rationalizing spending, while protecting priority social and developmental spending. A proactive monetary policy stance is also part of a mutually reinforcing prudent set of policies.

Washington, DC – July 17, 2023: The Executive Board of the International Monetary Fund (IMF) today completed the fifth reviews under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF) arrangements for Kenya. The Board has also approved an extension of the EFF/ECF arrangements from the current 38 months to 48 months (through April 1, 2025) to allow sufficient time to implement the authorities' reform agenda and realize the program's key objective and an augmentation of access amounting to 75 percent of quota (SDR407.1 million) over the extended program duration for balance of payments support.

The Board's decision allows for an immediate disbursement of SDR306.7 million (about US$415.4 million), bringing total disbursements under the arrangements so far to SDR1.51 billion (about US$2.04 billion). In completing the review, the Executive Board also approved modification of program conditionalities, waivers of nonobservance of the continuous performance criteria on accumulation of external arrears and end-June 2023 tax revenue target in light of corrective measures taken by the authorities and waiver of applicability for all other end-June 2023 and continuous quantitative performance criteria.

The Executive Board also approved Kenya's request for an arrangement under the Resilience and Sustainability Facility (RSF) of SDR407.1 million (75 percent of quota; about US$551.4 million) to support Kenya's ambitious efforts to build resilience to climate change. The RSF duration will coincide with the period remaining under the EFF/ECF arrangements, as extended.

The EFF/ECF arrangements (approved on April 2, 2021, see Press Release 21/98) aim to support Kenya's program to address debt vulnerabilities, the authorities' response to the COVID-19 pandemic and global shocks, and to enhance governance and broader economic reforms while safeguarding resources to protect vulnerable groups and address developmental needs. The Kenyan authorities have made good progress in implementing their economic reform program despite facing the worst drought in decades and a challenging external environment. The RSF-supported program is expected to further integrate climate-related considerations in macro policies and frameworks by adopting green public financial management and climate-sensitive public investment management reforms, introduce carbon pricing, enhance effectiveness of Kenya’s existing frameworks to mobilize climate finance, and strengthening disaster risk reduction and management.

Executive Board Assessment

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

“Kenya's economy has been resilient despite the worst drought in many decades and a difficult external environment. The ECF and EFF arrangements continue to support the authorities’ efforts to address emerging challenges to sustain macroeconomic stability and market confidence, promote growth, and advance ongoing reforms. While the medium-term outlook remains positive, in the near-term global headwinds continue to have a bearing on economic activity, amid elevated inflationary pressures. The authorities' commitment to robust policies to sustain reforms that promote resilient and inclusive growth will support Kenya's positive medium-term prospects.

“The approval of the FY2023/24 Budget and 2023 Finance Act are crucial steps to support ongoing consolidation efforts to reduce debt vulnerabilities while protecting social and development expenditures. However, recent challenges in resource mobilization and elevated uncertainty call for contingency plans that can be quickly deployed to ringfence fiscal performance going forward. Tighter financing conditions also require a prudent debt policy and continued efforts to prioritize concessional loans.

“The Central Bank of Kenya’s (CBK) commitment to a data dependent policy stance is essential to keep inflation expectations anchored. The CBK should also continue taking appropriate steps to strengthen its reserves position and deepen the FX market, while allowing exchange rate flexibility as a shock absorber.

“Sustaining the momentum in the structural reform agenda will require prioritizing strengthening public financial management systems; management of fiscal risks from state-owned enterprises—including by enhancing their governance and oversight; enhancing the anti-corruption framework; addressing shortcomings in the AML/CFT framework; and ensuring effective expenditure audits for transparency and accountability.

“The reforms under the RSF program are expected to advance Kenya’s already strong track-record at addressing climate-related challenges. These reforms will advance efforts to incorporate climate risks into fiscal planning and the investment framework, reduce emissions through carbon pricing, enhance Kenya’s existing frameworks to mobilize climate finance; and strengthen disaster risk reduction and management.”

Table 1. Kenya: Selected Economic Indicators, 2021—2026

	2021 Act.	2022 Act.	2023 Proj.	2024 Proj.	2025 Proj.	2026 Proj.
Output						
Real GDP growth (%)	7.6	4.8	5.0	5.3	5.3	5.4
Prices						
Inflation –average (in %)	6.1	7.6	7.8	6.6	5.4	5.4
Central government finances (fiscal year)[1]						
Total revenue (% GDP)	16.1	17.6	17.7	18.3	18.3	17.9
Expenditure and net lending (% GDP)	24.4	23.8	23.6	22.6	22.3	21.2
Overall fiscal balance (% GDP)	–8.3	–6.2	–6.0	–4.3	–4.0	–3.3
Public debt						
Gross nominal debt (% GDP)	68.2	68.4	70.6	68.5	66.9	65.2
Gross external debt (% GDP)	34.7	34.5	37.9	37.8	36.7	35.5
Money and Credit						
Broad money (% change)	6.1	7.1	7.5	9.5	10.3	11.1
Credit to private sector (% change)	8.6	12.5	9.5	12.1	12.8	12.4
Policy rate, end-of-period (%)	7.0	8.75	…	…	…	…
Balance of payments						
Current account balance (% GDP)	–5.2	–5.1	–4.8	–5.0	–5.0	–5.0
Gross international reserves (in months of imports)	4.7	3.9	3.3	3.5	3.7	3.8
Exchange rate						
REER (% change; positive = appreciation)	–2.6	2.2	…	…	…	…

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

[1] Based on fiscal year (i.e., 2023 represents fiscal year 2022/23).

INTERNATIONAL MONETARY FUND

KENYA

June 30, 2023

FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS AND REQUEST FOR A 20-MONTH ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY; REQUESTS FOR EXTENSION, REPHASING, AND AUGMENTATION OF ACCESS, MODIFICATION OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA AND WAIVER OF NONOBSERVANCE FOR A PERFORMANCE CRITERION, AND MONETARY POLICY CONSULTATION CLAUSE

EXECUTIVE SUMMARY

Context. The Kenyan economy faces multiple near-term challenges—including limited fiscal and external buffers, elevated cost of living, exchange rate pressures, tight financial conditions—while global headwinds are weighing on activity. Tackling these challenges and ensuring a steady reduction of Kenya's debt and debt vulnerabilities will require addressing difficult policy trade-offs with mutually reinforcing policies and carefully prioritizing the authorities' "bottom-up" reform agenda. Downside risks to the program baseline are significant in the near term from elevated uncertainty in major economies' outlook and in the event of insufficient policy actions to sustainably address the FX market dislocation, elevated inflation, and emerging slowdown in tax revenues.

Program performance. The authorities reaffirmed their commitment to the program and are pursuing reforms consistent with the program objectives. All end-December 2022 quantitative performance criteria (QPC) and continuous performance criteria (PC) since the last EFF/ECF reviews were met. The end-December 2022 indicative target on protecting social spending was met but the one on exchequer requests was missed due to difficulties in timely mobilization of budget resources. The structural benchmarks (SBs) for January–April 2023 were met. On the end-December 2022 SBs, Cabinet submission of the action plan for the power company was not met but implemented with a delay in May 2023 and the SB on fuel price decisions to align with budgeted resources remains outstanding and is proposed to be reset for end-August 2023. The end-June 2023 SB on draft amendments to address legal and regulatory gaps in the AML/CFT framework is on-track. Under the EFF arrangement, the-June 2023 QPC on tax revenues is likely to be missed. The authorities commit to take corrective measures on tax revenues to remedy the underperformance in taxes and ensure it does not impact achievement of the

FY2023/24 tax targets. The end-December 2022 Monetary Policy Consultation Clause was triggered and would be triggered for end-June 2023 if inflation in June stays above 6.75 percent. The authorities raised the policy rate in March 2023 and further tightened the monetary policy stance in June 2023.

Focus of the Review. The review focused on realigning policy priorities to tackling ongoing domestic and external challenges while meeting the program objectives. These include for monetary policy to proactively respond to the inflationary developments and shocks facing the economy, supported by the ongoing fiscal consolidation. Domestic revenue mobilization, strengthening CBK's reserve position, deepening the FX market and promoting exchange rate flexibility while also advancing structural reforms and addressing governance concerns are all part of the authorities' plans to create a solid foundation for resilient growth. With challenges and uncertainties elevated, including from regional and global sources, the review also considered contingency plans that can be quickly deployed to ringfence fiscal performance which are expected to help boost readiness to recalibrate policies.

Requests. Against the backdrop of a difficult global environment and tight external financial conditions, the authorities are seeking an extension of the EFF/ECF arrangements by 10 months through April 1, 2025 and a blended augmentation of access by 75 percent of quota under the EFF/ECF arrangements as balance of payments support to navigate the challenges posed by a highly uncertain outlook for frontier economies' access to international capital markets and to help underpin market confidence to facilitate Kenya's market access in 2024, and rephasing of budget support over the extended duration of the EFF/ECF arrangements. For the end-June 2023 QPCs under the EFF arrangement, the authorities are requesting waiver of nonobservance for the tax revenues target and waiver of applicability for all other end-June 2023 PCs. In addition, they request a modification of the end-December 2023 target on net international reserves and its adjustors. Finally, the authorities are seeking support under a 20-month Resilience and Sustainability Facility (RSF) with an access of 75 percent of quota to complement Kenya's already-strong efforts at addressing climate-related challenges.

Approved By
Catherine Pattillo (AFR) and Eugenio Cerutti (SPR)

The mission team comprised H. Teferra (head), T. Rasmussen (Resident Representative in Nairobi Office), V. Crispolti, S. Gupta, and G. Amidžić (all AFR); S. Hida (FAD); P. Iossifov (SPR); T. Kapan and G. Pasricha (both MCM); D. Robinson, J. Duasing, and R. Snipeliski (all LEG, virtually); and D. Tallam and K. Tuitoek (IMF Nairobi Office), with assistance from F. Nyankiye, F. Morán Arce, and M. Nsanzimana (all AFR), Isabella Pérez (MCM), and C. Odwogi and E. Muiruri (IMF Nairobi office). Discussions were held in Nairobi during May 8–22, 2023. E. Nyamongo (OEDAE) participated in the discussions. The team met with President William Ruto; Cabinet Secretary for the National Treasury & Economic Planning (NT), Prof. Njuguna Ndung'u; Governor of the Central Bank of Kenya (CBK), Dr. Patrick Njoroge, whose term ended on June 18; the Principal Secretary for NT, Dr. Chris Kiptoo; Deputy Governors of the CBK, Ms. Sheila M'Mbijjewe and Dr. Susan Koech; members of the National Economic Council; and other senior government and CBK officials. Staff also had productive discussions with a range of government agencies, the private sector, and development partners.

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Abbreviations

AML/CFT	anti-money laundering/ combatting the financing of terrorism
ASAL	Arid and Semi-Arid Land
BoP	balance of payments
CA	current account
CBK	Central Bank of Kenya
DIGNAD model	Debt, Investment, Growth, and Natural Disasters model
DSA	Debt Sustainability Analysis
DPO	Development Policy Operation
EAC	East African Community
FATF	Financial Action Task Force
FPAS	Forecasting and Policy Analysis System
FX	foreign exchange
FY	fiscal year
GDP	gross domestic product
GEF	Global Environmental Facility
GHG	greenhouse gas
IT	indicative target
KQ	Kenya Airways
KPLC	Kenya Power and Lighting Company
MEFP	Memorandum of Economic and Financial Policies
MPCC	Monetary Policy Consultation Clause
MTRS	Medium-Term Revenue Strategy
NDC	nationally determined contribution
NIR	net international reserves
NPL	non-performing loans
NT	National Treasury and Economic Planning
PAYE	Pay As You Earn
PFM	public financial management
PIM	public investment management
PIMIS	Public Investment Management System
PPP	public-private partnership
PV	present value
QPC	quantitative performance criterion
RM	reform measure
SB	structural benchmark
SC	state corporation
SOE	state-owned enterprise
SSA	Sub-Saharan Africa
TA	technical assistance
TMU	Technical Memorandum of Understanding
UCT	upper credit tranche
VAT	value-added tax
y/y	year-on-year

CONTEXT

1. Kenya is confronted with multiple challenges, exacerbated by the difficult global environment. The authorities are facing several near-term issues related to the high cost of living; exchange rate pressures; difficulties in mobilizing budgeted resources—including due to worsened outlook for external commercial financing since the 4th EFF/ECF reviews and underperformance in revenue collection. At the same time, they are spearheading several initiatives—including the Financial Inclusion Fund ("Hustler Fund"); affordable housing; expansion of water infrastructure; privatization of state-owned enterprises (SOEs); and efforts to address domestic arrears accumulated over the past several years by public entities, among others in the roads sector. In addition, climate-related events, such as the recent multi-season drought, are expected to occur more frequently, further complicating the economic challenges. Doing all this will require tackling difficult policy trade-offs and improving coordination across government entities.

2. Against this backdrop, the authorities are seeking augmentation of access and extension of the EFF/ECF arrangements. The request for extension of the EFF/ECF arrangements through April 1, 2025, will provide additional time to implement the authorities' reform agenda and realize the program's key objective of putting overall public debt/GDP firmly on a downward trend after a prospective temporary worsening in 2023 on account of faster exchange rate depreciation. In addition, as part of a comprehensive strategy to address challenges posed by continued disruptions in global markets and untested market access for over a year, the authorities are requesting augmentation of access under the EFF/ECF arrangements, supported by more robust and mutually reinforcing policies to achieve the program's objectives and underpin market confidence.

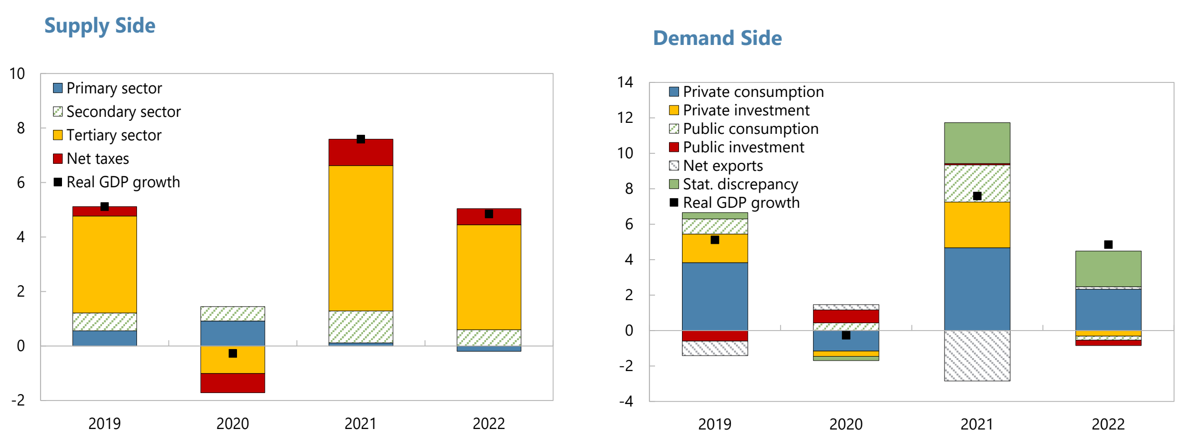
3. The authorities are also seeking support under a 20-month Resilience and Sustainability Facility (RSF) to sustain their climate-related reform efforts. Despite its modest contribution to global greenhouse gas (GHG) emissions, the Kenyan economy is highly vulnerable to climate change shocks such as droughts, locust invasion, and floods (Annex III). While Kenya has made considerable achievement in addressing its climate related vulnerabilities, the authorities consider the RSF support would advance their ambitious climate objectives while exploiting synergies with other official financing and further catalyzing private financing for climate-related efforts (Box 4).

RECENT MACROECONOMIC AND FINANCIAL DEVELOPMENTS

4. Kenya's economy remains resilient amid a challenging environment—including due to the worst drought in decades (Text Figure 1).

- In 2022, real GDP growth stood at 4.8 percent — a level below expectations and relative to regional peers—reflecting the intensification of the multi-decade-worst drought, which also exacerbated food and economic insecurity among the vulnerable population and slowed activity in the downstream sectors (e.g., manufacturing and wholesale and retail trade). On the demand side, consumption and investments were constrained by the higher cost of living, and tighter policy environment. Against this backdrop, the current account (CA) deficit narrowed (5.1 percent of GDP) as non-energy imports declined, and exports remained resilient.

Text Figure 1. Kenya: Contributions to Real GDP Growth
(Percentage points)



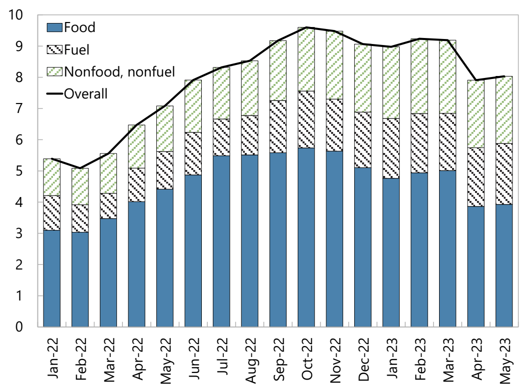
Source: Kenya National Bureau of Statistics.

- Developments in food prices continued to affect inflation (8 percent y/y in May 2023) which remained above the target band of 2.5–7.5 percent since June 2022 (Text Figure 2). Meanwhile, adjustments in domestic fuel and energy prices continued, with added urgency under the new administration.[1] Contributions from nonfood, nonfuel inflation have inched up. Following the June 26, 2023 interest rate hike of 100 basis points, the Central Bank of Kenya (CBK) has tightened the policy rate by a cumulative 350 basis points since May 2022. Producer price inflation was at a decade high level in 2022 and well above consumer price inflation (Text Figure 3).
- Fiscal policy was further tightened by adopting a Supplementary I FY2022/23 Budget targeting a smaller primary deficit than under the program baseline (1.0 vs. 1.1 percent of GDP), including by offsetting spending pressures from early FY2022/23 (CR/22/382). Budget execution to date has been prudent. However, mobilizing planned resources proved challenging for most part of the year due to tight financing conditions (both external and domestic) and a slowdown in tax collection.

[1] The authorities removed petrol (gasoline) subsidies in September 2022 and, effective May 15, 2023, cross-subsidization across fuels. On electricity prices, they resumed cost-reflective variable adjustments in September 2022 and, effective April 1, 2023, introduced upward base tariff adjustments, first since 2018, across all tariff lines.

Text Figure 2. Kenya: Contributions to Headline Inflation

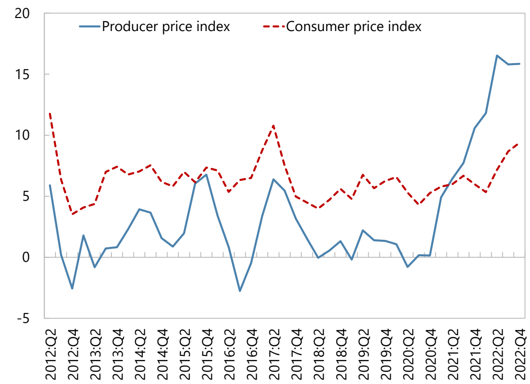
(In percentage points)



Sources: Kenya National Bureau of Statistics; and Central Bank of Kenya.

Text Figure 3. Kenya: Consumer and Producer Price Inflation

(y/y, in percent)

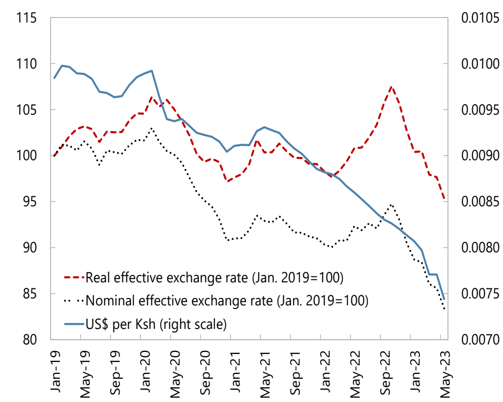


Source: Kenya National Bureau of Statistics.

- The Shilling has further weakened in 2023, reversing the appreciation of the real effective exchange rate observed last year (Text Figure 4).[2] In early 2023, dollar shortages became more widespread, widening spreads between the largely dysfunctional interbank FX market and the rate at which banks transact with clients, and within the bank-client market itself. In late-March, the CBK took steps to restart the interbank FX market, including by issuing a Kenyan Foreign Exchange Code for market participants, bringing back two inter-dealer brokers, increasing engagement with market participants, and providing verbal clarifications on existing circulars.[3] In the interim, to temporarily alleviate a sizeable share of FX demand the government introduced a new rolling six-month credit fuel import scheme (Box 3). Liquidity in interbank FX market (Text Figure 5) and spreads in the bank-client FX market have both seen some improvements since end-March. Gross official reserves remain adequate. The CBK has intervened with modest but persistent FX sales in the market.

Text Figure 4. Kenya: Effective and Bilateral Nominal US Dollar Exchange Rates

(upward = appreciation; as of May 2023)



Source: IMF, *Information Notice System* database.

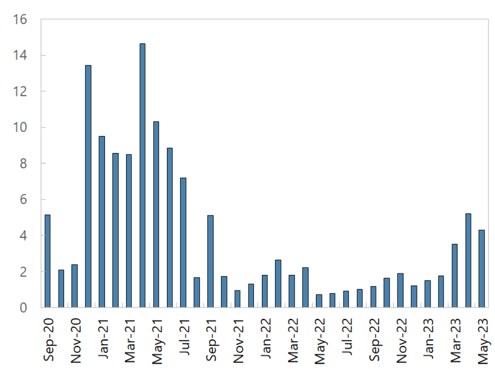
[2] As of June 29, 2023, the year-to-date change in Shilling per US$ was 13.8 percent (or 19.2 percent y/y compared to 9 percent y/y by end-2022). On real effective basis, the currency depreciated 7.2 percent between end-2022 and May 2023.

[3] The CBK started holding more regularly scheduled meetings with market participants to increase two-way communication and transparency, and provided verbal clarifications on banking circulars 10 and 11 of 2015 that interbank transactions need not be limited to, and can be smaller than, the standard ticket size and that the spread limits only apply to the indicative quotes for the standard ticket size.

- The banking sector remains sound but exposed to elevated credit and FX risks (Table 5, Figures 6 and 7). Capital and liquidity levels remain well above the statutory requirements, though have marginally declined recently, and profitability is strong, with significant contributions from FX business.[4] Banks' shares of FX loans, deposits, and liabilities continue to rise.[5] FX market dysfunction led to a buildup of larger gross FX positions on banks' balance sheets, i.e., larger on-balance sheet net short FX open positions (foreign currency asset to deposit ratio less than 100 percent) mainly offset by off-balance sheet net long positions, the majority of which were swaps with clients (Box 1). Private credit growth rose in April 2023, breaking a trend slowdown since mid-2022 (Text Figure 6). In 2022Q4, nonperforming loans (NPLs) remained elevated at 11.1 percent of total gross loans, partly due to government pending bills as well as the economic slowdown (Box 2). Both banks and pension funds have shifted their demand toward shorter- to medium-term treasury securities in the face of rising interest rates.[6]

Text Figure 5. Kenya: Interbank FX Spot Trading Volumes, All Currencies

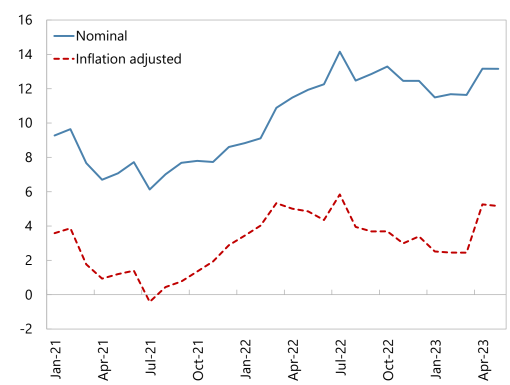
(Percent of all transacted volume)



Source: Central Bank of Kenya

Text Figure 6. Kenya: Private Sector Credit

(y/y percent change)



Sources: Kenya National Bureau of Statistics; Central Bank of Kenya; and IMF staff calculations.

PROGRAM PERFORMANCE

5. Most quantitative targets were met but some structural reforms faced implementation delays (MEFP¶11). Continuous conditionalities are also assessed to be met.

- *Quantitative performance criteria (QPCs):* All end–December 2022 QPCs and the continuous PCs since the 4th EFF/ECF reviews were met. Notably, the QPCs on tax revenues and the

[4] The authorities took steps to address incidences of gaps in compliance in capital, liquidity, and single- and related-counterparty exposures in 13 banks, as noted in the 2022 Banking Supervision Report.

[5] Banks' shares of FX loans, deposits, and liabilities stood at 30, 25.6, and 31.5 percent, respectively, at end-2022, compared to 28, 24.5, and 29 percent, respectively, at end-2021.

[6] Most pension funds are defined contribution schemes, and nearly all of the sector's assets are invested domestically, mainly in government securities (46 percent of assets), guaranteed investment funds, stocks, and real estate. The government security holdings are largely of 1- to 5-year maturity.

primary fiscal balance overperformed by 0.4 and 1.5 percentage points of GDP, respectively, and net international reserves (NIR) by US$226 million. For the end-June 2023 QPCs under the EFF arrangement, preliminary data indicate that the tax target is expected to be missed while others are expected to be met. The authorities are committing to take corrective tax revenue measures to ensure this underperformance is temporary and does not impact achievement of the FY2023/24 tax targets.

- *Indicative targets (ITs):* The end–December 2022 IT on priority social expenditure was met, while that on exchequer requests outstanding for more than 90 days was missed by 0.2 percent of GDP on tight liquidity conditions that constrained spending below budgeted levels.
- *Monetary policy consultation clause (MPCC):* The MPCC was triggered for end-December 2022 as the three-month average of headline inflation breached the 2.5–7.5 percent target range by 1.9 percentage points. The MPCC for end-June 2023 would be triggered if inflation in June stays above 6.75 percent. The authorities tightened the monetary policy rate by 100 basis points in June 2023.
- *Structural benchmarks (SBs, MEFP¶11 and Table 2):* SBs for January-April 2023 were met. One of the two SBs for end-December 2022 was not met but implemented with a delay while the other one remains outstanding and is proposed to be reset to end-July 2023. The end-June 2023 SB is on-track.
- *End-December 2022 SBs.*
    - On May 16, 2023, the Cabinet approved an action plan to restore Kenya Power and Lighting Company's medium-term profitability and recover liquidity gaps.
    - Despite some initial delays, a taskforce to review the fuel pricing mechanism and ensure that fuel price decisions are aligned with budgeted resources at all times was constituted in May 2023. While the review of the pricing mechanisms has started, the delays in establishing the taskforce has impacted the timeline for review of fuel price mechanism. The findings of the taskforce are now expected to be publicly communicated by end-August 2023.
- *January – June 2023 SBs.* The authorities timely submitted the FY2022/23 Supplementary Budget (end-January 2023 SB) and the FY2023/24 Budget (end-April 2023 SB) consistent with program's objectives. The authorities plan to submit to Parliament by end-June draft legal amendments to address gaps in the AML/CFT framework to further support anticorruption efforts (end-June 2023 SB)

MACROECONOMIC OUTLOOK AND RISKS

6. **In 2023, economic activity is expected to gain momentum modestly with some easing in inflation (Table 1).** GDP growth is projected at 5 percent (4.8 percent in 2022) as mutually consistent tighter domestic policy environment weighs somewhat on demand and partly dampens the positive effect from a recovery in the agricultural sector from near-normal rains so far. While

inflation remains elevated, it is expected to durably ease into the target band in 2023Q3 on lower global and food prices. The current account deficit is set to narrow to 4.8 percent of GDP, reflecting resilient exports and a modest import growth. Gross reserves will remain adequate (3.3 months of prospective imports) despite a decline in the second half of the year due to contractual payments.

7. **The medium-term outlook is positive, supported by policies and reforms.** Growth in 2024 and beyond is projected at 5.3 percent as the impacts of recent global shocks wanes, policies remain mutually consistent and prudent, and Kenya reaps the benefits of reforms. Growth will be driven by the private sector. Inflation will continue easing to the center of the target band supported by projected lower global prices and supportive policies—including further fiscal consolidation. Further increases in exports and remittances along with a normalization in private capital inflows to historical levels will support higher reserves and strengthen external buffers.

8. **The near-term outlook is subject to sizeable downside risks, including from climate-related factors (Annex I).** Kenya remains exposed to elevated uncertainty in major economies' outlook—including from recent banking sector concerns. Another climate-related shock (including from El Niño) could worsen food insecurity, lower growth, push food prices up, and increase emergency fiscal financing needs. Costs of repeating patterns of climate-induced hazards, in particular droughts and floods, are estimated at 2–2.4 percent of GDP per year (Annex III). Inadequate or delayed policy actions in response to prevailing or new challenges (e.g., any spillover from developments in Sudan) could undermine market confidence in Kenya and exacerbate fiscal financing and external pressures—with implications for growth, debt, and inflation. Materialization of public sector contingent liabilities would worsen public debt dynamics. On the upside, rapid resolution of global uncertainty and Kenya's willingness to respond decisively to emerging economic policy challenges could support stronger confidence and investment, and earlier prospects for international capital market access.

POLICY DISCUSSIONS

Discussions centered on adopting an ambitious package of policies to support macroeconomic stability and underpin market confidence against the backdrop of a deteriorated global outlook for frontier economies. Specifically, discussions focused on i) reducing debt vulnerabilities and securing the program fiscal path based on a multi-year fiscal consolidation effort anchored on raising tax revenues and rationalizing spending, while protecting priority social spending; ii) adopting a more proactive monetary policy, enhancing exchange rate flexibility and effective functioning of the FX market, and safeguarding financial stability; and iii) advancing the structural reform and governance agenda to sustain an inclusive, green, and resilient economy. Discussions on RSF support considered reforms to further integrate climate-related considerations in macro policies and frameworks by adopting green public financial management and climate-sensitive public investment management reforms, carbon pricing, enhance effectiveness of Kenya's existing frameworks to mobilize climate finance, and strengthening disaster risk reduction and management.

A. Reducing Debt Vulnerabilities in the Face of Near-Term Pressures

9. Prolonged difficulties in mobilizing budgeted resources have complicated the conduct of fiscal policy (MEFP¶14–15). The primary balance posted a surplus of 1.1 percent of GDP through April 2023 (compared to the end-June 2023 deficit target of 1.1 percent of GDP) on account of robust non-tax revenues and slow spending execution (Text Table 1). The latter mainly reflected continued challenges in mobilizing planned domestic financing as investors' appetite for government paper waned—including due to insufficient adjustments in interest rates especially at longer maturities (¶16)—and continued difficulties in improving tax collection (particularly for PAYE and VAT) as planned since the beginning of 2023. The pace of tax collection has been affected by a host of factors—including weaker than previously anticipated economic activity (¶4); the under-execution of government spending, particularly for projects and transfers to counties and other government agencies;[7] and protracted difficulties in sourcing dollars for private sector's activities.

Text Table 1. Kenya: Fiscal Developments
(In Ksh. billions)

	2021/22	2022/23		
	June	December	April	June
	Actual	*Actual*	*Prel.*	*4th Rev.*
Revenues and grants	**2,231**	**1,151**	**1,914**	**2,541**
Tax revenue	1,770	913	1,511	2,035
Nontax revenue	430	234	383	478
Grants	31	4	19	28
Expenditure and net lending	**3,024**	**1,469**	**2,302**	**3,386**
Interest payments	578	319	542	687
Other current spending	1,910	944	1,445	2,090
Development and net lending	537	206	314	609
Overall balance including measures (cash basis, incl. grants)	-793	-233	-389	-845
Primary balance incl. grants	**-170**	**99**	**154**	**-158**
Memorandum:				
PC on tax collection	1,667	862		2,035
PC on the primary balance	-428	-110		-158

Sources: National Treasury; and IMF staff calculations.

10. On June 22, Parliament approved a second Supplementary Budget for FY2022/23 to reflect emerging challenges and the adoption of corrective measures (MEFP¶16). While the version of the Supplementary originally submitted to Parliament targeted a primary deficit consistent with the target under the program (Text Table 2), the version approved exceeds the end-June 2023 target by a small amount (0.04 percent of GDP). On the revenue side, Supplementary II reflects tax collection falling short of the FY2022/23 target by 0.2 percentage points of GDP despite recent corrective measures

Text Table 2. Kenya: Supplementary II FY2022/23 Budget
(In Ksh. billions)

	2023/24		
	June		
	4th Rev.	*Budget (submitted)*	*Budget (approved)*
Revenues and grants	**2,906**	**2,936**	**3,031**
Tax revenue	2,428	2,428	2,487
Nontax revenue	428	466	502
Grants	50	42	42
Expenditure and net lending	**3,620**	**3,599**	**3,749**
Interest payments	769	775	775
Other current spending	2,085	2,135	2,191
Development and net lending	765	689	783
Overall balance including measures (cash basis, incl. grants)	-714	-663	-718
Primary balance incl. grants	**55**	**112**	**-57**
Memorandum:			
PC on tax collection	2,428		
PC on the primary balance	55		

Sources: National Treasury; and IMF staff calculations.

[7] These expenditures have a direct impact on payments for PAYE (for example, delays in transfers for wages to counties resulted in delays in payment PAYE and social contributions) and indirect taxes (for example, slow execution of projects affects VAT, excise, and custom collection).

introduced by the Kenya Revenue Authority (KRA) (MEFP¶14) to sustain revenue collection. On the expenditure side, while protecting social spending, Supplementary II introduces targeted cuts of 0.2 percentage points of GDP mainly for undisbursed funds of development projects with low absorption. These cuts were however marginally reduced in parliament. National Treasury is firmly committed to keep the primary deficit within the programed level through strict control of expenditure commitments without leading to a build-up of unpaid bills (MEFP¶16). Against this backdrop, financing needs are expected to be met via higher domestic financing supported by recent efforts to ensure efficient operation of the government securities market to support liquidity and transmission along the entire yield curve of policy rate increases (¶15 and MEFP¶29).

11. However, there is significant uncertainty around the end-June 2023 outturn with potentials implications for FY2023/24. Under a downside scenario, staff projects that the resource shortfall from the approved Supplementary I could reach as high as 0.9 percent of GDP at end-June 2023. Such shortfall could reflect a more pronounced softening of tax revenues as the corrective measures introduced by KRA take time to bear fruits.[8] Under this scenario, the spending cuts envisaged under Supplementary II may not be sufficient to offset the reduction in available resources and avoid a significant accumulation of unpaid bills at end-June 2023, which will carry over to FY2023/24. Against this backdrop, accumulation of exchequer requests outstanding for more than 90 days (an IT under the EFF/ECF arrangements) could be avoided if National Treasury (NT) diligently prioritize execution of spending through end-June 2023 by clearing older requests first (MEFP¶17). Should there be a carryover of unpaid bills (i.e., exchequer request outstanding for less than 90 days) from end-June 2023, the authorities have identified budgetary offsets for up to 0.9 percent of GDP to be considered in a Supplementary FY2023/24 Budget—expected to be submitted to Parliament by end-October (***proposed SB***)—to ensure observance of FY2023/24 fiscal targets.

Text Table 3. Kenya: Fiscal Developments
(In Ksh. billions)

	2023/24 June 4th Rev.	2023/24 June Budget (submitted)
Revenues and grants	**2,906**	**2,936**
Tax revenue	2,428	2,428
Nontax revenue	428	466
Grants	50	42
Expenditure and net lending	**3,620**	**3,599**
Interest payments	769	775
Other current spending	2,085	2,135
Development and net lending	765	689
Overall balance including measures (cash basis, incl. grants)	-714	-663
Primary balance incl. grants	**55**	**112**
Memorandum:		
PC on tax collection	2,428	
PC on the primary balance	55	

Sources: National Treasury; and IMF staff calculations.

12. The FY2023/24 Budget and 2023 Finance Bill submitted to Parliament at end-April is consistent with program objectives (MEFP¶19).[9] The draft budget proposal carries forward ongoing consolidation efforts by targeting a primary surplus of 0.7 percent of GDP—a level higher than 0.3 percent under the 4th EFF/ECF reviews (Text Table 3). This is predicated on a comprehensive revenue package for 1.6 percent of GDP, which

[8] Despite difficulties in mobilizing domestic financing for most part of FY2022/23, the June 14 bond auction at a higher interest rate saw significant overbidding, helping bring net domestic financing much closer to the fiscal-year target.

[9] Parliament approved the Budget FY2023/24 and the 2023 Finance Bill on June 22. However, the details on the approved texts will be available only by end-June.

is significantly larger than the 0.9 percent of GDP agreed during the 4th reviews of Kenya's program to mitigate the likely underperformance of tax by end-June 2023 (¶11). The draft Budget also envisage a further rationalization of primary expenditures—particularly for slow-moving projects, while supporting new initiatives (e.g., "Hustler Fund") and protecting social spending (CR/22/382). Should the approved Finance Bill deviate from the one submitted to Parliament with changes that would undermine the envisaged ambitious new tax measures and associated yields and/or FY2022/23 tax collection falls short of expectations (¶11), the authorities stand ready to adopt contingency plans that could include new excise and VAT measures (MEFP¶20). They intend to submit to Parliament these contingency measures by end-October 2023 (***proposed SB***) to support confidence in fiscal consolidation and the continued reduction of Kenya's debt vulnerabilities.

13. Beyond FY2023/24, the authorities' fiscal strategy remains centered on reducing debt vulnerabilities while protecting high-priority service delivery programs. This will require maintaining the fiscal primary balance above its debt-stabilizing level during the extended EFF/ECF arrangements. To this end, the authorities will further strengthen tax compliance, consistent with Kenya's priorities identified under its Medium-Term Revenue Strategy (MTRS, MEFP¶21) and streamline recurrent expenditures—particularly for wages and transfers to public sector entities—while improving public investment management and budgetary controls (MEFP¶25).

14. Kenya's public debt is sustainable but remains at high risk of distress. The present value (PV) of public debt/GDP is expected to peak in 2023 and then decline steadily to below the 55 percent threshold for a country with moderate debt carrying capacity by 2028, as Kenya's primary balance overperforms its debt-stabilizing level.[10] The baseline PV of external debt/GDP remains below its threshold throughout the projection period. In line with staff recommendation, the Cabinet submitted to Parliament in March 2023, amendments to the Public Financial Management Act to replace the existing nominal debt ceiling with a medium-term debt anchor in PV terms of 55 percent of GDP to support Kenya's multi-year fiscal consolidation path and guide market expectations (CR/22/382). The authorities are proactively preparing for the June 2024 Eurobond rollover. They have launched the process for hiring international lead managers and considering alternative sources of financing from multilateral and bilateral lenders and the syndicated loans market.

B. Adopting a More Proactive Monetary Policy, Supporting Efficient Functioning of FX Markets, and Safeguarding Financial Stability

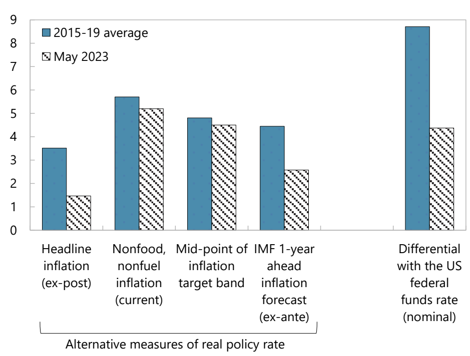
15. The CBK has tightened the monetary policy stance over the past year. The cumulative increase in the policy rate has reached 350 basis points since May 2022 but the ex-post real policy rate is below its pre-COVID-19 ex-ante levels, and the interest rate differential with the US federal funds rate is at a historical low, sustaining the expectations of further upward adjustments in policy rates, including due to expectations of the US policy rate staying elevated until late 2024

[10] The upward revision in PV of overall debt in 2023 reflects the revised FX-rate projections, resulting in real effective exchange rate depreciation, as well as the proposed additional access to IMF resources for BoP needs and higher interest expenses on loans with variable interest rates.

(Text Figure 7).[11,12] The interbank rate has risen since end-2022 (Text Figure 8).[13] However, transmission of the higher policy rate to bank lending rates has been slow, including due to delays in sector-wide approval of risk-based pricing. Treasury bill rates have gone up further but smaller increases in long-term domestic bond rates contributed to government's net domestic financing challenges as demand shifted to the shorter end of the yield curve, raising rollover needs.[14]

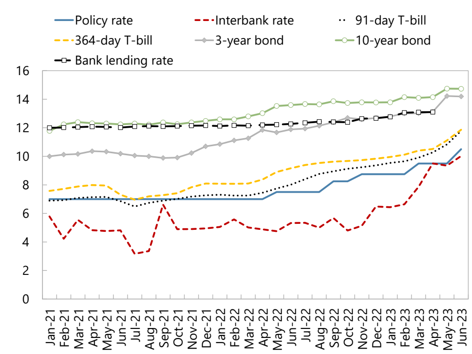
16. The authorities stated their commitment to adjust the monetary policy stance decisively as needed (MEFP¶44). Inflationary expectations have moved up over the past year and hover around the upper end of the target band (Text Figure 9). While annual inflation has eased since April, its momentum (seasonally adjusted monthly changes) has gone up, coinciding with faster exchange rate depreciation (Text Figure 10). Under the program baseline, inflation is projected to durably move within the target band in 2023Q3 (the end-June 2023 MPCC would be triggered if inflation in June is above 6.75 percent) but remain close to its upper end by end-year as higher contributions from nonfood, nonfuel inflation offset favorable supply-side contributions (food and fuel). Near-term upside risks to inflation from delayed passthrough from the higher domestic producer price inflation and/or global shocks remain. The CBK is making progress in modernizing the monetary policy framework (MEFP¶46). Efforts to strengthen forecasting and policy analysis are advancing, including with support from IMF technical assistance (TA).[15]

Text Figure 7. Kenya: Policy Rate
(In percent)



Sources: Central Bank of Kenya; Haver Analytics; and IMF staff calculations.

Text Figure 8. Kenya: Interest Rates
(In percent; end of period as of June 26)[1/]



Source: Central Bank of Kenya.
[1/] Bank lending rates are monthly averages.

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[11] Ex-ante and ex-post real policy rates are measured against 1-year-forward and current inflation, respectively.

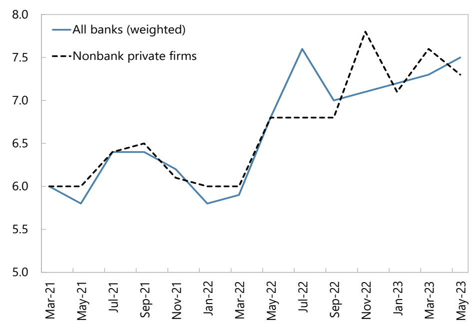
[12] See IMF Country Report No. 2023/208.

[13] Movements in the interbank rate reflect a combination of structural factors (market segmentation) and liquidity condition, latter being impacted by slower government spending amid financing challenges. Liquidity improved somewhat since May following the anticipated arrival of external financing.

[14] As of June 23, 2023, interest rates on the T-bills were higher by 205 to 404 basis points (latter for the 91-day bills) since end-May 2022. However, this was between 200 and 255 basis points for 2- to 5-year bonds, 120–205 basis points for 6- to 10-year bonds, and 59–114 basis point for longer maturities.

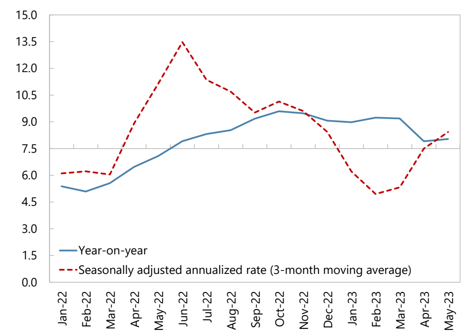
[15] The CBK hosted IMF TA missions on Kenya's Forecasting and Policy Analysis System (FPAS) in 2022 and 2023, focusing on improvement of the quarterly projection model, refining business surveys, and developing a nowcasting framework.

Text Figure 9. Kenya: Market Expectations of 12-Month-Ahead Inflation
(In percent)



Source: Central Bank of Kenya, Market Perceptions Survey.

Text Figure 10. Kenya: Headline Inflation
(In percent)



Sources: Kenya National Bureau of Statistics; and IMF staff calculations.

17. The authorities are committed to allowing exchange rate flexibility and supporting official reserves (MEFP¶45). The external position of Kenya in 2022 is assessed to be broadly in line with the medium-term fundamentals and desirable policies (Annex II). The real effective exchange rate gap is estimated to be in the range of 4–15 percent. Fiscal consolidation, tighter monetary policy, and real exchange rate depreciation would help mitigate some of the balance of payments (BoP) pressures and support reserves. The CBK committed to publishing updates to previous banking circulars on inter-bank standards and operational conventions, in close consultation with market participants, to support efficient and effective market-making, interbank liquidity, and price discovery in line with global best practices, and to issuing a statement of their own commitment to the Global FX Code. The launch of the Central Securities Depository, which is expected to facilitate collateralized transactions among banks and support liquidity in the money market, is yet to be launched to allow additional time for testing.

18. The government has also recently launched a temporary credit scheme for fuel imports to ease forex pressures (**Box 3 and MEFP¶68).** Under this scheme, NT provides comfort letters to exporters and local banks for fuel purchase from Saudi Arabia and the United Arab Emirates by designated oil importers. Review of the legal arrangements under the scheme by the Attorney General of Kenya has established that they do not give rise to government guarantees of private debt under domestic law. The government is, nevertheless, exposed to calls on the national budget in case prices at the pump are not adjusted to fully passthrough any FX valuation losses to final consumers and to provide access to US$ to cover any potential shortage of FX in the domestic market. The authorities committed that the exchange rate used for FX transactions under this scheme would be consistent with the program's continuous conditionality on multiple currency practice (MEFP¶71). After the initial rollout period, staff advised that the import scheme should be reconfigured so that all risks are borne by the private sector.

19. The banking system is sound, yet risks are significant (MEFP, Section G). Resolution of NPLs and continued adequate provisioning remain a priority. The CBK is consolidating and proactively dealing with shortfalls in weaker banks. With support from IMF TA, the CBK is in the process of developing Internal Liquidity Adequacy Assessment Program Guidelines to strengthen banks' liquidity management frameworks. The shares of FX loans and deposits have continued to rise, and the sizable on- and off-balance sheet FX positions of banks increase their vulnerability to exchange rate shocks. Staff also welcomes the CBK's engagement with banks on the banking charter, where faster issuance of no-objection certificates for risk-based loan pricing models could help support private credit. Higher than anticipated sovereign borrowing needs, rising interest rates and asset quality issues—particularly at small and medium-sized banks with greater exposure to riskier lending—would constrain the growth of private credit. Asset quality improvements remain contingent on the economic recovery and the resolution of government pending bills. Staff encouraged CBK to incorporate interest rate and foreign exchange depreciation scenarios in macroprudential, top-down system-wide stress tests, and to conduct FX liquidity stress tests.

C. Advancing the Structural Reform Agenda and Emerging Priorities

Modernizing the Fiscal Framework

20. The authorities are modernizing the tax system and strengthening revenue administration to increase revenue mobilization on a durable basis (MEFP¶21). A draft MTRS was prepared in February 2023, supported by IMF TA. It provides policymakers with a coherent framework to identify mutually supportive tax policy and administrative measures to widen the tax base and mobilize domestic revenues, while ensuring equity and fairness. The MTRS is expected to be submitted to Cabinet together with an implementation plan and mechanisms to oversee its implementation by end-September 2023 (***proposed SB***), and to Parliament by end-December 2023 with a view to start implementing in early 2024. The KRA has also started several initiatives to improve tax compliance by strengthening audits and implementing data-driven compliance risk management measures to reduce abuse—particularly related to VAT exemptions.

21. Strengthening public financial management (PFM) systems remains a priority to safeguard budget credibility and manage fiscal risks (MEFP¶20, ¶23–26, and ¶58). To this end, the Auditor General is conducting a special audit on the mechanism, efficiency, and effectiveness of supplementary budgets—including under Article 223 of the Constitution—which is expected to be published by end-September 2023 (***SB***). The authorities are also working to: i) enhance Public Investment Management (PIM) practices by developing a Public Investment Management Information System (PIMIS) to automate the investment project cycle[16]; ii) strengthen expenditure controls by developing a budget costing methodology to facilitate expenditure prioritization and estimation of fiscal space; iii) durably address long-standing issues with pending bills (Box 2); iv) review stalled projects (accounting for about 8 percent of GDP) with a view to determine whether to prioritize them under Kenya's medium-term expenditure framework or to terminate them; v) reform fuel pricing decisions to ensure that domestic prices are aligned with budgeted resources

[16] The PIMIS will be piloted in three main sectors (roads, health, education) in FY2023/24, and subsequently extended to all ongoing and new public projects—including public-private partnership projects. Only projects processed through the PIMIS will be eligible to receive public and aid-related funding.

at all times (***proposed to rephase SB to end-August 2023***); and vi) improve monitoring and assessment of fiscal risks by stepping up operations of the Fiscal Risk Committee with a view to provide recommendations for corrective actions.

22. The authorities are taking steps to address long-standing issues with pending bills (Box 2 and MEFP¶26). With the stock of pending bills exceeding 4.4 percent of GDP at end-December 2022, NT is developing a comprehensive and time-bound strategy to clear such bills over the medium term in a fiscally prudent fashion. The strategy will center on the validation of the outstanding stock of pending bills—including related to the road sector—identification of measures to address the PFM deficiencies that led to the accumulation of pending bills, and on an action plan to clear verified bills over the medium term, consistent with the consolidation path envisaged under the program. The authorities intend to submit the strategy to the Cabinet for approval by end-September 2023 (***proposed SB***).

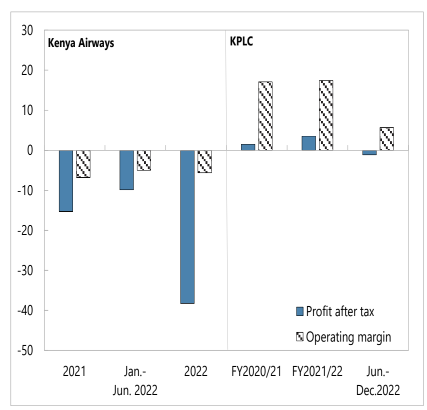
Addressing SOEs' Financial Challenges and Governance

23. The new Administration has identified key policy priorities for reforming the SOEs (MEFP¶33 and ¶42). A new Privatization Act 2023, repealing the previous one, has been submitted to Parliament to support an accelerated privatization process for SOEs. Other areas of focus include streamlined governance structures, efficient utilization of budgetary resources, better management of fiscal risks, and enhanced accountability.

24. Kenya Airways (KQ) and Kenya Power and Lighting Company (KPLC) continue to rely on budgetary support (MEFP¶34). In the second half of 2022, both KQ and KPLC posted weaker financial results as improvements in revenues were offset by higher operating costs (Text Figure 11). KQ has a negative equity and KPLC had a liquidity gap of Ksh.64 billion as of FY2021/22. Extra-budgetary support allocated to these two entities under the FY2022/23 Supplementary Budget is Ksh.23.5 billion (0.2 percent of GDP), lower than the original Budget primarily due to reduced allocation to KQ. In addition, the government is currently servicing KQ's guaranteed senior external debt (US$95 million between October 2022 and April 2023) and provides debt moratorium to both entities on its on-lent support.

Text Figure 11. Kenya: Financial Performance at KQ and KPLC

(In billions of Kenyan shillings)



Sources: Kenya Airways; and KPLC.
Note: operating margin is the difference between operating income and operating cost.

25. Fresh policy direction is being sought in dealing with challenges at KQ (MEFP¶37–39). While KQ made progress under its business reorientation plan with a focus on cost savings (e.g., fleet and route optimization, other cost management), it faced difficulty in negotiating the collective bargaining agreements. The authorities are seeking Cabinet advice on an optimal strategy on KQ with least fiscal impact to the government.

26. In May 2023, Cabinet approved an action plan to restore KPLC's medium-term profitability and address its liquidity gap (MEFP¶36). The action plan (***end-December 2022 SB***) envisages improving KPLC's current ratio from 0.5 in FY2021/22 to 0.7 by 2025/26[17] by i) transferring the power transmission lines (assets) to the relevant public entity and offsetting the balance sheet impacts via lowering KPLC's liabilities to the government and raising government's equity in the transmission entity; ii) settling outstanding dues and reviewing understandings about cost sharing on rural electrification; and iii) developing a turnaround strategy that will include reduction in systems losses and iv) a new governance structure to give private shareholders a fair representation. Moreover, the approved changes in electricity base tariff would help boost KPLC's current ratio further to unity by 2025/26. Reforms at KPLC will also be supported by the World Bank.[18]

27. The authorities remain committed to strengthening governance and oversight of the state corporations (SCs) as they prioritize rationalization of SCs (MEFP¶39-40).

- An updated inventory and new classification of SCs approved by Cabinet and published by end-July 2023.
- A draft Ownership Policy for SCs, describing a new governance architecture and legal ecosystem to improve performance and transparency, is expected to be approved by Cabinet and published by end-October 2023 (***proposed SB***). The authorities will also begin work with IMF TA on the legal reforms necessary to anchor the new ownership arrangements and other measures outlined in the SOE Blueprint with a view of submitting draft amendments to Parliament by end-February 2024.
- The analytical framework for financial evaluation and risks from SCs under the Government Investment Management Information System is being strengthened. To this effect, the authorities will undertake financial evaluation for fifty SCs, using their FY2022/23 audited accounts, and report the outcome to the Fiscal Risk Committee by end-June 2024 (***proposed SB***). Publication of SCs' financial statements and annual reports on NT's website will continue to be expanded to enhance transparency.
- The authorities plan to submit to the National Assembly regulations providing for more effective oversight of government investment in SCs by end-June 2024. By end-October 2024, they also plan to conduct a comprehensive assessment of the national government's continued involvement in SCs and government-linked corporations, and to publish a report that will (i) include specific recommendations for privatization as well as for mergers, dissolutions, transfers to counties, and reversions to government departments, (ii) identify and propose solutions for the main legal and operational challenges to implement the recommendations, and (iii) establish a time-bound action plan for execution (***proposed SB***).

[17] The current ratio is a liquidity ratio used to measure a firm's ability to meet its short-term liabilities. It is usually defined in terms of a ratio of liquid assets to liabilities falling due within a year.

[18] Under a multi-phase programmatic approach toward green and resilient expansion of energy in Kenya, the World Bank recently launched an operation to help strengthen KPLC's governance, financial, and operational foundations.

Strengthening Governance and Fighting Corruption

28. Strengthening Kenya's anti-corruption legal framework and safeguarding financial integrity remain a priority.

- Publication of beneficial ownership information of companies awarded tenders on the government procurement portal commenced in November 2022. The authorities are taking additional measures to ensure public procuring entities continue to comply with the publication requirements, including by conducting capacity building activities. To further strengthen the country's beneficial ownership framework, Kenya Business Registration Services has developed the centralized electronic register for beneficial ownership information in October 2020, which provides for timely access to the information by competent authorities. Further legal amendments are underway to also grant access to the e-register by financial institutions for AML/CFT purposes. However, continued low level of reporting of beneficial ownership information by companies is hampering effective implementation of the beneficial ownership framework.
- The authorities intend to strengthen follow-up on audit findings of the Auditor-General by promoting greater coordination among state bodies, including law enforcement agencies, strengthening monitoring capabilities, and enhancing public reporting (MEFP¶56).
- The authorities have prepared draft amendments to address gaps in the AML/CFT legal framework as identified in the Kenya 2022 Mutual Evaluation Report including requirements for politically exposed persons, to be in line with FATF standards and plan to submit the amendments to Parliament for approval by end-June 2023 (***SB; MEFP¶60***). The national AML/CFT action plans have been developed based on the findings of the 2021 National Risk Assessment, supported by establishment of tracking mechanisms to ensure accountability and timely completion of plans. The authorities have also taken steps to further strengthen AML/CFT risk-based supervision by enhancing its risk assessment tools and using the outputs to inform onsite supervision.

Enhancing Pandemic Preparedness

29. The authorities are working toward addressing enhancing pandemic preparedness. The 2023/2024 budget allocates Ksh.20 billion (US$186 million) toward scaling up of health care infrastructure, including through construction of the National Biosafety Laboratory, supported by a World Bank loan, and by helping establish the National Pandemic Response Centre, in coordination with the African Development Bank. The budget also supports the construction of the National Data Centre, co-financed by the European Union grant, and establishment of the National Cybersecurity Authority, with the help from the Swedish International Development Cooperation Agency.

D. Sustaining Efforts to Enhance Climate-Change Resilience

30. Despite its modest contribution to global greenhouse gas (GHG) emissions, the Kenyan economy is highly vulnerable to climate change shocks such as droughts, locust

invasion, and floods (Annex III). Kenya was ranked as the world's 69th largest emitter in 2019, having emitted 73.4 metric tons of CO_2 equivalent (MtCo2e) with an estimated contribution of about 0.15 percent to global GHG. It is ranked as 173rd out of 198 countries in terms of emissions per capita, with 1.8 MtCo2e, significantly below the global average of 6.5 MtCo2e.[19] Nevertheless, the country faces very high risk for humanitarian crisis, ranking 17th out of 191 countries in the 2023 Inform Risk Index.[20] The agricultural sector, which is highly exposed to climate change, is nearly 98 percent rainfed and where 84 percent of land is classified as arid and semi-arid, constitutes over a quarter of the GDP, and provides employment, directly or indirectly, to approximately 40 percent of total population and 70 percent of the total rural labor force.

31. Climate change poses significant costs to Kenya. The total cost of climate change is estimated at 2–2.4 percent of GDP per year. Climate-induced natural disasters put pressure on Kenya's BoP through short-term output losses from destruction of capital, the import component of reconstruction spending, and terms-of-trade shocks stemming from price pressures in climate-sensitive economic activities (e.g., agriculture, energy, and tourism).[21] They also increase food imports (especially, maize, rice, and wheat), exert pressures on the exchange rate, impacting external stability. An illustrative scenario in the Debt Sustainability Analysis's tailored stress test for Kenya finds very limited scope for meeting additional financing needs without jeopardizing debt sustainability if faced with a large climate-related disaster (DSA¶24). Climate change has also increased the frequency of drought-induced food insecurity episodes from every 20 years (in the 1980s) to every 2–3 years.[22]

32. Kenya has an established track record in implementing climate change policies and mobilizing climate finance. It has developed a strong climate policy and institutional framework for climate action. The country's strategy to finance its ambitious adaptation and mitigation agenda is outlined in Kenya's updated Nationally Determined Contribution (NDC).[23] In addition to official sources, including those mobilized through global climate funds such as the Global Environmental Facility (GEF), Kenya leverages private climate finance through various channels, including public-private partnerships (PPPs) in renewable energy projects, corporate green bond issuance, and

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[19] IMF Climate Policy Diagnostic: Kenya, May 2023.

[20] The INFORM Risk Index is an indicator-based disaster risk assessment tool for crises and disasters. It has three dimensions: climate-driven hazard and exposure, vulnerability, and lack of coping capacity. The rank reflects the risk level. Non-IMF indicators provide qualitative information of country's crisis and disaster preparedness and do not represent the IMF assessment of Kenya's crisis and disaster preparedness level.

[21] While droughts are estimated to cost about 8 percent of GDP every five years, the cost of floods is estimated at 5.5 percent of GDP every seven years (National Disaster Risk Management Policy, Government of Kenya, 2017). Similarly, the World Bank's Kenya Economic Update highlights that adverse weather conditions caused by climate change negatively affect output by 3-5 percent of GDP annually, resulting in losses in production, income and employment and increased operational costs (Kenya Economic Update, June 2023, World Bank).

[22] Following one of the most severe droughts on the record, the latest data by the Integrated Food Security Phase Classification (IPC) estimates that over 5.4 million people (nearly 10 percent of Kenya's total population) have experienced acute food insecurity between March and June 2023, an annual increase of 1.4 million people.

[23] While Kenya's adaptation plan prioritizes protecting public infrastructure, supporting social and economic development, and safeguarding lives and livelihoods in the short and longer term, the mitigation plans reflect the implications of the economic growth ambitions and the need to contain related emissions, through renewable power, energy efficiency, electrification, and reforestation to reach its NDC target.

several blended finance mechanisms to de-risk private sector investments (Box 4). At end-2022, more than 90 percent of electricity production was generated from renewable sources, with targets to reach 100 percent by 2030.[24]

33. Despite considerable achievements in pursuing its climate objectives, additional efforts will be needed to mobilize resources for climate investments, especially for adaptation projects. Kenya's updated NDC estimates that climate-related investment needs amount to US$62 billion by 2030 (about 6 percent of the 2022 GDP per year over 2023–30).[25] However, current commitments have fallen short of projected financing requirement: according to the latest audited data, only US$2.4 billion was directed to climate related investments in 2018, of which nearly 80 percent for mitigation purposes.

34. Meeting Kenya's ambitions climate objectives will require accelerating institutional reforms and capacity building to enhance the efficiency of public investment and facilitate private climate investments. There is a need to improve expenditure composition that prioritizes climate investment, including in disaster risk mitigation, and promotes critical low-carbon technologies, including clean energy options to displace fossil fuels in the power generation sectors and electrifying transport with clean electricity. Additional efforts are also needed to incentivize large- and small-scale adaptation investments in key sectors, such as water resources, agriculture, and land-use. While some public project pipelines are coordinated from the public investment management perspective, not all are fully integrated into the budget planning and preparation processes. Kenya is yet to develop a green finance taxonomy, which in addition to a limited pipeline of bankable projects, prevents scaling up of climate finance.

35. Against this backdrop, the authorities have requested for support under the RSF to advance their adaptation and mitigation objectives. They have identified a high-quality output-oriented package of reform measures (RMs) to underpin their RSF request across four priority areas for reform (Table 11 and MEFP, Table 3). This package of reform measures (RMs) was informed by the recommendations of recent IMF (FAD) climate policy diagnostics mission, which helped identify critical climate policy and institutional gaps; and Climate Public Investment Management Assessment (C-PIMA), which helped design recommendations to improve Kenya's public investment management (PIM) practices and build low-carbon and climate-resilient public infrastructure. MCM climate finance expert also helped formulate reforms aimed at facilitating climate investments. RMs are expected to help: i) incorporate climate risks into fiscal planning and investment framework;

[24] Kenya has achieved remarkable success in developing a well-diversified power generation mix, with about 90 percent of electricity being generated from clean sources with geothermal (48 percent), hydro (33 percent), and wind (12 percent). About 30 percent of installed generation capacity is owned and operated by Independent Power Producers (IPPs), which have mobilized at least US$2.5 billion in private capital (Kenya Economic Update, June 2023, World Bank).

[25] On mitigation, Kenya committed to cover 21 percent of the US$17.7 billion of estimated mitigation requirements between 2020 and 2030 from domestic sources, while the remaining 79 percent is subject to international support in the form of finance, technology development and transfer, and capacity building. The total estimated cost of adaptation actions up to 2030 is estimated at US$43.9 billion, of which 90 percent will require international support in form of finance, investment, technology development and transfer, and capacity building support, while 10 percent is to be financed from domestic sources.

ii) mobilize climate-revenue while strengthening climate-spending efficiency; iii) enhance effectiveness of Kenya's existing frameworks to mobilize climate finance; and iv) strengthen disaster risk reduction and management. Specifically:

- **Reform Priority 1:** *Incorporate climate risks into fiscal planning and investment framework.* Simulations using the IMF Debt, Investment, Growth, and Natural Disasters (DIGNAD) model show that accelerating investment in adaptation infrastructure, catalyzing climate finance, and raising Kenya's public investment efficiency to reach the regional efficiency frontier would save Kenya nearly 3 percent in output loss (US$71.2 million) while reducing macroeconomic and fiscal risks (Annex IV).[26] To this end, the reforms in this area would entail conducting a long-term fiscal sustainability analysis under different climate change scenarios and publishing the results in the Fiscal Risk Statement starting in FY2024/25 (***proposed RM2***); developing a standardized climate change and disaster risk methodology to be integrated in project appraisal, including climate considerations in project selection criteria, reflecting the use of the analysis in project concept notes, and feasibility studies, and publishing the project selection criteria (***proposed RM5***); and implementing a prototype of climate budget tagging in key climate-sensitive sectors, developing guidelines (applied to all sectors) in the FY2024/25 Medium-Term Expenditure Framework circular for budget preparation with clear definition of climate-related expenditure, and publishing the results (***proposed RM8***). Development partners' and IMF TA could help the authorities amass capacity needed to operationalize the climate budget tagging framework, including by helping define climate-related expenditure and guide the budget tagging reform process. In addition to helping internalize climate change considerations in allocation of budgetary resources and improving transparency and accountability in their use, reform measures in this area will help safeguard climate-spending in the context of the envisioned fiscal consolidation and improve resilience to climate-induced shocks.
- **Reform Priority 2:** *Mobilizing climate-revenue and strengthening climate-spending efficiency*. Reforms in this area would help Kenya achieve emissions reduction targets in line with the updated NDC and better reflect the externalities of fossil fuel consumption, including by implementing carbon pricing reforms (***proposed RM3***).[27] The authorities' recent efforts to phase out subsidies and increase taxes on fossil fuels is helping Kenya achieve its mitigation goals (¶4). Going forward, possible options include introduction of a carbon tax or increase the excise tax on fossil fuels to better capture the externalities associated with fossil fuel consumption in line with recommendations from the IMF climate policy diagnostic mission. These carbon pricing options would help Kenya meet its mitigation goals while raising additional fiscal revenues, which could in turn be used to compensate vulnerable groups and offset the costs of higher energy prices. A successful rollout of this reform will need to be accompanied by a well-planned communication strategy to clearly explain how revenue from higher carbon pricing reforms will be spent, including steps the authorities plan to take to mitigate adverse social impact of the reform. The World Bank's support will be

[26] The DIGNAD model can demonstrate the impact of investing in ex-ante adaptation on output growth and public debt, in countries vulnerable to climate-induced disasters (Marto and others, 2018).

[27] Fuel imports averaged 3.1 percent of GDP between 2015–20 but increased to nearly 5 percent of GDP in 2022.

instrumental in complementing the IMF climate policy diagnostics mission's assessment of the distributional effects of carbon pricing measures, in addition to helping enhance targeting of Kenya's social safety nets.[28] Additional IMF TA would help assess the overall impact of carbon pricing measures on emissions reduction targets. To promote climate-resilient investment, the authorities will adopt priority fiscal incentives in agriculture, water, and land management sectors, as outlined in the draft National Green Fiscal Incentive Policy Framework (***proposed RM6***).[29] With the support of IMF TA, impact assessment of incentive measures listed in the Framework can help facilitate their prioritization, including helping develop an implementation framework to put into effect priority fiscal measures supportive of the NCCAP and Kenya's updated NDC. To promote energy efficiency, and distributed renewable power generation in the residential, commercial, and industrial sectors, the authorities plan to approve net metering regulation, including rates determination methodology (***proposed RM7***). These reforms would provide strong signal to investors and support establishing a pipeline of projects, and the acceleration of private financing in certain sectors (such as adoption of electric buses and other electric vehicles, and renewable energy).

- **Reform Priority 3:** *Enhancing effectiveness of Kenya's existing frameworks to mobilize climate finance*. Kenya's vibrant green finance ecosystem comprises a rich set of financing mechanisms, enabling climate-related investments. These mechanisms could be further strengthened by developing green finance taxonomy, which would build on the green bond taxonomy standards developed for Kenya's Sovereign Green Bond Framework, and help Kenya channel capital toward sustainable investments by improving transparency in the financial system, reducing greenwashing, while ensuring that investors are making informed decisions about their investments.[30] As defining green finance taxonomy is generally a lengthy but inclusive process, reforms in this area strive to further strengthen Kenya's climate finance ecosystem by producing a draft green finance taxonomy adapted to Kenya's updated NDC and circulating the draft for stakeholder consultations (***proposed RM4***). The authorities expect TA provided by the European Investment Bank will enable the CBK to reflect stakeholders' comments and adopt the taxonomy, issue guidelines for the implementation of climate-related disclosures for the banking sector in line with international best practices and introduce time-bound targets for the implementation of climate disclosure requirements (***proposed RM9***).

[28] In addition to the country's main social safety net program, Hunger Safety Net Programme (HSNP), the World Bank has also provided financial and TA to support the other social safety net programs covering the elderly, disabled, orphans and vulnerable children. In addition, the Bank has also helped strengthen the governance and management of the country's social safety nets programs, including by supporting the development of a national social protection policy, strengthening the capacity of the National Social Security Fund, and promoting coordination among government agencies involved in social protection.

[29] The draft National Green Fiscal Incentive Policy Framework, to be adopted by end-2023, aims to accelerate the transition to a low-carbon economy by providing fiscal incentives for investments in climate-friendly activities. The framework identifies a range of potential fiscal instruments that could be used to promote climate-friendly investments, including carbon pricing, tax breaks, subsidies, and grants.

[30] Compared to green *bond* taxonomy, green *finance* taxonomy is a broader framework that defines what constitutes a green investment across a range of financial products, including bonds, loans, and equity investments.

- **Reform Priority 4:** *Strengthening disaster risk reduction and management.* The authorities are preparing the National Risk Financing Strategy to enable efficient disaster response in collaboration with development partners, including mechanisms that would allow partners to contribute financing to the government-led disaster response, and a coordinated and swift reaction in a disaster situation. With a view to further strengthen Kenya's capacity to mitigate the impact of natural disasters, the reform measure in this area envisages adopting the National Framework for Climate Services to enable the dissemination of a digital early warning system platform for a multi-sector climate-related information to most vulnerable counties, including Arid and Semi-Arid Lands (ASALs) and coastal regions (***proposed RM1***).[31] This would provide counties and farmers with advance notice of possible drought conditions, enabling them to adopt water conservation strategies in a timely manner.

36. The proposed RMs will complement development partners' efforts in helping Kenya integrate climate considerations into macroeconomic policy formulation. For example, the 2023 World Bank Development Policy Operation (DPO), informed by Kenya's forthcoming Country Climate and Development Report (CCDR), focuses on agricultural policies to promote green and inclusive growth, and enhance the institutional framework for climate policy discussions and implementation. Other development partners are also actively assisting Kenya in enhancing its climate resilience (Text Table 5).

37. The RSF support will reinforce Kenya's already-strong efforts to address climate-related challenges and build resilience and support efforts to catalyze further private financing. The RSF is also expected to exploit synergies with other official financing. While the reforms, such as developing a budget tagging system, are expected to allow detailed identification and tracking of climate-related investment, RSF resources will substitute costlier domestic financing options (e.g., national saving certificates) and they will help mitigate prospective BoP financing needs given the high import content of climate related investments.[33] The RSF RMs will demonstrate Kenya's long-term commitment to mitigating its vulnerabilities to climate change, including by helping enhance its climate-related investment roadmaps, sectoral priorities, funding plans, fiscal incentives, and tax policies.

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[31] On May 16, 2023, Parliament passed the Kenya Meteorological Bill, establishing the Kenya Meteorological Services (KMS) as a statutory body with the access to budgetary resources and the authority to collect and analyze weather data, develop early warning systems, and disseminate warnings to the public. While the passage of the bill provides the KMS with a legal framework to operate within, the National Framework for Climate Service (NFCS) is expected to provide the KMS a roadmap for developing and delivering climate services in Kenya, including by improving production, co-production, tailoring, delivery, and use of science-based climate predictions and services.

[33] Among others, RSF resources will help augment FY2023/24 budgetary allocations for: (i) investments in ongoing renewable energy projects (Ksh.15 billion; US$135 million), (ii) improvements in the coverage and dissemination of Kenya early warning systems (Ksh.2 billion; US$18 million), (iii) reforestation efforts implemented through the National Forest Action Plan and the National Tree Planting Campaign (Ksh.2.8 billion; US$117 million), and (iv) construction of climate-resilient infrastructure, through the National Irrigation Development Project (Ksh.10 billion; US$90 million).

PROGRAM MODALITIES AND RISKS

38. Extension of the current EFF/ECF arrangements by 10 months is proposed with blended augmentation of access of 75 percent of quota (SDR407.10 million or, about US$544 million) as balance of payment support, and rephasing over the extended program duration of previously approved access as budget support.

- The proposed extension until April 1, 2025, will provide additional time to help implement the authorities' reform agenda and ensure that overall public debt/GDP firmly declines during the program (a key program objective) after a projected temporary rise this year. The proposed extension is consistent with the maximum four-year duration under an EFF arrangement.

- The proposed augmentation is for BoP support to help ease pressures on official reserves (actual BoP need). It will be complemented by further decisive actions to reinforce mutually consistent and prudent fiscal, monetary, and FX policies. It will help underpin market confidence ahead of the June 2024 Eurobond rollover and in the face of a significantly deteriorated global outlook for frontier economies' access to international bond market since the 4th ECF/EFF reviews.

- The proposed augmentation would comprise 43.5 percent of quota (SDR236.12 million or, about US$316 million) under the EFF arrangement and 31.5 percent of quota (SDR170.98 million or, about US$228 million) under the ECF arrangement (Text Table 4 and Table 7a).[34] Augmented purchases and disbursements are proposed to be phased evenly across reviews for each arrangement over the extended duration of the program.

- Outstanding budget support commitments approved at the time of the 4th EFF/ECF reviews are proposed to be rephased over the extended duration of the program.

Text Table 4. Kenya: Proposed Access to IMF Resources[1]

Availability dates for the EFF/ECF Arrangements	Status of availability dates	Approved access			Proposed total access				Of which: budget support				Of which: BoP support (augmentation)		
		GRA	PRGT	Total	GRA	PRGT	RST	Total	GRA	PRGT	RST	Total	GRA	PRGT	Total
		(in percent of quota)													
May 7, 2023	Approved	33.5	8.0	41.5	42.2	14.3	0.0	56.5	33.5	8.0	0.0	41.5	8.7	6.3	15.0
November 7, 2023	Approved	34.0	8.0	42.0	31.9	11.6	8.3	51.8	23.2	5.3	8.3	36.8	8.7	6.3	15.0
May 7, 2024	Approved	24.0	6.0	30.0	31.9	11.6	25.0	68.5	23.2	5.3	25.0	53.5	8.7	6.3	15.0
October 30, 2024	Proposed (new)	...	...	...	14.5	8.1	25.0	47.6	5.8	1.8	25.0	32.6	8.7	6.3	15.0
March 15, 2025	Proposed (new)	...	...	...	14.5	8.1	16.7	39.2	5.8	1.8	16.7	24.2	8.7	6.3	15.0
Total (2021-22)		138.5	83.0	221.5	138.5	83.0	0.0	221.5	138.5	83.0	0	221.5	...	...	...
Total (prospective)		91.5	22.0	113.5	135.0	53.5	75.0	263.5	91.5	22.0	75.0	188.5	43.5	31.5	75.0
Of which: EFF/ECF augmentation		...	...	...	43.5	31.5	...	75.0	0.0	0.0	...	0.0	43.5	31.5	75.0
Cumulative by April 2025		**230.0**	**105.0**	**335.0**	**273.5**	**136.5**	**75.0**	**485.0**	**91.5**	**22.0**	**75.0**	**188.5**	**43.5**	**31.5**	**75.0**
		(in millions of SDR)													
May 7, 2023	Approved	181.8	43.4	225.3	229.1	77.6	0.0	306.7	181.8	43.4	0.0	225.3	47.2	34.2	81.4
November 7, 2023	Approved	184.6	43.4	228.0	173.2	62.7	45.2	281.1	125.9	28.5	45.2	199.7	47.2	34.2	81.4
May 7, 2024	Approved	130.3	32.6	162.8	173.2	62.7	135.7	371.5	125.9	28.5	135.7	290.1	47.2	34.2	81.4
October 30, 2024	Proposed (new)	...	...	...	78.7	43.7	135.7	258.1	31.5	9.5	135.7	176.7	47.2	34.2	81.4
March 15, 2025	Proposed (new)	...	...	...	78.7	43.7	90.5	212.9	31.5	9.5	90.5	131.4	47.2	34.2	81.4
Total (2021-22)		751.8	450.5	1,202.3	751.8	450.5	0.0	1,202.3	751.8	450.5	0.0	1202.3	...	...	...
Total (prospective)		496.7	119.4	616.1	732.8	290.4	407.1	1,430.3	496.7	119.4	407.1	1023.2	236.1	171.0	407.1
Of which: EFF/ECF augmentation		...	...	...	236.1	171.0	...	407.1	...	...	...	...	236.1	171.0	407.1
Cumulative by April 2025		**1,248.4**	**569.9**	**1,818.4**	**1,484.6**	**740.9**	**407.1**	**2,632.6**	**1248.4**	**569.9**	**407.1**	**2225.5**	**236.1**	**171.0**	**407.1**

1/ No disbursement at approval under the RSF policies.
Note: Kenya's quota is SDR542.8 million.

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[34] The Board approved a temporary increase in the normal annual/cumulative GRA access limits to 200/600 percent of quota (see the March 6, 2023 decision) . The proposed augmentation under the program will make the ratio of GRA to PRGT resources under the extended program 2:1 with the total PRGT resource commitment reaching 136.5 percent of quota (cap under blended programs: 145 percent of quota per program). Post augmentation, Kenya's outstanding IMF credit (excluding the RSF), net of repurchases/repayments, will reach 510 percent of quota by 2025, remaining within the temporarily higher normal cumulative access limit of 600 percent of quota.

Text Table 5. Development Partners' Involvement in Climate-Related Issues in Kenya

Development Partner	Areas of Focus
African Development Bank	climate change preparedness and management of climate change shocks in agriculture; forest conservation; food security
Agence Française de Développement (AFD)	NDC implementation
British High Commission	solar street lighting; green housing; TA on green guidelines for PPP projects; green finance projects; TA on green asset registry
Danish International Development Agency (DANIDA)	NDC implementation; water management
Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)	NDC implementation and financing capacity, including for adaptation finance; agriculture sector productivity and value chain integration; climate-resilient agriculture sector; soil protection and for the rehabilitation of degraded soils; solar irrigation
European Investment Bank	transit infrastructure; energy (geothermal power plant); energy (electrification project targeting the connection of customers to the distribution network); water and sanitation (expansion of the water supply and rehabilitation and expansion of the wastewater system); green finance taxonomy
European Union	Public Expenditure Framework Assessment (PEFA), including Climate Finance module; access to climate-related finance in agriculture sector; climate adaptation finance for young companies (grants, loans and guarantees); TA to enhance the technical and institutional capacity of the Climate Finance and Green Economy Unit in the National Treasury
Italian Agency for Development Cooperation (AICS)	development of an integrated sustainable waste management system; community organization and rural development; farmers market access; restoration and rehabilitation of river watersheds; sustainable land management practices; forest preservation; climate finance; agriculture sector productivity
Japan International Cooperation Agency (JICA)	deforestation prevention
Korea International Cooperation Agency (KOICA)	climate finance
Swedish International Development Cooperation Agency (SIDA)	NDC implementation; natural resource management; biodiversity preservation
Swiss Agency for Development and Cooperation (SDC)	climate finance
U.S. Agency for International Development (USAID)	carbon market framework development
World Bank	access to financial services for drought risk mitigation; livestock trade facilitation; agricultural productivity enhancements and improvements in profitability of targeted rural communities; private infrastructure investment strengthening by leveraging PPPs; strengthening of systems for preparedness against locust outbreak; agriculture sector climate-resilience; farmers market participation and value addition; resilience of food systems and preparedness for food insecurity

39. The authorities also request a 20-month RSF arrangement to support their climate-related efforts (Tables 7b and 13).[35]

- The RSF arrangement, with an access level of 75 percent of quota (SDR407.1 million, about US$544 million), is proposed as budget support and phased evenly across the proposed

[35] The exact duration of the RSF arrangement is through April 1, 2025.

reform measures (Text Table 4 and Table 7b). Kenya is eligible for RSF financing with Group B interest rates applied (¶35 and ¶43 in IMF, 2022).

- RSF resources would substitute for more expensive domestic financing, improving public debt dynamics, while the reforms are expected to reduce medium- to longer-term BoP vulnerabilities from import-intensive climate investment. RSF-supported reforms could crowd in other financing, help mobilize additional private climate financing while strengthening the institutional setup.

40. The EFF/ECF program is fully financed, with firm commitments over the next twelve months and good prospects for the remainder of the program (Text Table 6 and Table 6). In addition to support from IMF, Kenya's external budget financing needs would be met by prioritizing concessional financing but would see a mix of official and commercial loans:

- **Program financing.** Program financing in 2023 is stronger than projected at the 4th EFF/ECF reviews, reflecting larger budget support by development partners and the authorities' request for augmentation of access under the EFF/ECF arrangements.[36]

- **External commercial financing.** Authorities have successfully raised US$840 million in syndicated bank loans in FY2022/23. The baseline projection of a rollover of the US$2 billion Eurobond in June 2024 is premised on the re-opening of international markets for frontier economies. The authorities have launched the process for hiring international lead managers and are considering alternative sources of financing from multilateral and bilateral lenders and the syndicated loans market.

Text Table 6. Kenya: External Financing Needs and Sources, 2022–25

(In millions of U.S. dollars)

	2022		2023		2024		2025
	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	Proj.
External financing needs 1/	**1,600**	**1,586**	**1,199**	**1,994**	**818**	**1,482**	**165**
Official financing	**1,600**	**1,586**	**1,199**	**1,994**	**818**	**1,482**	**165**
IMF EFF/ECF purchases and disbursements	682	673	603	729	218	482	165
2023 EFF/ECF augmentation (BOP support)	...	...	...	219	...	219	110
Budget support (excl. RSF)	682	673	603	510	218	263	55
Other external budget support	919	913	596	1,265	600	1,000	0
IMF RSF disbursements	**...**	**...**	**...**	**61**	**...**	**365**	**122**
Memorandum item							
Eurobond issuance (net) 2/ 3/	0	0	0	0	0	0	495
Syndicated bank loans (net)	496	298	400	541	0	0	0

Source: IMF staff estimates and projections.

1/ After Eurobond issuance (see memo item).

2/ Reflects rollover of the 2024 Eurobond on maturity.

3/ In 2025, assumes pre-financing of the conversion of US$500 million of 3-year syndicated bank loans drawn in FY2022/23.

41. The program continues to face significant risks (¶8 and Annex I). Program risks from high global uncertainty, policy slippages, and decline in availability of concessional resources remain but are mitigated by the authorities' continued performance to date and commitment toward stronger and mutually-supportive policies to safeguard macroeconomic stability by i) deploying

[36] The 2023 Development Policy Operation (US$1 billion) was approved in May 2023.

contingency measures to limit the impact of the emerging slowdown in tax collection on performance against FY2022/23 and FY2023/24 targets; ii) maintaining close engagement with donors; and iii) adopting a tailored capacity development strategy to support the implementation of structural reforms—including those supported by the RSF.

42. Kenya's capacity to repay the IMF is adequate but is subject to risks (Table 8).

- At end-2022, the share of Kenya's multilateral debt was less than half of its total external public debt and is projected to remain below 55 percent over the medium term under the baseline (Table 10). These ratios are slightly below the average and median for PRGT programs.
- The total amount of outstanding credit to the IMF (including the proposed augmentation and RSF) is projected at SDR 3,093 million, or 569.8 percent of quota in 2025, with the ratios to GDP and gross international reserves peaking at 3.5 and 47.2 percent in 2024, respectively, both exceeding the 75th percentile of the IMF's past Upper Credit Tranche (UCT)-quality arrangements for LICs (Figure 8). Total debt service to the IMF would peak by 2029 at 2.9 percent of exports of goods and services and 2.7 percent of fiscal revenue, both well above the top quartile of past IMF UCT-quality arrangements for LICs. These relatively elevated levels of scheduled debt service to the IMF may pose risks to capacity to repay over the medium term. In the near term, the materialization of downside risks, such as a continued lack of market access for frontier issuers and any delays in reform implementation could increase pressure on Kenya's capacity to repay the IMF. However, these risks are mitigated by Kenya's continued access to concessional financing, expected normalization of international market access ahead of the Eurobond rollover in 2024, and Kenya's strong track record of servicing debts to the IMF and other creditors. Risks are further mitigated by the multi-year fiscal consolidation that anchors the program, supported by tax policy measures to boost revenues.
- One of the key objectives of the program is to undertake growth-friendly fiscal consolidation, achieving the debt stabilizing primary balance during the program to put the public debt/GDP ratio on a downward path. The four external debt indicators (DSA) are also on a downward path, with near-term breaches relative to the five LIC-DSA thresholds declining over the medium term.

43. The following modifications to program conditionality are proposed (MEFP, Tables 1 and 2):

- Modification of the end–December 2023 QPC on the floor on net international reserves based on updated information (higher expected outturn for end-June 2023 on larger budget financing than reflected earlier in the baseline and revised information on projected net flows in the second half of 2023) and its adjustors, including a floor on downward adjustment to mitigate downside risks to reserves;

- Under the EFF arrangement, based on preliminary information, for the end-June 2023 test date, waiver of nonobservance for the QPC on tax revenues and waiver of applicability for other the end-June 2023 PCs;[37]
- Establishment of targets for end–June 2024 test date;
- Establishment of a new IT on ceiling on non-accumulation of new net domestic arrears on a cumulative basis within a fiscal year by MDAs and State Corporations (SCs);
- Establishment of new SBs and proposal that the target date for the end-December 2022 SB to complete a review of how the fuel pricing mechanism has been applied to date and announce and constitute a taskforce be reset to end-August 2023; and
- Modification of TMU language to remove ambiguity on the grace period for publicly guaranteed debt.

STAFF APPRAISAL

44. Despite the multi-decade-worst drought and ongoing external shocks, the authorities are taking important steps to strengthen Kenya's economic reform program. While growth was resilient in 2022, global headwinds continue to have a bearing on economic activity, amid elevated inflationary pressures. The near-term outlook remains subject to important downside risks. Nevertheless, the authorities are committed to the program objectives and advancing the reform agenda, while planning to undertake further adjustments to maintain external and debt sustainability. The medium-term outlook is positive but subject to climate-related risks.

45. Monetary policy needs to continue to proactively respond to maintaining price stability and external sustainability. The CBK's decisive move to tighten the monetary policy stance in June 2023 was warranted. Going forward, the authorities should stand ready to adjust monetary policy, as needed, in line with a data-dependent and forward-looking approach, supported by clear and transparent communication. This would also uphold confidence in macroeconomic stability and meeting government's financing needs. The authorities' effort to facilitate reactivation of Kenya's interbank foreign exchange market is a welcome development. Against a difficult external environment, the CBK should continue taking appropriate steps to strengthen its reserves position and deepen the FX market, while promoting exchange rate flexibility as a shock absorber.

46. Kenya should continue to deliver on fiscal consolidation as part of a mutually reinforcing prudent set of policies, supported by contingency planning. Further fiscal consolidation focused on revenue mobilization and prudent spending will support reducing debt

[37] Reviews of performance under an arrangement in the IMF's General Resources Account are based on the most recent PCs. For the end-June 2023 QPCs, no final data are available, prompting the request for a waiver of applicability of those PCs under the EFF arrangement for which there is not deterministic evidence of not meeting the targets. However, the QPC on taxes is likely to be missed as per information available as of May 2023. The 5th review under the ECF arrangement, a facility in the Poverty Reduction and Growth Trust, remains based on the end-December 2022 performance criteria.

and external vulnerabilities. Contingencies to contain the overall fiscal balance within available margins are appropriate. FY2023/24 revenue package in the draft Finance Bill will be critical to achieve the tax path envisaged under the program and to further reduce the fiscal deficit, while making room for needed social and development spending. With challenges and uncertainties elevated both from regional and global sources, contingency plans—including corrective tax measures—that can be quickly deployed to ringfence fiscal performance would help boost readiness to recalibrate policies. Going forward, further improvements in strengthening spending efficiency and improving tax policy and revenue administration will remain essential.

47. NT should limit fiscal risks from fuel pricing to ensure sustainability of public finance. Risks associated with the new oil import scheme should be limited by adjusting its setup after the initial rollout period, so that all risks are borne by the private sector. Similarly, to reduce risks to the budget, changes in the mechanism for setting pump prices should ensure that fuel price decisions are always aligned with budgeted resources.

48. Kenya's public debt is sustainable but remains at high risk of distress. Debt reduction will be supported by the fiscal consolidation path under the program with the debt-to-GDP ratio stabilizing and gradually converging to more prudent levels over the medium term, while securing resources to support social spending. Improvement in the external debt service-to-exports ratio will remain gradual. Staff also welcomes the authorities' comprehensive strategy to strengthen debt management.

49. While banks are well-capitalized and liquid overall, the authorities should continue to closely monitor and address emerging vulnerabilities. Resolution of NPLs and continued adequate provisioning should be priorities, while the CBK's approach to consolidating and proactively dealing with shortfalls in weaker banks is welcome. Continued attention to risks from banks' FX positions from a macro prudential perspective should be a priority. Resolution of FX market dislocation durably would mitigate the trend toward increasing FX exposures in the banking sector. The CBK should continue to closely monitor spillovers and spillbacks from local banks' regional expansion and operational risks from digitalization.

50. Focus on minimizing fiscal risks from SOEs and improving their governance and oversight is welcome. The 2023 comprehensive revision of base electricity tariff and a Cabinet-approved action plan to strengthen KPLC's financial health should be steadfastly implemented while monitoring any residual fiscal risks. On KQ, the optimal strategy should be based on least cost to the exchequer. The new administration's privatization goals should also be supported by expediting progress in the SOE governance and oversight reform agenda.

51. Strengthening the anti-corruption legal framework, enhancing transparency and financial integrity measures, and effective follow up on audit findings should remain priorities. Recent measure to publish beneficial ownership information through the Public Procurement Information Portal should be sustained while also strengthening data analysis capabilities on procurement-related information. The planned special audit on supplementary budget spending, including under Article 223 of the Constitution, should help ensuring spending outcomes are consistent with plans going forward. The authorities should take timely actions to address the strategic deficiencies identified in the Kenya 2022 Mutual Evaluation Report by ESAAMLG to safeguard financial and macroeconomic stability. The authorities should address gaps in the AML/CFT legal framework and prioritize measures to improve effectiveness of the AML/CFT framework. Enhancing AML/CFT risk-based supervision would further support an effective AML/CFT regime. Staff welcomes the submission to Parliament of a draft Conflict of Interest Bill in March 2023.

52. Given performance under the EFF/ECF arrangements, continued commitment toward meeting the program's objectives, and prevailing balance of payments needs, staff supports the authorities' requests for completion of the 5th EFF/ECF reviews, extension of the arrangements by 10 months, blended augmentation of 75 percent of quota and rephasing of access, modification of a quantitative performance criterion, completion of monetary policy consultation, and, for the end-June 2023 performance criteria under the EFF arrangement, waiver of nonobservance for the target on tax revenue based on the committed corrective measures and waiver of applicability for the other PCs as there are no clear evidences that those will not be met, allowing a successful implementation of the program.

53. Staff also supports the authorities' request for a 20-month Resilience and Sustainability Facility (RSF) to address climate related challenges and advance their commendable efforts to date. To this end, the authorities have presented strong and comprehensive package reforms to address climate-related challenges facing Kenya. Staff encourages the authorities to leverage the RSF to exploit synergies with other official financing and catalyze further private financing for climate mitigation and adaptation efforts.

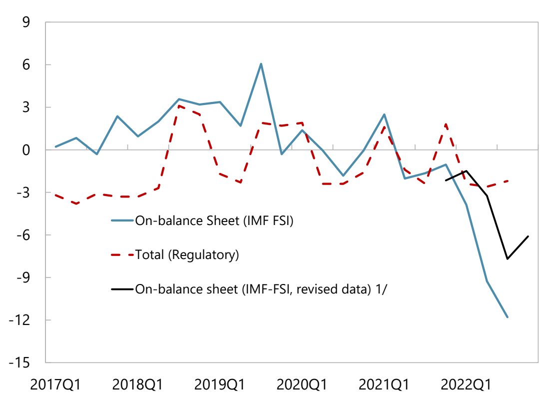
Box 1. Kenyan Banks' Exposure to Foreign Exchange (FX) Risk

Central Bank of Kenya (CBK) limits FX risks in the banking system via a net open position (NOP) limit and a capital charge. The limit on total net open FX positions (including both on- and off-balance sheet exposures) is 10 percent of core capital and the capital charge for total net open position is also 10 percent. The CBK also encourages banks to limit FX lending only to clients having a natural hedge against FX risks.

Imbalances in the FX market are contributing to greater gross exposures in the banking system. While the regulatory FX NOP remained stable in 2022 after a decline in 2022Q1 at the start of the Russia Ukraine war, the on-balance sheet NOP reported in IMF's Financial Soundness Indicators (FSI) database declined rapidly during 2022 (Box Figure 1.1). Regulatory data show that several banks, including some Tier-1 banks, had larger off-balance sheet NOPs in 2022Q4 (funded by on-balance sheet positions, reflected in a foreign currency asset to deposit ratio profile less than 100 percent) than in 2021Q4 (Box Figures 1.2 and 1.3). The off-balance sheet long positions consist largely of swaps with the oil sector, which are of less than 6 months maturity and generally rolled over. However, these swaps are expected to gradually unwind as they are expensive from the clients' perspective and had expanded substantially due to the dollar shortage. The government-to-government oil import scheme (see Box 3) is expected to ease the demand for these swaps by the oil companies. Banks are on the net borrowers of US$ via swaps with other financial institutions.

Kenyan on-balance sheet FX NOPs are large compared to peers (Box Figure 1.4). In 2022Q4 (or latest available quarter), Kenyan banks had the third largest short FX net open position (NOP) for on-balance sheet items, among emerging and frontier economies for which comparable data were available.

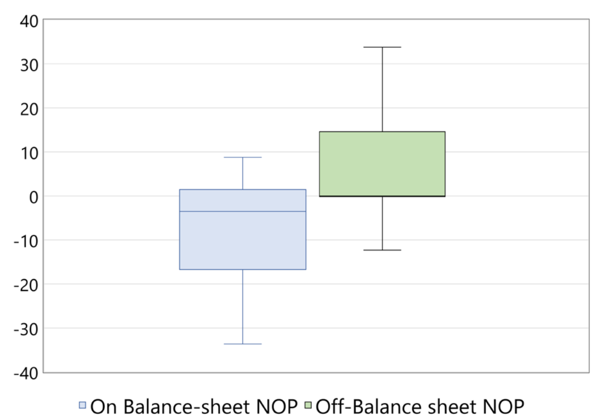
Box Figure 1.1. Kenya: FX NOPs
(Percent of capital)



Sources: Central Bank of Kenya and IMF, *Financial Soundness Indicators* database.

1/ Per IMF FSI methodology, FX NOPs are computed as percent of total regulatory capital, whereas CBK methodology computes FX NOPs as percent of core capital. Revised FSI data follows the 2016 methodology.

Box Figure 1.2. Kenya: Distribution of On and Off-Balance Sheet NOPs: 2022Q4
(Percent of core capital)

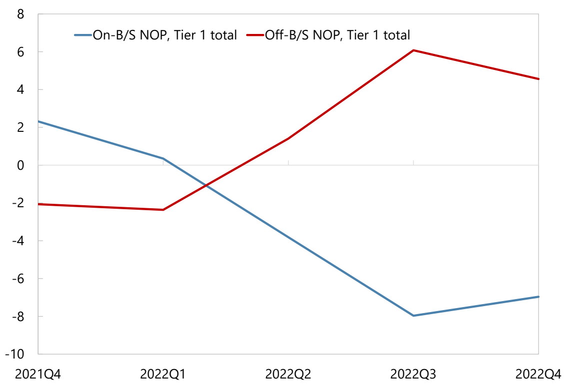


Sources: Central Bank of Kenya and IMF staff calculations.
Note: The chart plots the median, 25th and 75th percentiles (in the boxes) and 1.5 times the interquartile range of bank-level NOPs as the whiskers. It excludes the outliers, which range from -117 to 103 for on-balance sheet and -96 to 97 for off-balance sheet positions.

Box 1. Kenyan Banks' Exposure to Foreign Exchange (FX) Risk (Concluded)

Box Figure 1.3. Kenya: On and Off-Balance Sheet NOPs: Tier-1 Banks 2022Q4

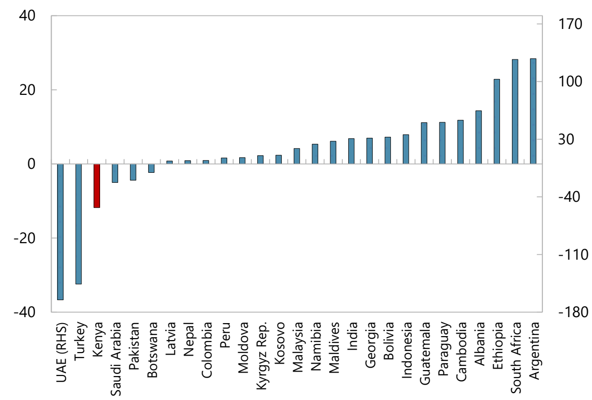
(Percent of group core capital)



Sources: Central Bank of Kenya; and IMF staff calculations.

Box Figure 1.4. On-Balance Sheet FX NOPs in Selected Countries

(Percent of total regulatory capital, latest available quarter in 2022)



Sources: IMF, *Financial Soundness Indicators* database; and staff calculations.

Box 2. Pending Bills

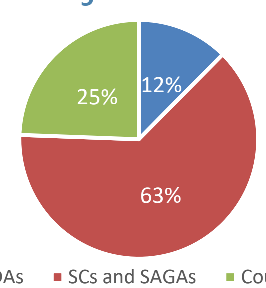
In Kenya, pending bills are overdue payables—incurred by any level of the public sector. For Ministries, Departments, and Agencies (MDAs) and counties these comprise any amounts unpaid at the end of the fiscal year (IMF, 2020**).** These thus include both invoices for goods and services delivered or consumed during the year (i.e., current payables) and expenditure arrears (i.e., financial obligations for which payments have not been made by the due date; IMF, 2014).[1] For State Corporations (SCs) and Semi-Autonomous Governmental Agencies (SAGAs) pending bills are outstanding obligations that the entity does not have the resources to pay, including amounts due within the same fiscal year. Due to data limitations, the current program with Kenya only tracks a subset of pending bills through an Indicative Target—namely, the national government exchequer requests outstanding for more than 90 days (TMU¶27).[2]

Pending bills have been a long-standing issue in Kenya (IMF, 2000; PEFA, 2019; PER 2020). The causes of pending bills are varied—including overly-optimistic own-source revenue projections resulting in unrealistic expenditure estimates, delays in releasing cash from the Exchequer, weak commitment control—including related to the use of extraordinary budget procedures (e.g., Art. 223 of the Constitution). The situation is further complicated by deep-rooted shortcomings in reporting and validation systems. While pending bills at MDAs are mostly captured in the IFIMIS system and subject to a robust vetting process, those related SCs/SAGAs and counties are not in IFIMS and generally subject to minimal vetting (e.g., self-verification).

Kenya's total outstanding pending bills were estimated at about Ksh.641 billion or 4.4 percent of GDP billion at end-December 2022 (about Ksh.567 billion at end-December 2021). State Corporations (SCs) and SAGAs have the lion share of the outstanding stock of bills with about Ksh.401 billion (Box Figure 2.1). These mainly included payments due to contractors/projects, suppliers, unremitted statutory and other deductions, and pension arrears for local authorities Pension Trust (about ⅔ of total). Outstanding pending bills at MDAs were mainly historical and related to recurrent expenditure (about ¾ of total).

The EFF/ECF program has improved visibility on pending bills, building on previous TA recommendations from development partners (IMF 2020, PEFA, 2019; PER 2020). At program approval, structural conditionality included a SB to initiate regular quarterly reporting on pending bills, covering MDAs, Counties, SCs/SAGAs, and SCs—which the authorities met at end-March 2021. In addition, the National Treasury has started submitting monthly information by spending center (i.e., vote) on pending bills at MDAs by spending center (i.e., vote). More generally, the program has a significant focus on strengthening public financial management (PFM) systems, particularly in the area of budget control and execution processes, cash management, and public investment management (CR/21/72).

Box Figure 2.1. Kenya: Composition of Pending Bills at End-2022



Source: Office of the Controller of Budget, Kenya.

Against this backdrop, the authorities recognize the need to do more to strengthen PFM systems and avoid future accumulation of pending bills (MEFP¶27). Accordingly, they have established a task force which is expected to submit to Cabinet by end-September 2023 (SB) a comprehensive strategy to validate the stock of pending bills outstanding at end-June 2023, identify measures to address the shortcomings in the PFM systems that led to the accumulation of pending bills, and propose a timeline for the clearance of the validated arrears over the medium term and consistent with the objective of reduce debt vulnerabilities.

[1] The precise point at which a government liability falls into arrears typically varies according to the type of expenditure. In practice, what constitutes a payment arrear may vary from country to country because there may be no clearly stated deadline for payment in laws, regulations, or policies. International practice on what is an acceptable delay between receipt and payment of the invoices varies from anywhere between 30 to 120 days. In low-income countries, the payment period is often longer and may depend upon the efficiency and development of the payment system.

[2] These are invoices incurred by the Ministries, Departments, and Agencies (MDAs) for which requisitions for payment have been received in the Integrated Financial Management Information System (IFMIS) but corresponding funds from the exchequer account have not been released.

Box 3. New Fuel Import Mechanism

Under the new government-to-government mechanism for importation of fuel products launched in April 2023, the government of Kenya has negotiated directly with the governments of Saudi Arabia and United Arab Emirates the terms of imports of the entire supply of fuels (jet fuel, diesel, and gasoline) destined for the domestic market and transiting through Kenya to other countries in the region.[1] The scheme includes the issuance of letters of support by the government to domestic oil marketing companies (OMCs) that also benefit the banks, financial institutions, credit insurance providers, lenders and any hedging counterparties providing financing, insurance, refinancing or hedging to the OMC.

Under the terms of the agreement, which has an initial duration of nine months (through end-December 2023), the fuel is imported on 6-month credit, backed by commercial letters of credit (LCs) issued by domestic banks, and confirmed by international banks. Within around 5 days of receiving a cargo of fuels, OMCs deposit the US$ proceeds of their sales, in the case of jet fuel and fuels destined to the region, and the shilling equivalent of their value, in the case of domestically marketed diesel and gasoline, in escrow accounts with the LC-issuing domestic banks.

The shilling escrow account is interest bearing at the 91-day T-bill rate minus 2 percent, with the interest paid into a Stabilization Fund set up by the government to cover any FX-currency losses stemming from the potential for depreciation of the shilling in the period between importation and payment in US$. The LC-issuing banks start gradually purchasing US$ 90 days after the Bill of Lading date. A Treasury and Risk Management Committee (TRIMCOM), comprising representatives of the government, local banks, and OMCs, will monitor the implementation of the agreement and the terms of FX purchases. On the 180th day, the exporter is paid directly by the international bank confirming the LC, which then seeks reimbursement from the domestic LC-issuing bank. The government regulator is expected to adjust prices at the pump to offset any FX valuation losses.

The total amount of outstanding obligations of OMCs to fuel exporters will peak at 6-months of fuel imports and will then rollover as the first received cargo is settled and a new one is received (if the scheme is extended past the initial 9-month period). Based on April 2023 prices, the total obligation incurred is estimated at around US$700 million per month for a total of over US$ 4 billion by end-September 2023.

Review of the legal arrangements under the scheme by the Attorney General of Kenya has established that they do not give rise to government guarantees of private debt under domestic law. The government is, nevertheless, exposed to calls on the national budget in case prices at the pump are not adjusted to fully passthrough any FX valuation losses to final consumers and/or to raise US$ financing to cover any shortfalls of FX at the domestic market should FX market dislocation not be durably resolved. To ensure consistency with the continuous conditionality on multiple currency practice under the EFF/ECF arrangement the authorities have committed that the exchange rate that will be used for purchasing FX under this importation scheme, and the rate at which the government will provide access to US$ should the need arise, would not deviate from the prevailing market rate by more than 2 percent.

[1] Fuel suppliers, which were selected following an open tender process, are Saudi Aramco, ENOC, and ADNOC. Their nominated importers and contractual counterparties are Oryx Energies Kenya Ltd, Galana Oil Kenya Ltd, and Gulf Energy, Ltd.

Box 4. Climate Finance Landscape in Kenya

Kenya has developed a vibrant ecosystem to facilitate private climate finance. Examples of a diverse set of financing mechanisms put in place to enable various stakeholders to participate in enhancing climate resilience of the Kenya's economy include:

- *Private-to-private debt investments.* Acorn issued Kenya's first corporate green bond in October 2019 raising US$40 million on the Nairobi and London Stock Exchanges to finance the construction of green-certified properties. Similarly, M-Kopa, which pioneered a pay-as-you-go-model for solar panels and smartphones, has raised over US$250 million in debt and equity in May 2023, marking one of the largest fundraising efforts on the continent to-date.[1]

- *Private-to-private (P2P) equity investments.* Private-to-private (P2P) equity investments are a type of financing that help businesses reduce their cost of capital and improve the efficiency of the Kenyan capital market. They can also help channel capital to climate-friendly businesses and projects, expand diversification opportunities for investors, and reduce risk premia. For example, P2P platforms, such as GreenThumb, Eneza, and Acumen, are facilitating capital flow to small-scale farmers, renewable energy projects, and businesses working towards water and sanitation improvement in Kenya. For example, Komaza secured US$28 million of its planned US$33 million equity financing in July 2020. Similarly, Apollo Agriculture, an Agri-Tech company based in Nairobi, raised US$40 million in March 2022.

- *Private-to-public debt investments.* Government of Kenya issued the 'M-Akiba' retail infrastructure bond in November 2022, raising nearly US$466 million to finance government infrastructural development projects, including those related to climate adaptation.

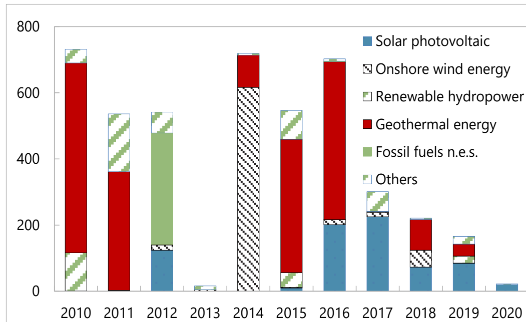
- *Private-to-public equity investments.* About 30 percent of installed generation capacity is owned and operated by Independent Power Producers (IPPs), which have mobilized at least US$2.5 billion in private capital.[2] For example, government of Kenya and the Marsabit Solar Power Limited (a consortium of companies led by Scatec Solar) entered a US$120 million public-private partnership (PPP) project in March 2023 to construct and operate a 50 MW solar power plant in Marsabit County.

- *Bilateral support.* Governments of Kenya and the United Kingdom signed partnership on climate change in November 2022 valued at approximately US$4.1 billion over five years.

- *Blended finance mechanisms.* In December 2022, the World Bank Group's Multilateral Investment Guarantee Agency (MIGA) extended a partial risk guarantee for US$51.4 million to Standard Bank of South Africa Limited and Stanbic Bank Kenya Limited to cover loans for the road construction, rehabilitation and climate adaptation works.

- *Global climate funds.* Kenya has received over US$535 million from global climate funds, including US$246.4 million from the Global Climate Fund (GCF), US$1113.3 million from the Climate Investment Fund (CIF), and US$175.2 million from Global Environmental Facility (GEF).

Box Figure 4.1. Kenya: Public Flows to Renewable Energy Projects [1]
(In millions of 2020 U.S. dollars)



Source: International Renewable Energy Agency.
[1]Financial flows in the form of commitments originating from public institutions like governments, multilateral development banks and other public finance institutions.

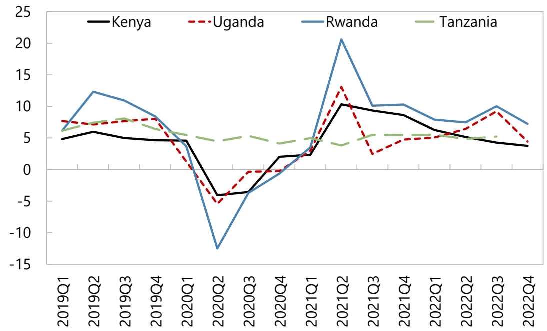
[1] Standard Bank provided US$100 million of US$202 million in debt, while other lenders include the International Finance Corporation (US$65 million), Lion Head's Group, and British International Investment. Sumitomo Corporation, which previously invested US$5 million, contributed with US$36.5 million equity investment.

[2] Kenya Economic Update, June 2023, World Bank.

Figure 1. Kenya: Real Sector Developments

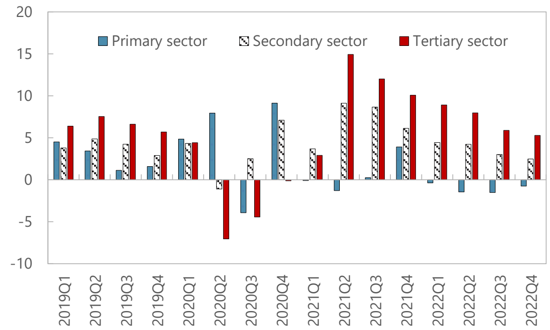
Kenya's growth remains resilient amid multiple shocks and has generally followed the regional peers.

Real GDP Growth
(Percent, y/y)



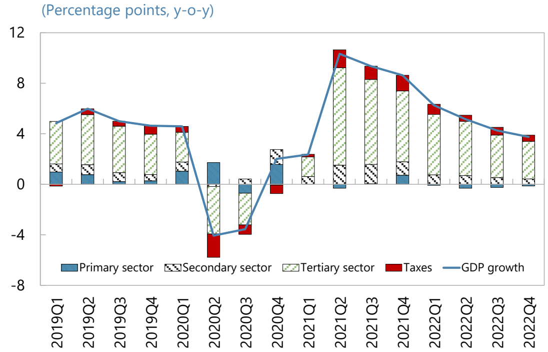
In 2022, agriculture declined in each quarter amid an intensifying drought while services growth decelerated.

Quarterly GDP Growth
(Percent, y/y)



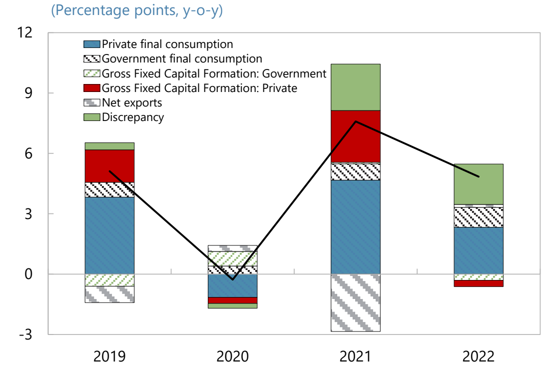
On the supply-side, 2022 growth was driven by the services sector

Contributions to GDP Growth
(Percentage points, y-o-y)



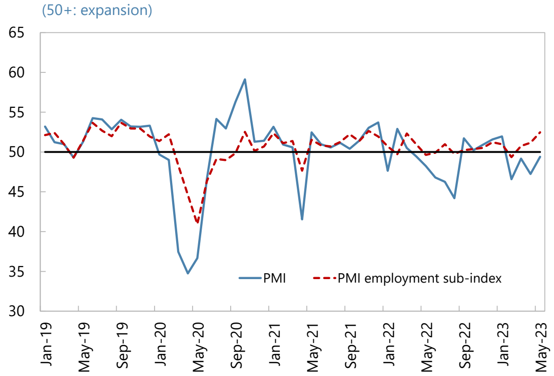
On the demand-side, 2022 growth was driven by the private sector albeit at a slower pace than a year before.

Contributions to GDP Growth
(Percentage points, y-o-y)



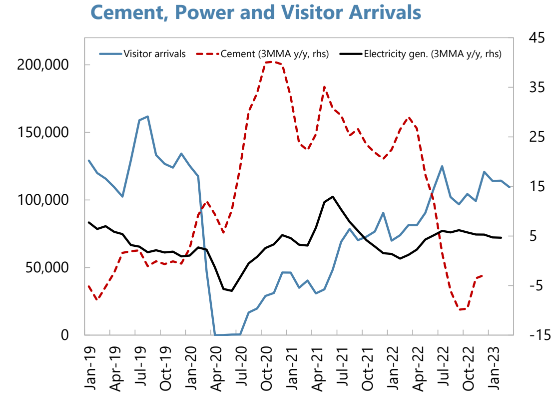
High frequency indicators show recent weakness in the manufacturing sector…

Manufacturing PMI Index
(50+: expansion)



…and in cement, though recovering, while growth in electricity productions and tourist arrivals are holding up.

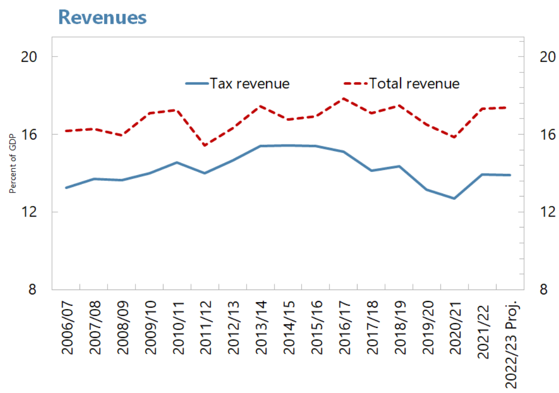
Cement, Power and Visitor Arrivals



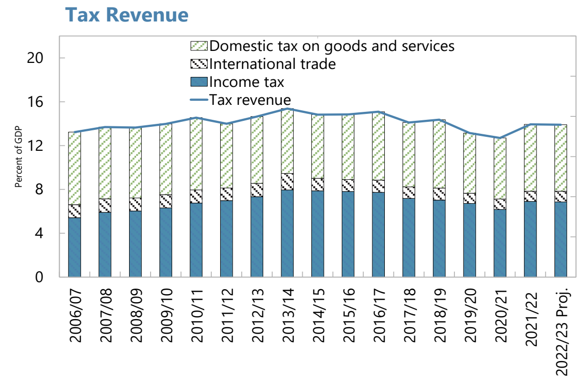
Sources: Kenyan authorities; Markit Economics; and IMF staff calculations and projections.

Figure 2. Kenya: Fiscal Sector Developments

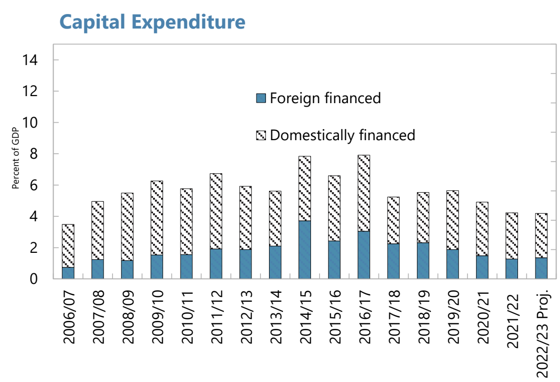
Tax revenues are projected to further increase in FY2022/23 despite an emerging slowdown in early 2023....



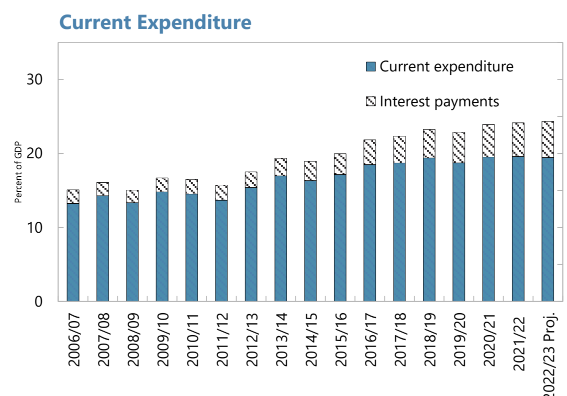
... driven by domestic and income taxes.



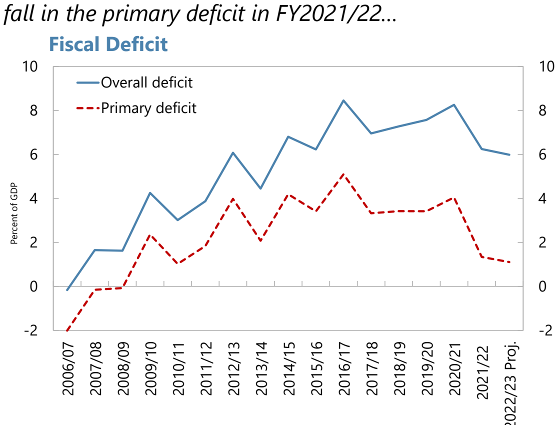
Capital expenditure is expected to remain constrained by delays in mobilizing financing....



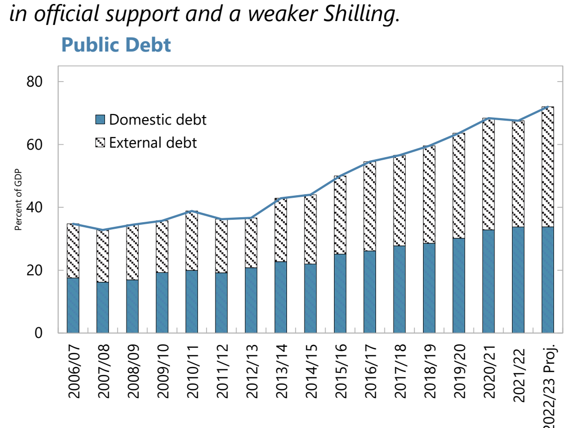
... while current expenditure/GDP is set to be similar to FY2021/22.



Significant spending under-execution resulted in a large fall in the primary deficit in FY2021/22...



... while debt continued to rise mainly reflecting a scale up in official support and a weaker Shilling.

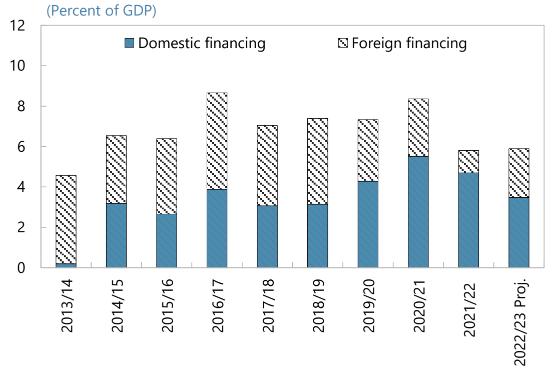


Sources: Kenyan authorities; and IMF staff calculations and projections.

Figure 3. Kenya: Financing

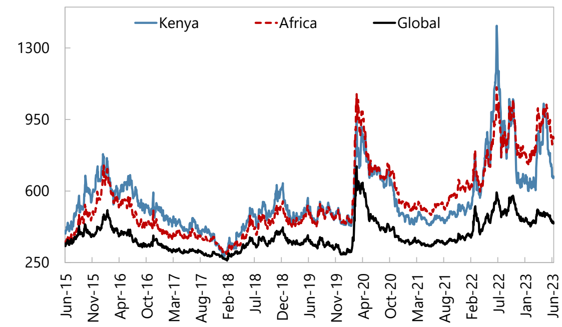
Scaled up budget support and commercial borrowing contributed to higher external financing in FY2022/23….

Financing
(Percent of GDP)



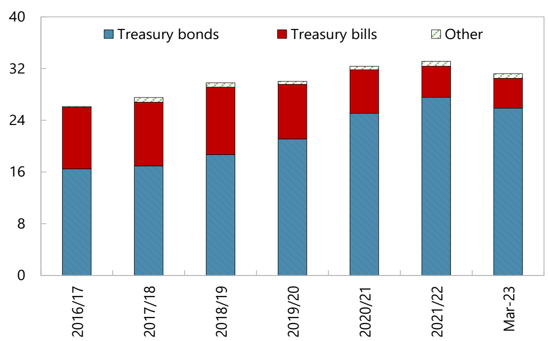
…while conditions for accessing the international bond market remains tight since the onset of war in Ukraine.

EMBIG Spreads
(Basis points)



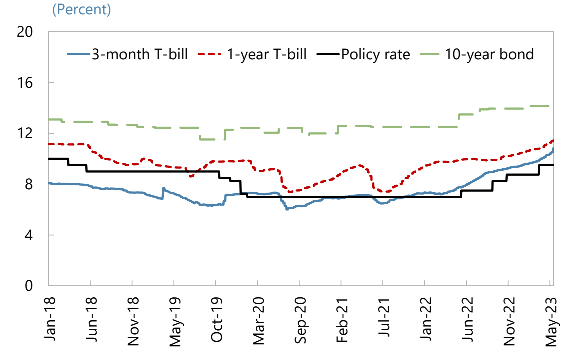
The bulk of domestic debt stock remains in Treasury bonds….

Domestic Debt
(Percent of GDP)



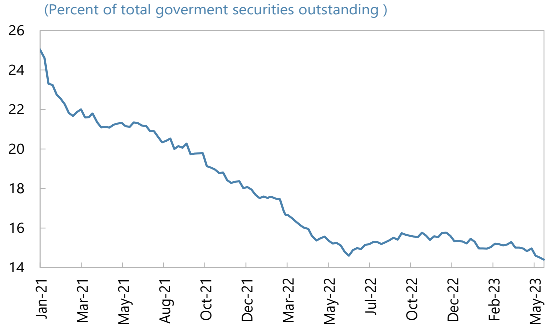
… benefiting from past efforts that have locked in improvements in the maturity of Kenya's domestic debt.

Domestic Yields
(Percent)



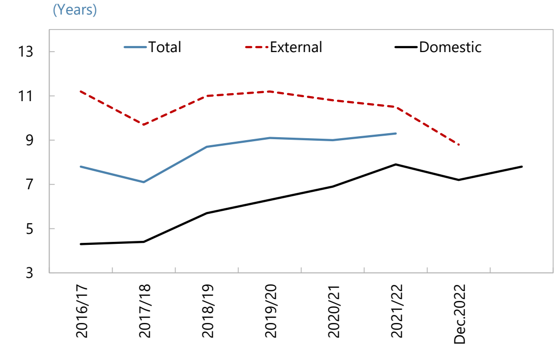
Share of T-bills in domestic debt stock has declined marginally since FY2021/22.

T-Bills
(Percent of total goverment securities outstanding)



Over the past several years the authorities have been able to extend the maturity profile of domestic debt.

Average Time to Maturity of Debt
(Years)

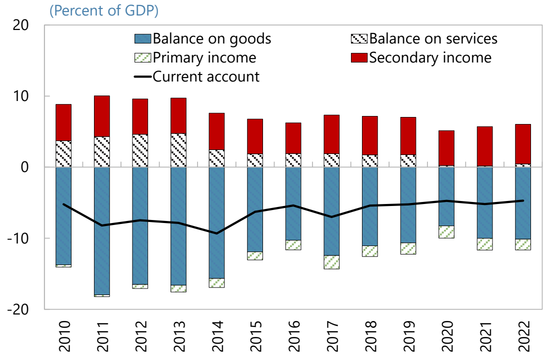


Sources: Kenyan authorities; Bloomberg L.P; and IMF staff calculations and projections.

Figure 4. Kenya: External Sector Developments

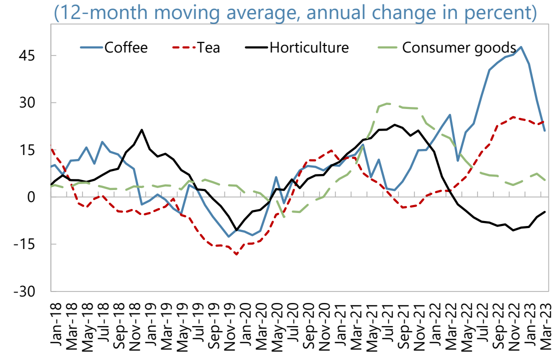
The current account deficit narrowed in 2022 on account of weakness of non-energy imports and the strength of tourism and transportation….

Current Account
(Percent of GDP)



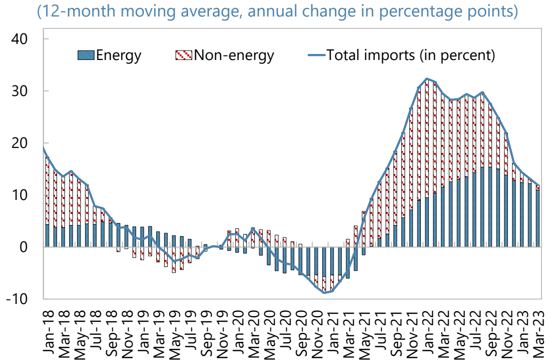
Following initial disruptions in global supply chains, exports benefitted from favorable trends in world prices of agricultural commodities, while horticulture was affected by drought in 2022.

Value of Selected Export Products
(12-month moving average, annual change in percent)



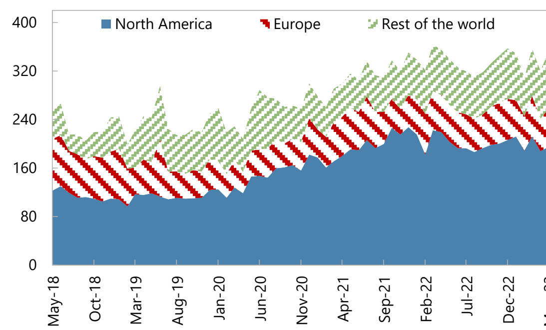
Since mid-2021, energy imports surged on higher prices, while the initial strong recovery on non-energy imports began to reverse in 2022, as capital goods fell with the completion of large-scale infrastructure projects….

Contributions to Imports Growth
(12-month moving average, annual change in percentage points)



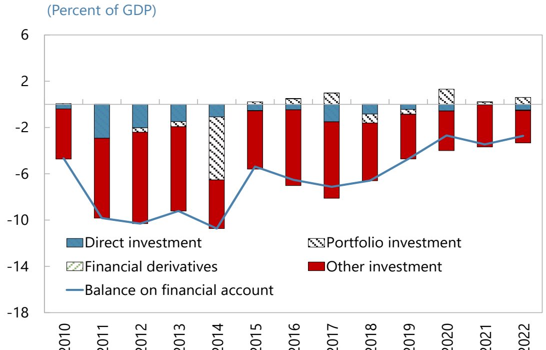
Remittances increased by 8 percent in 2022 but have shown early signs of slowdown since.

Remittances
(Millions of U.S dollars)



Public and private debt flows remain the main source of financing of the current account while FDI is yet to recover.

Balance on Financial Account [1]
(Percent of GDP)



FX reserves have declined but remain adequate

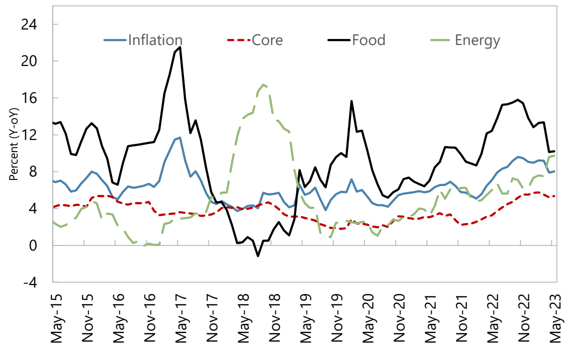
Gross International Reserves

Sources: Kenyan authorities; and IMF staff estimates.

Figure 5. Kenya: Monetary and Exchange Rate Developments

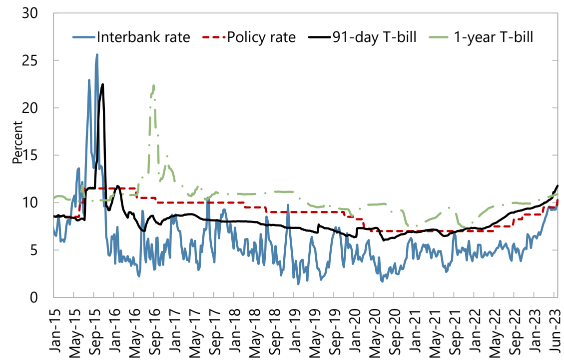
Inflation has eased somewhat since April on lower food inflation but was still above the target as of May.

Inflation



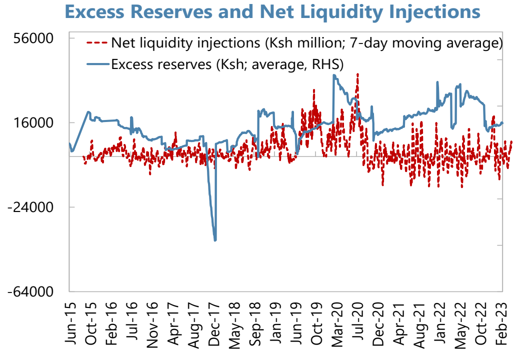
Policy rate has been tightened by 350 points since May 2022 and other rates have gone up.

Interest Rates



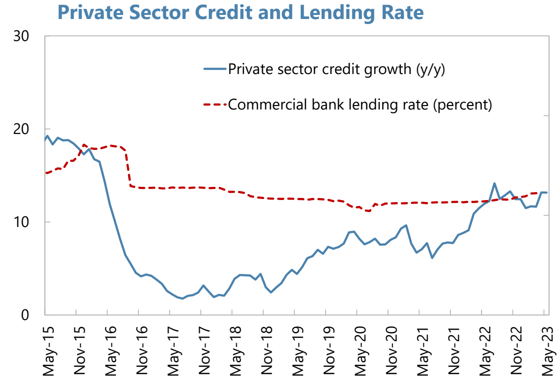
Excess reserves have declined.

Excess Reserves and Net Liquidity Injections



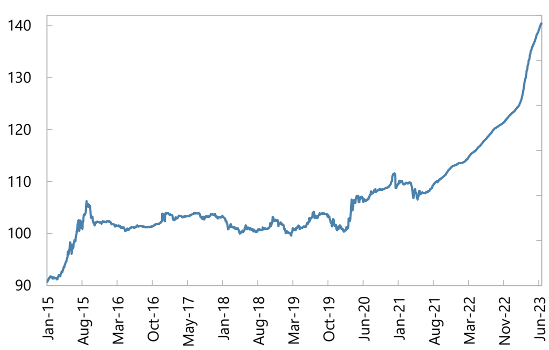
Private sector credit growth has broken into double digits after several years.

Private Sector Credit and Lending Rate



The exchange rate has depreciated further against the U.S. dollar and at a faster pace in 2023 so far…

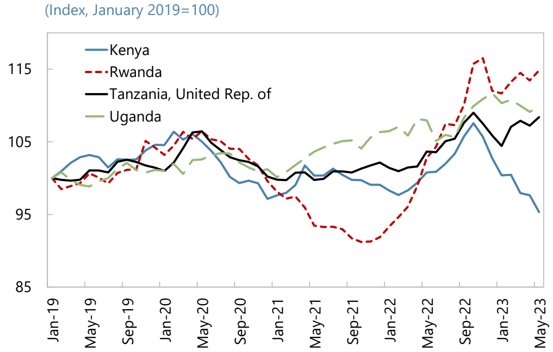
Kenyan Shilling per U.S dollar



…helping reverse the real appreciation seen in 2022 as U.S. dollar strengthened against major currencies.

Real Effective Exchange Rate

(Index, January 2019=100)

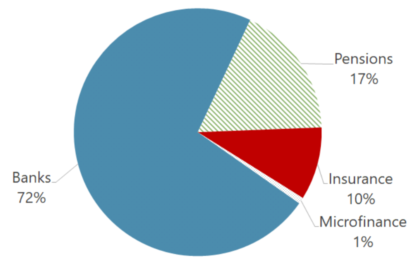


Sources: Kenyan authorities; and IMF staff calculations.

Figure 6. Kenya: Financial Sector Structure

Financial sector is dominated by banks…

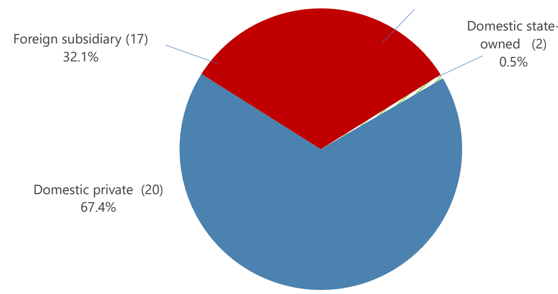
Financial Sector Structure
(September 2022) 1/



1/ Total net assets of 8.9 trillion KSH (76 billion USD, 65 percent of GDP)

Of which most are domestic private banks.

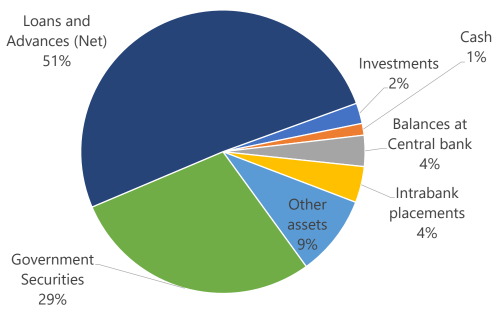
Banking System Structure
(December 2022) 1/2/



1/ Total net assets of 6.6 trillion KSH (56 billion USD, 49 percent of GDP).
2/ Number of banks in brackets; percentages are for net assets.

A significant share of banks' assets are government securities....

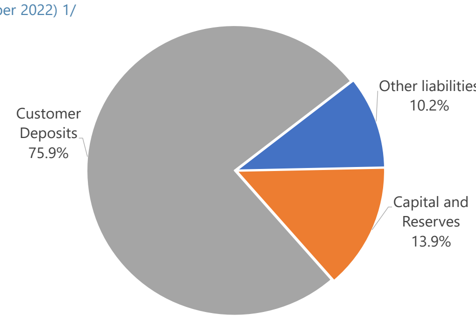
Banks' Assets
(December 2022) 1/



1/ Total assets of 6.6 trillion KSH

…and funding is largely deposits.

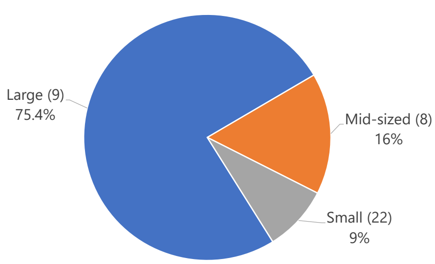
Banks' Liabilities
(December 2022) 1/



1/ Total liabilities of 6.6 trillion KSH

Nine banks account 76 percent of banking assets…

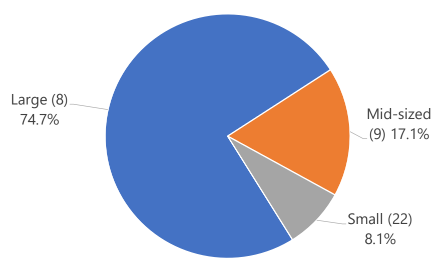
Banking System Assets by Tier Groups
(December 2022) 1/ 2/



1/ Total net assets of 6.6 trillion KSH (56 billion USD, 49 percent of GDP).
2/ Number of banks in brackets; percentages are for assets.

… as well as deposits.

Banking System Deposits by Tier Groups
(December 2022) 1/ 2/



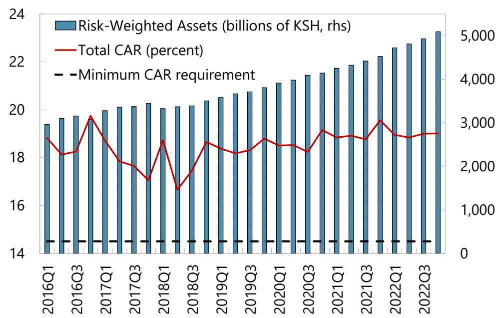
1/ Total deposits of 4.6 trillion KSH.
2/ Number of banks in brackets; percentages are for customer deposits.

Source: Central Bank of Kenya.

Figure 7. Kenya: Financial Sector Developments

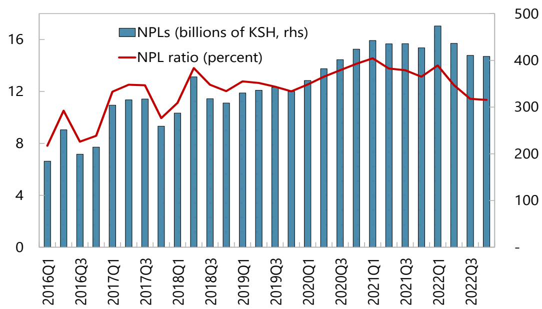
Capital levels are well above the minimums.

Capital Adequacy



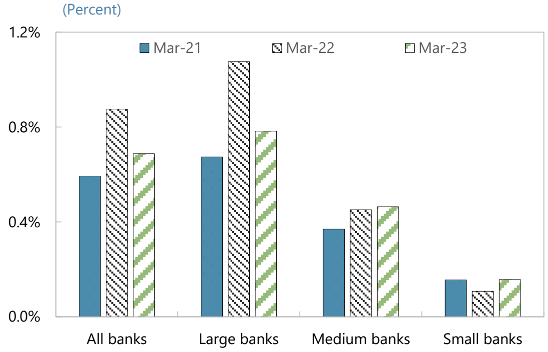
NPL's have started to decline but remain high.

NPLs [1]



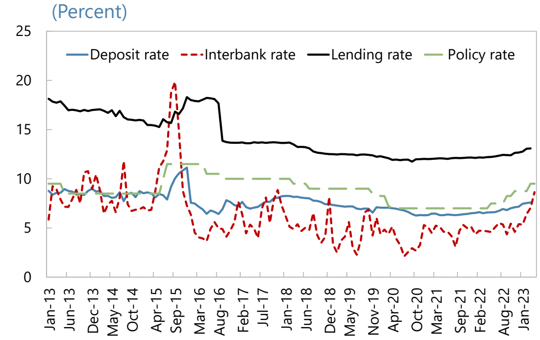
Profitability remains strong....

Return on Assets [2]
(Percent)



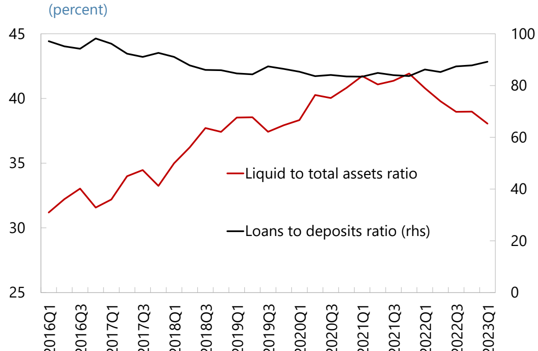
.... with significant spreads between deposits and lending rates.

Interest Rates
(Percent)



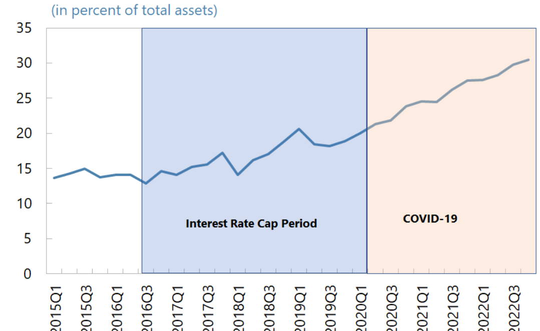
Banking sector has ample liquidity...

Liquidity [3]
(percent)



...driven by increasing holdings of government securities.

Banks' Holdings of Government Securities
(in percent of total assets)



Sources: Central Bank of Kenya; Financial disclosures of Kenyan banks; and IMF staff calculations.

[1] NPLs= Gross NPLs minus accrued interest.

[2] The figure excludes a bank which had negative assets and/or return in March 2021 and 2022.

[3] Based on IMF, *Financial Soundness Indicator* database.

Figure 8. Kenya: Capacity to Repay Indicators Compared to Upper Credit Tranche Arrangements for PRGT Countries

Notes:
1) T = date of arrangement approval. PPG = public and publicly guaranteed.
2) Red lines/bars indicate the CtR indicator for the arrangement of interest.
3) The median, interquartile range, and comparator bars reflect all UCT arrangements (including blends) approved for PRGT countries between 2012 and 2022.
4) PRGT countries in the control group with multiple arrangements are entered as separate events in the database.
5) Comparator series is for PRGT arrangements only and runs up to T+10.
6) Debt service obligations to the Fund reflect prospective payments, including for the current year.
7) In the case of blenders, the red lines/ bars refer to PRGT+GRA. In the case of RST, the red lines/ bars refer to PRGT+GRA+RST.

Table 1. Kenya: Selected Economic Indicators, 2021–26

	2021	2022		2023		2024		2025		2026
	Act.	4th Rev.	Act.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)									
Output, prices, and exchange rate										
Real GDP	7.6	5.3	4.8	5.1	5.0	5.5	5.3	5.5	5.3	5.4
GDP deflator	4.3	7.2	6.0	7.7	8.2	5.7	6.7	5.0	5.4	5.4
CPI (period average)	6.1	7.7	7.6	7.8	7.8	5.7	6.6	5.0	5.4	5.4
CPI (end of period)	5.7	9.5	9.1	6.5	7.1	5.0	6.5	5.0	5.0	5.0
Terms of trade (goods; deterioration, -)	-2.2	-7.4	2.8	2.1	3.8	0.7	0.8	0.6	0.9	0.7
Exchange rate (Kenyan shilling/US$, average, depreciation, -)	-3.0	.	-6.9	.	.	.	.	.	.	.
Real effective exchange rate (average, depreciation, -)	-2.6	.	2.2	.	.	.	.	.	.	.
Money and credit										
Broad money (M3)	6.1	9.0	7.1	7.4	7.5	9.4	9.5	10.7	10.3	11.1
Reserve money	11.0	11.4	-1.4	1.1	19.0	5.6	0.1	8.3	3.7	12.3
Credit to non-government sector	8.6	12.0	12.5	12.3	9.5	13.3	12.1	12.5	12.8	12.4
Policy rate	7.0	.	8.75	.	.	.	.	.	.	.
M3/GDP (percent)	35.2	33.8	33.9	32.1	32.1	31.5	31.3	31.5	31.1	31.1
Non-performing loans (percent of total gross loans)	10.9	.	11.1	.	.	.	.	.	.	.
	(Percent of GDP, unless otherwise indicated)									
Central government budget [1]										
Total revenue, grants and unidentified tax policy measures	16.1	17.3	17.6	17.5	17.7	17.8	18.3	18.0	18.3	17.9
Tax revenues	12.7	13.7	13.9	14.0	13.9	14.9	15.1	15.1	15.2	15.2
Non-tax revenues	3.1	3.3	3.4	3.3	3.5	2.6	2.9	2.7	2.9	2.5
Grants	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.2	0.2
Expenditure and unidentified offsets	24.4	23.5	23.8	23.3	23.6	22.1	22.6	21.9	22.3	21.2
Current	19.5	19.3	19.6	19.1	19.5	17.5	18.3	17.1	17.3	16.3
Capital	4.9	4.2	4.2	4.2	4.2	4.7	4.3	4.9	5.0	5.0
Primary balance	-4.0	-1.3	-1.3	-1.1	-1.1	0.3	0.7	0.7	0.9	1.1
Overall balance	-8.3	-6.2	-6.2	-5.8	-6.0	-4.4	-4.3	-3.9	-4.0	-3.3
Excluding grants	-8.5	-6.4	-6.5	-6.0	-6.2	-4.7	-4.6	-4.2	-4.2	-3.6
Net domestic borrowing	5.6	4.7	4.8	3.9	3.8	2.5	2.0	3.1	2.6	3.0
Public debt										
Public gross nominal debt	68.2	68.6	68.4	67.0	70.6	64.9	68.5	63.0	66.9	65.2
Public net nominal debt	64.2	64.4	65.3	64.1	68.3	63.0	66.8	61.8	65.6	64.1
Public gross debt, PV	61.6	61.7	63.1	60.0	64.4	57.8	61.9	55.9	60.2	58.3
Public net debt, PV	55.4	57.5	60.0	57.1	62.1	55.8	60.2	54.6	58.8	57.3
Gross domestic debt	33.5	33.6	33.9	32.6	32.7	31.3	30.7	29.9	30.2	29.7
Gross external debt	34.7	35.0	34.5	34.4	37.9	33.6	37.8	33.1	36.7	35.5
Investment and saving										
Investment	20.4	19.5	19.2	20.0	17.8	20.6	18.5	21.0	19.5	19.7
General government	4.5	4.2	4.2	4.4	4.2	4.8	4.7	4.9	5.0	4.9
Nongovernment	15.9	15.3	14.9	15.6	13.6	15.8	13.9	16.1	14.5	14.7
Saving	15.2	13.9	14.0	14.6	13.0	15.3	13.6	16.0	14.5	14.7
General government	-2.9	-2.0	-2.1	-0.4	-1.1	1.3	0.4	2.0	1.4	1.3
Nongovernment	18.0	15.9	16.2	15.0	14.1	14.0	13.2	14.0	13.1	13.4
External sector										
Exports (goods and services)	10.8	12.0	12.2	12.8	13.4	13.3	14.5	13.7	15.0	15.4
Imports (goods and services)	19.9	21.6	21.5	22.0	21.9	22.2	23.1	22.3	23.6	24.0
Current account balance (including grants)	-5.2	-5.7	-5.1	-5.4	-4.8	-5.3	-5.0	-5.1	-5.0	-5.0
Gross international reserves										
In billions of US$	9.5	8.1	8.0	7.0	7.3	8.1	8.5	9.2	9.7	10.5
In months of next year imports	4.7	3.7	3.9	3.0	3.3	3.2	3.5	3.3	3.7	3.8
Memorandum items:										
GDP at current market prices (billions of Kenyan shilling)	12,028	13,650	13,368	15,453	15,179	17,237	17,041	19,087	18,920	21,019
GDP per capita (nominal US$)	2,209	2,299	2,245	2,311	2,189	2,401	2,195	2,511	2,289	2,390

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

[1] Fiscal year basis. Fiscal year runs from July 1 – June 30 (e.g., FY2023/24 runs from July 1, 2023 to June 30, 2024).

Table 2a. Kenya: Central Government Financial Operations 2020/21–2025/26 [1]

(Billions of Kenyan Shilling)

	2020/21	2021/22	2022/23					2023/24			2024/25			2025/26
	Actual	Actual	4th Rev.	Proj.	Budget	Suppl. I	Suppl. II	4th Rev.	Proj.	Budget	4th Rev.	Proj.	BPS	Proj.
Revenues and grants	**1,815.1**	**2,230.8**	**2,540.8**	**2,519.3**	**2,495.7**	**2,560.2**	**2,520.3**	**2,905.8**	**2,944.8**	**2,935.8**	**3,269.4**	**3,297.9**	**3,280.4**	**3,573.4**
Revenue	**1,783.7**	**2,199.8**	**2,512.7**	**2,481.9**	**2,462.4**	**2,528.8**	**2,478.6**	**2,856.3**	**2,893.7**	**2,893.6**	**3,220.7**	**3,255.2**	**3,231.1**	**3,526.5**
Tax revenue (including unidentified tax measures)	1,429.5	1,770.2	2,035.1	1,985.1	2,024.1	2,035.1	1,999.4	2,427.8	2,427.8	2,427.8	2,734.9	2,734.9	2,710.8	3,025.5
Income tax	694.1	876.7	1,004.3	978.7	997.3	1,004.3	982.1	1,102.4	1,198.6	1,198.5	1,221.0	1,312.3	1,305.7	1,472.9
Personal income	363.3	462.4	512.7	496.7	512.7	512.7	511.1	544.7	619.0	619.0	594.8	669.3	683.9	730.5
Corporate income	330.7	414.4	491.6	482.1	484.6	491.6	471.0	557.7	579.5	579.5	626.2	643.0	621.7	742.4
Import duty (net)	108.4	118.3	145.9	139.3	144.9	145.9	142.7	171.0	173.3	173.3	187.9	201.4	199.4	210.3
Excise duty	216.3	252.1	297.2	291.4	297.2	297.2	294.0	345.5	352.7	352.7	381.0	396.7	401.1	430.3
Value-added tax	410.8	523.1	587.6	575.7	584.7	587.7	580.6	669.1	703.3	703.3	745.5	764.6	804.7	852.4
Domestic	197.1	244.9	304.2	294.0	304.2	304.2	297.2	323.8	356.3	356.3	355.7	387.9	375.6	439.7
Imports	213.7	278.2	283.4	281.7	280.4	283.4	283.4	345.4	347.0	347.0	389.8	376.7	429.1	412.7
Nontax revenue	354.2	429.6	477.6	496.8	438.3	493.8	479.2	428.5	465.9	465.8	485.7	520.2	520.3	501.0
Investment income	45.1	43.7	35.5	38.6	31.5	35.5	35.5	32.6	33.1	33.1	34.2	34.7	34.7	38.5
Other	87.4	104.1	121.3	121.3	86.0	121.4	110.5	94.6	110.3	110.3	131.8	133.1	133.1	108.8
Ministerial and Departmental Fees (AIA)	193.2	245.5	285.7	300.0	285.7	300.0	296.4	268.4	289.3	289.3	276.7	308.9	308.9	304.1
Railway Levy	28.5	36.4	35.1	36.8	35.1	36.8	36.8	32.8	33.2	33.2	43.0	43.5	43.5	49.6
Grants	**31.3**	**31.0**	**28.1**	**37.4**	**33.3**	**31.4**	**41.7**	**49.5**	**51.1**	**42.2**	**48.7**	**42.7**	**49.3**	**46.9**
Project grants	22.4	27.4	28.1	30.5	33.3	31.4	34.7	49.5	51.1	42.2	48.7	42.7	49.3	46.9
Program grants	8.9	3.6	0.0	6.9	0.0	0.0	7.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**2,749.5**	**3,024.0**	**3,385.7**	**3,373.9**	**3,358.6**	**3,384.3**	**3,366.6**	**3,620.1**	**3,641.8**	**3,599.3**	**3,982.0**	**4,011.9**	**3,991.9**	**4,241.4**
Recurrent expenditure (including spendig offsets)	**2,197.2**	**2,487.4**	**2,776.8**	**2,776.2**	**2,675.0**	**2,766.7**	**2,806.0**	**2,854.6**	**2,952.8**	**2,910.2**	**3,097.9**	**3,111.7**	**3,090.4**	**3,250.3**
Transfer to counties	368.3	340.4	407.0	436.3	407.0	436.3	436.3	417.3	429.7	429.7	417.5	394.3	417.9	424.7
Interest payments	495.1	577.7	686.9	696.5	690.6	675.8	682.9	769.4	808.7	775.1	846.2	878.9	833.6	894.5
Domestic interest	388.8	456.8	547.7	545.5	553.4	537.4	527.9	617.9	607.4	628.3	678.8	654.2	680.9	715.7
Foreign interest due	106.3	120.8	139.2	151.0	137.2	138.4	154.9	151.5	201.3	146.9	167.4	224.7	152.7	178.7
Wages and benefits (civil service)	493.0	520.0	537.2	539.6	537.2	539.6	539.6	600.0	600.0	600.0	645.3	621.2	645.3	645.2
Civil service reform	3.3	26.4	31.9	31.9	25.9	31.9	31.9	28.5	28.5	28.5	31.3	30.8	31.3	39.6
Pensions and Other Consolidated Fund Services	112.9	122.4	145.3	145.4	150.6	145.4	144.7	170.6	165.4	165.4	192.9	192.9	192.9	213.5
Defense and NSIS	157.7	175.8	160.2	172.2	174.3	172.2	172.2	170.1	170.0	170.0	170.0	176.5	170.0	197.3
Other	566.8	724.7	808.3	754.3	689.4	765.5	798.5	698.8	750.5	741.4	794.7	817.2	799.4	835.5
of which: Emergency spending (droughts, security)		24.0	0.0					0.0			0.0			
Development and net lending	**552.3**	**536.6**	**608.9**	**597.7**	**683.6**	**617.6**	**560.5**	**765.5**	**689.1**	**689.1**	**884.1**	**900.1**	**901.5**	**991.1**
Domestically financed	385.3	374.7	419.8	404.4	388.9	424.4	366.7	415.6	408.5	408.5	494.1	513.3	511.5	553.8
of which: SOEs emergency funding	36.6	36.6	37.3	38.8	46.0	38.2	38.8	16.8	18.2	17.2	17.2	18.6	42.2	18.3
Foreign financed	167.0	161.9	189.0	193.2	294.7	193.2	193.9	349.9	280.6	280.6	390.0	386.9	390.0	437.3
of which: SGR project	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines		8.1	0.0	0.0	0.0	0.0	0.0	0.0			0.0			
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	5.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-929.3**	**-793.2**	**-844.9**	**-854.6**	**-862.9**	**-824.0**	**-846.2**	**-714.3**	**-697.0**	**-663.5**	**-712.6**	**-713.9**	**-711.5**	**-667.9**
Financing	**950.5**	**747.8**	**844.9**	**854.6**	**862.9**	**824.0**	**846.2**	**714.3**	**697.0**	**663.5**	**712.6**	**713.9**	**711.5**	**667.9**
Net foreign financing	323.3	142.5	270.8	317.2	280.7	348.5	315.4	303.9	380.3	131.5	143.4	249.4	99.7	70.7
Disbursements	451.6	327.1	497.2	553.7	521.8	572.2	549.9	795.4	924.8	607.1	482.1	564.0	381.1	520.3
Project loans	157.1	192.0	178.5	194.1	286.5	186.9	188.2	374.3	329.0	271.6	398.2	412.8	377.6	395.0
Program loans	168.6	135.0	208.2	250.0	129.7	275.3	256.8	152.6	301.5	65.4	0.0	62.8	3.5	0.0
of which: IMF (RCF+ EFF/ECF+RSF)	77.6	28.9	120.8	81.2	63.2	116.9	82.8	69.1	138.8	61.9	0.0	62.8	0.0	0.0
Non-concessional	114.3	0.0	110.5	109.5	105.6	110.0	104.8	268.5	294.3	270.0	83.9	88.3	0.0	125.4
Standard Gauge Railway	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due	-128.3	-184.5	-226.4	-236.5	-241.1	-223.8	-234.5	-491.6	-544.5	-475.6	-338.7	-314.6	-281.5	-449.6
Net domestic financing	627.2	605.3	574.1	537.3	582.2	475.5	530.8	410.4	316.7	532.0	569.2	464.6	611.8	597.2
Memorandum items:														
Nominal GDP	11,256.1	12,698.0	14,551.3	14,273.5	14,273.6	14,273.6	14,273.5	16,344.7	16,110.0	16,106.0	18,161.8	17,980.6	17,968.7	19,969.6
Primary balance incl. grants	-455.4	-170.2	-158.0	-158.0	-172.3	-148.2	-163.4	55.1	111.7	111.7	133.6	165.0	122.1	226.5
Fuel subsidies (net of Petroleum Levy resources)		60.6	0.0	31.1				0.0	0.0		0.0	0.0		
Tax overperformance		102.9												
Expenditure carryover from FY21/22		88.7												
Unidentified spending offsets due to SOE supports		0.0	0.0	0.0				0.0	18.2		0.0	18.6		18.3
RSF budget support				0.0					35.5			46.1		
Net domestic financing (before RSF)				537.3					352.2			510.6		
Debt Service (DS) Relief	46.2	0.0	0.0	0.0				0.0	0.0		0.0	0.0		0.0
Repayment	0.0	0.0	14.6	14.9				15.2	16.6		15.4	16.9		17.2
Total gross public debt, gross	7,696.6	8,579.1	9,831.0	10,277.3				10,816.8	11,285.8		11,728.9	12,332.0		13,316.4
external debt	3,999.5	4,290.8	4,968.5	5,451.6				5,544.0	6,143.4		5,886.9	6,725.1		7,112.3
domestic debt	3,697.1	4,288.3	4,862.4	4,825.7				5,272.8	5,142.3		5,842.1	5,606.9		6,204.1
Total net public debt	7,140.2	8,161.0	9,412.8	9,859.1				10,398.6	10,867.6		11,310.8	11,913.9		12,898.3
Unidentified tax policy measures	0.0	0.0	0.0	0.0				139.7	0.0		59.9	59.9		-0.2
Pending bills	24.9	149.7	0.0	0.0				0.0			0.0			
Government deposits	556.4	418.2												

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

[1] Fiscal year runs from July to June.

Table 2b. Kenya: Central Government Financial Operations 2020/21-2025/26[1]

(Percent of GDP)

	2020/21	2021/22	2022/23					2023/24			2024/25			2025/26
	Actual	Actual	4th Rev.	Proj.	Budget	Suppl. I	Suppl. II	4th Rev.	Proj.	Budget	4th Rev.	Proj.	BPS	Proj.
Revenues and grants	**16.1**	**17.6**	**17.5**	**17.7**	**17.5**	**17.9**	**17.7**	**17.8**	**18.3**	**18.2**	**18.0**	**18.3**	**18.3**	**17.9**
Revenue	**15.8**	**17.3**	**17.3**	**17.4**	**17.3**	**17.7**	**17.4**	**17.5**	**18.0**	**18.0**	**17.7**	**18.1**	**18.0**	**17.7**
Tax revenue (including unidentified tax measures)	12.7	13.9	14.0	13.9	14.2	14.3	14.0	14.9	15.1	15.1	15.1	15.2	15.1	15.2
Income tax	6.2	6.9	6.9	6.9	7.0	7.0	6.9	6.7	7.4	7.4	6.7	7.3	7.3	7.4
Personal income	3.2	3.6	3.5	3.5	3.6	3.6	3.6	3.3	3.8	3.8	3.3	3.7	3.8	3.7
Corporate income	2.9	3.3	3.4	3.4	3.4	3.4	3.3	3.4	3.6	3.6	3.4	3.6	3.5	3.7
Import duty (net)	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.0	1.1	1.1	1.1
Excise duty	1.9	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.2	2.2	2.1	2.2	2.2	2.2
Value-added tax	3.6	4.1	4.0	4.0	4.1	4.1	4.1	4.1	4.4	4.4	4.1	4.3	4.5	4.3
Domestic	1.8	1.9	2.1	2.1	2.1	2.1	2.1	2.0	2.2	2.2	2.0	2.2	2.1	2.2
Imports	1.9	2.2	1.9	2.0	2.0	2.0	2.0	2.1	2.2	2.2	2.1	2.1	2.4	2.1
Nontax revenue	3.1	3.4	3.3	3.5	3.1	3.5	3.4	2.6	2.9	2.9	2.7	2.9	2.9	2.5
Investment income	0.4	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	0.8	0.8	0.8	0.9	0.6	0.9	0.8	0.6	0.7	0.7	0.7	0.7	0.7	0.5
Ministerial and Departmental Fees (AIA)	1.7	1.9	2.0	2.1	2.0	2.1	2.1	1.6	1.8	1.8	1.5	1.7	1.7	1.5
Railway Levy	0.3	0.3	0.2	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	**0.3**	**0.2**	**0.2**	**0.3**	**0.2**	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.2**	**0.3**	**0.2**
Project grants	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.2	0.3	0.2
Program grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**24.4**	**23.8**	**23.3**	**23.6**	**23.5**	**23.7**	**23.6**	**22.1**	**22.6**	**22.3**	**21.9**	**22.3**	**22.2**	**21.2**
Recurrent expenditure (including spendig offsets)	**19.5**	**19.6**	**19.1**	**19.5**	**18.7**	**19.4**	**19.7**	**17.5**	**18.3**	**18.1**	**17.1**	**17.3**	**17.2**	**16.3**
Transfer to counties	3.3	2.7	2.8	3.1	2.9	3.1	3.1	2.6	2.7	2.7	2.3	2.2	2.3	2.1
Interest payments	4.4	4.5	4.7	4.9	4.8	4.7	4.8	4.7	5.0	4.8	4.7	4.9	4.6	4.5
Domestic interest	3.5	3.6	3.8	3.8	3.9	3.8	3.7	3.8	3.8	3.9	3.7	3.6	3.8	3.6
Foreign interest due	0.9	1.0	1.0	1.1	1.0	1.0	1.1	0.9	1.2	0.9	0.9	1.2	0.8	0.9
Wages and benefits (civil service)	4.4	4.1	3.7	3.8	3.8	3.8	3.8	3.7	3.7	3.7	3.6	3.5	3.6	3.2
Civil service reform	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Pensions and Other Consolidated Fund Services	1.0	1.0	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1	1.1
Defense and NSIS	1.4	1.4	1.1	1.2	1.2	1.2	1.2	1.0	1.1	1.1	0.9	1.0	0.9	1.0
Other	5.0	5.7	5.6	5.3	4.8	5.4	5.6	4.3	4.7	4.6	4.4	4.5	4.4	4.2
of which: Emergency spending (droughts, security)		0.2												
Development and net lending	**4.9**	**4.2**	**4.2**	**4.2**	**4.8**	**4.3**	**3.9**	**4.7**	**4.3**	**4.3**	**4.9**	**5.0**	**5.0**	**5.0**
Domestically financed	3.4	3.0	2.9	2.8	2.7	3.0	2.6	2.5	2.5	2.5	2.7	2.9	2.8	2.8
of which: SOEs emergency funding	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.2	0.1
Foreign financed	1.5	1.3	1.3	1.4	2.1	1.4	1.4	2.1	1.7	1.7	2.1	2.2	2.2	2.2
of which: SGR project	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines		0.1												
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-8.3**	**-6.2**	**-5.8**	**-6.0**	**-6.0**	**-5.8**	**-5.9**	**-4.4**	**-4.3**	**-4.1**	**-3.9**	**-4.0**	**-4.0**	**-3.3**
Financing	**8.4**	**5.9**	**5.8**	**6.0**	**6.0**	**5.8**	**5.9**	**4.4**	**4.3**	**4.1**	**3.9**	**4.0**	**4.0**	**3.3**
Net foreign financing	2.9	1.1	1.9	2.2	2.0	2.4	2.2	1.9	2.4	0.8	0.8	1.4	0.6	0.4
Disbursements	4.0	2.6	3.4	3.9	3.7	4.0	3.9	4.9	5.7	3.8	2.7	3.1	2.1	2.6
Project loans	1.4	1.5	1.2	1.4	2.0	1.3	1.3	2.3	2.0	1.7	2.2	2.3	2.1	2.0
Program loans	1.5	1.1	1.4	1.8	0.9	1.9	1.8	0.9	1.9	0.4	0.0	0.3	0.0	0.0
of which: IMF (RCF+ EFF/ECF+RSF)	0.7	0.2	0.8	0.6	0.4	0.8	0.6	0.4	0.9	0.4	0.0	0.3	0.0	0.0
Non-concessional	1.0	0.0	0.8	0.8	0.7	0.8	0.7	1.6	1.8	1.7	0.5	0.5	0.0	0.6
Standard Gauge Railway	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due	-1.1	-1.5	-1.6	-1.7	-1.7	-1.6	-1.6	-3.0	-3.4	-3.0	-1.9	-1.7	-1.6	-2.3
Net domestic financing	5.6	4.8	3.9	3.8	4.1	3.3	3.7	2.5	2.0	3.3	3.1	2.6	3.4	3.0
Memorandum items:														
Primary balance incl. grants	-4.0	-1.3	-1.1	-1.1	-1.2	-1.0	-1.1	0.3	0.7	0.7	0.7	0.9	0.7	1.1
Fuel subsidies (net of Petroleum Levy resources)		0.5	0.4	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax overperformance		0.8												
Expenditure carryover from FY21/22			0.0	0.0								0.0		0.0
Unidentified spending offsets due to SOE supports		0.0		0.0					0.1			0.1		0.1
RSF budget support				0.0					0.2			0.3		
Net domestic financing (before RSF)				3.8					2.2			2.8		
Debt Service (DS) Relief	0.4	0.0	0.0	0.0				0.0	0.0		0.0	0.0		0.0
Repayment	0.0	0.0	0.1	0.1				0.1	0.1		0.1	0.1		0.1
Total gross public debt, gross	68.4	67.6	67.6	72.0				66.2	70.1		64.6	68.6		66.7
external debt	35.5	33.8	34.1	38.2				33.9	38.1		32.4	37.4		35.6
domestic debt	32.8	33.8	33.4	33.8				32.3	31.9		32.2	31.2		31.1
Total net public debt	63.4	64.3	64.7	69.1				63.6	67.5		62.3	66.3		64.6
Unidentified tax policy measures	0.0	0.0	0.0	0.0				0.9	0.0		0.3	0.3		0.0
Pending bills	0.2	1.2	0.0	0.0				0.0	0.0		0.0	0.0		0.0
Government deposits	4.9	3.3												

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

[1] Fiscal year runs from July to June.

Table 3. Kenya: Monetary Survey Dec. 2020–June 2024

	Dec-20	Jun-21	Dec-21	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In billions of Kenyan Shillings; end of period)											
Central Bank of Kenya (CBK)												
Net foreign assets	738	836	701	642	569	537	434	742	598	562	431	551
Net domestic assets	-269	-386	-179	-123	-14	-23	75	-191	-16	50	114	42
Net domestic credit	33	-53	147	222	315	337	497	266	452	524	595	528
Government (net)	-32	-50	67	148	190	207	362	386	428	464	460	513
Of which: on-lending and transfer of IMF resources[1]	85	161	195	234	277	350	401	426	468	504	500	553
Commercial banks (net)	61	-6	76	70	121	127	131	-124	20	56	131	11
Private sector (net)	3	3	3	4	4	4	4	4	4	4	4	4
Other items (net)	-301	-333	-326	-344	-329	-360	-376	-457	-467	-474	-481	-486
Reserve money (RM)	470	450	522	519	555	514	509	551	582	612	545	592
Currency in circulation	234	226	253	251	252	259	253	287	310	331	255	292
Bank reserves	236	224	268	268	303	255	256	264	273	281	291	300
Other depository corporations												
Net foreign assets	8	-52	-110	-185	-274	-254	-125	-91	-63	-43	-45	-47
Reserves	236	224	268	268	303	255	256	264	273	281	291	300
Credit to CBK	-61	6	-76	-70	-121	-127	-131	124	-20	-56	-131	-11
Net domestic assets	3,507	3,684	3,850	4,179	4,271	4,401	4,416	4,243	4,288	4,368	4,660	4,627
Net domestic credit	4,274	4,493	4,806	5,034	5,147	5,225	5,333	5,442	5,573	5,579	5,776	5,847
Government (net)	1,375	1,511	1,656	1,696	1,709	1,713	1,697	1,733	1,778	1,729	1,801	1,773
Other public sector (net)	91	84	100	84	79	82	92	92	92	92	92	92
Private sector (net)	2,808	2,898	3,050	3,253	3,359	3,430	3,543	3,617	3,704	3,757	3,883	3,982
Other items (net)	-767	-809	-956	-855	-876	-824	-916	-1,199	-1,285	-1,211	-1,117	-1,220
Total deposits	3,691	3,862	3,931	4,152	4,145	4,221	4,372	4,517	4,661	4,805	4,967	5,131
Monetary survey												
Net foreign assets	747	784	590	457	295	283	309	651	535	518	386	504
Net domestic assets	3,244	3,354	3,645	3,986	4,136	4,251	4,360	4,177	4,252	4,362	4,643	4,658
Net domestic credit	4,246	4,446	4,877	5,186	5,341	5,435	5,698	5,832	6,005	6,046	6,241	6,364
Government (net)	1,343	1,460	1,724	1,845	1,899	1,920	2,059	2,119	2,205	2,193	2,261	2,285
Other public sector (net)	91	84	100	84	79	82	92	92	92	92	92	92
Private sector (net)	2,811	2,901	3,053	3,257	3,362	3,434	3,547	3,621	3,707	3,761	3,887	3,986
Other items (net)	-1,002	-1,092	-1,232	-1,200	-1,205	-1,184	-1,338	-1,341	-1,342	-1,343	-1,344	-1,344
M1	1,720	1,779	1,848	1,907	1,916	1,967	1,886	1,950	1,934	1,971	2,031	2,085
Money and quasi-money (M2)	3,250	3,377	3,432	3,552	3,553	3,613	3,611	3,712	3,732	3,805	3,906	4,000
M2 plus resident foreign currency deposits (M3)	3,991	4,138	4,235	4,443	4,430	4,534	4,669	4,827	4,787	4,880	5,029	5,162
M3 plus nonbank holdings of government debt (L)	5,665	5,900	6,202	6,630	6,694	6,893	7,094	7,285	7,294	7,429	7,622	7,784
Memorandum items	(Annual percentage change, unless otherwise indicated)											
RM	1.9	5.4	11.0	15.4	15.9	-1.4	6.1	6.3	5.0	19.0	7.2	7.4
M2	11.9	4.6	5.6	5.2	4.3	5.3	5.9	4.5	5.0	5.3	8.2	7.8
M3	13.2	6.4	6.1	7.4	6.1	7.1	10.6	8.7	8.1	7.6	7.7	6.9
L	17.3	9.9	9.5	12.4	10.2	11.1	12.5	9.9	9.0	7.8	7.4	6.8
Deposits	12.0	7.0	6.5	7.5	6.1	7.4	11.0	8.8	12.5	13.8	13.6	13.6
Net domestic credit	17.0	13.1	14.9	16.6	15.0	11.4	13.4	12.5	12.4	11.2	9.5	9.1
Government (net, monetary survey)	42.7	27.1	28.3	26.3	19.8	11.4	17.1	14.9	16.2	14.2	9.8	7.8
Private sector (net)	8.4	7.7	8.6	12.3	12.9	12.5	11.6	11.2	10.3	9.5	9.6	10.1
Net domestic assets (NDA) of the banking sector	14.1	11.8	9.8	13.4	12.1	14.3	11.3	1.6	0.4	-0.7	5.5	9.0
NDA growth (as percent of the base period M3)	12.3	10.0	8.6	11.9	11.0	13.0	10.6	1.5	0.4	-0.7	5.2	7.9
Multiplier (M2/RM; ratio)	6.9	7.5	6.6	6.8	6.4	7.0	7.1	6.7	6.4	6.2	7.2	6.8
Multiplier (M3/RM; ratio)	8.5	9.2	8.1	8.6	8.0	8.8	9.2	8.8	8.2	8.0	9.2	8.7
Velocity (GDP/M2; ratio)	3.5	3.6	3.5	3.6	3.7	3.7	3.8	3.8	3.9	4.0	4.0	4.0
Velocity (GDP/M3; ratio)	2.8	2.9	2.8	2.9	3.0	2.9	3.0	3.0	3.1	3.1	3.1	3.1

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

[1] Includes resources under the RCF (approved on May 6, 2020), the current EFF/ECF arrangements, and local currency lending using the August 2021 SDR allocation, and prospective budget support resources from the RSF.

Table 4a. Kenya: Summary Balance of Payments, 2021–27

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

	2021	2022		2023		2024		2025		2026		2027	
	Act.	4th Rev.	Act.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.
Current account	-5,744	-6,617	-5,822	-6,530	-5,447	-6,818	-5,699	-6,917	-6,050	-7,351	-6,441	-7,815	-6,839
Merchandise trade	-11,065	-12,907	-11,715	-13,048	-11,095	-13,646	-11,741	-14,327	-12,463	-15,317	-13,440	-16,494	-14,541
Exports f.o.b.	6,789	7,742	7,421	8,593	8,163	9,491	8,975	10,491	9,874	11,383	10,715	12,296	11,629
Imports f.o.b.	17,854	20,649	19,136	21,640	19,258	23,137	20,717	24,818	22,337	26,700	24,156	28,790	26,170
Energy	3,280	4,995	5,058	4,573	4,478	4,526	4,454	4,539	4,444	4,601	4,479	4,703	4,535
Non-energy	14,574	15,654	14,079	17,067	14,780	18,611	16,263	20,279	17,894	22,098	19,677	24,088	21,635
Services	1,037	1,631	1,164	2,080	1,561	2,284	1,796	2,572	1,990	2,872	2,258	3,128	2,653
Credit, *of which*	5,036	6,322	6,436	6,867	6,957	7,536	7,659	8,269	8,452	9,041	9,295	9,832	10,218
Transportation	1,646	2,404	2,303	2,656	2,520	2,928	2,757	3,199	3,002	3,464	3,248	3,718	3,516
Travel receipts	844	1,013	1,107	1,113	1,206	1,225	1,315	1,323	1,420	1,429	1,533	1,523	1,656
Debit, *of which*	3,999	4,691	5,271	4,787	5,396	5,252	5,863	5,696	6,462	6,169	7,037	6,703	7,565
Transportation	1,568	2,069	2,137	1,909	1,930	2,041	2,091	2,189	2,149	2,355	2,246	2,540	2,309
Primary income	-1,835	-2,073	-1,788	-2,673	-2,763	-2,948	-3,002	-3,236	-3,350	-3,659	-3,587	-3,906	-3,868
Credit	62	235	46	405	73	307	126	237	174	234	221	250	275
Debit	1,896	2,307	1,834	3,079	2,837	3,255	3,128	3,473	3,524	3,894	3,808	4,156	4,143
Secondary income, *of which*	6,119	6,732	6,516	7,111	6,851	7,491	7,249	8,074	7,773	8,753	8,329	9,457	8,917
Remittances	3,770	4,108	4,083	4,478	4,412	4,834	4,766	5,220	5,149	5,635	5,561	6,084	6,004
Capital account	196	200	142	200	200	200	200	200	200	200	200	200	200
Financial account [1]	-3,819	-3,448	-3,278	-4,064	-2,530	-6,888	-4,835	-7,928	-6,880	-8,189	-7,394	-9,087	-8,097
Direct investment, net	-53	-700	-339	-996	-751	-1,201	-1,024	-1,500	-1,334	-1,699	-1,738	-1,998	-1,943
Assets	410	150	53	100	100	100	100	100	100	100	100	100	100
Liabilities	-463	-850	-392	-1,096	-851	-1,301	-1,124	-1,600	-1,434	-1,799	-1,838	-2,098	-2,043
Portfolio investment, net, *of which*	225	568	712	836	583	852	868	-34	387	879	893	876	544
Assets	1,067	750	481	1,000	729	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Liabilities	-842	-182	230	-164	-146	-148	-131	-1,033	-613	-120	-107	-123	-456
Eurobonds (net)	-1,000	0	0	0	0	0	0	-900	-495	0	0	0	-345
Financial derivatives, net	23	0	42	0	0	0	0	0	0	0	0	0	0
Other investment, net	-4,014	-3,316	-3,693	-3,903	-2,362	-6,539	-4,679	-6,395	-5,933	-7,370	-6,549	-7,966	-6,698
Assets	159	-750	-557	0	-250	500	500	500	500	500	500	250	250
Liabilities, *of which*	-4,173	-2,566	-3,135	-3,903	-2,112	-7,039	-5,179	-6,895	-6,433	-7,869	-7,049	-8,216	-6,947
Public sector loans (excl. official budget support) (net)	258	-29	174	-642	-457	-1,089	-734	-1,531	-338	-2,700	-2,101	-3,064	-1,970
Issuance [2]	-1,197	-1,853	-1,607	-2,549	-2,369	-2,919	-2,652	-3,828	-2,792	-4,666	-3,716	-4,471	-3,615
Amortization	1,455	1,825	1,781	1,906	1,912	1,831	1,918	2,297	2,454	1,967	1,615	1,407	1,644
SDR allocation	-740	0	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	569	0	-700	0	0	0	0	0	0	0	0	0	0
Overall balance ("+" indicates a surplus)	-1,160	-2,968	-3,103	-2,266	-2,717	270	-663	1,211	1,031	1,038	1,154	1,473	1,458
Financing	1,160	2,968	3,103	2,266	2,717	-270	663	-1,211	-1,031	-1,038	-1,154	-1,473	-1,458
Reserve assets [2]	-1,159	1,436	1,572	1,096	691	-1,088	-1,183	-1,100	-1,206	-762	-877	-1,076	-1,082
Program financing	1,814	1,533	1,530	1,171	1,965	818	1,482	-111	53	-276	-277	-397	-376
IMF EFF/ECF (net)	847	614	617	574	700	218	482	-111	53	-276	-277	-397	-376
of which, IMF EFF/ECF purchases and disbursements	980	682	673	603	729	218	482	0	165	0	0	0	0
2023 EFF/ECF augmentation (BOP support)	...	...	...	...	219	...	219	...	110	...	0	...	0
Budget support	980	682	673	603	510	218	263	0	55	0	0	0	0
Official budget support (other)	968	919	913	596	1,265	600	1,000	0	0	0	0	0	0
Exceptional financing	505	0	0	0	0	0	0	0	0	0	0	0	0
of which, DSSI	505	0	0	0	0	0	0	0	0	0	0	0	0
IMF RSF (net)	...	...	...	...	61	...	365	...	122	...	0	...	0
of which, IMF RSF disbursements	...	...	...	...	61	...	365	...	122	...	0	...	0
Memorandum items:													
Gross international reserves (USD million)	9,514	8,078	7,969	6,983	7,278	8,071	8,461	9,171	9,667	9,933	10,544	11,009	11,626
In months of next year's imports of goods and services	4.7	3.7	3.9	3.0	3.3	3.2	3.5	3.3	3.7	3.4	3.8	3.5	3.9
Gross international reserves excl. RSF (USD million)	...	...	7,969	...	7,217	...	8,035	...	9,119	...	9,996	...	11,078
In months of next year's imports of goods and services	...	...	3.9	...	3.3	...	3.3	...	3.5	...	3.6	...	3.7
Gross international reserves excl. RSF and augm. (USD million)	...	...	7,969	...	6,998	...	7,598	...	8,572	...	9,449	...	10,531
In months of next year's imports of goods and services	...	...	3.9	...	3.2	...	3.2	...	3.3	...	3.4	...	3.5
Current account (CA) (percent of GDP)	-5.2	-5.7	-5.1	-5.4	-4.8	-5.3	-5.0	-5.1	-5.0	-5.0	-5.0	-5.0	-5.0
CA excl. energy imports (percent of GDP)	-2.2	-1.4	-0.7	-1.6	-0.9	-1.8	-1.1	-1.7	-1.3	-1.9	-1.5	-2.0	-1.7
Energy imports (percent of GDP)	3.0	4.3	4.4	3.8	4.0	3.5	3.9	3.3	3.6	3.1	3.5	3.0	3.3
Merchandize exports growth (percent)	12.2	14.0	9.3	11.0	10.0	10.5	10.0	10.5	10.0	8.5	8.5	8.0	8.5
Merchandize imports growth (percent)	24.1	15.7	7.2	4.8	0.6	6.9	7.6	7.3	7.8	7.6	8.1	7.8	8.3
Energy (percent)	59.4	54.9	54.2	-8.4	-11.5	-1.0	-0.6	0.3	-0.2	1.4	0.8	2.2	1.3
Non-energy (percent)	18.2	7.0	-3.4	9.0	5.0	9.0	10.0	9.0	10.0	9.0	10.0	9.0	10.0
Travel receipts growth (percent)	55.9	20.0	31.2	10.0	9.0	10.0	9.0	8.0	8.0	8.0	8.0	6.6	8.0
Remittances growth (percent)	21.3	9.0	8.3	9.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0

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

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

[2] Negative entries reflect an increase in assets.

Table 4b. Kenya: Summary Balance of Payments, 2021–27

(In percent of GDP)

	2021	2022		2023		2024		2025		2026		2027	
	Act.	4th Rev.	Act.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.
Current account	-5.2	-5.7	-5.1	-5.4	-4.8	-5.3	-5.0	-5.1	-5.0	-5.0	-5.0	-5.0	-5.0
Merchandise trade	-10.1	-11.0	-10.3	-10.8	-9.8	-10.7	-10.2	-10.5	-10.2	-10.5	-10.4	-10.6	-10.6
Exports f.o.b.	6.2	6.6	6.5	7.1	7.2	7.4	7.8	7.7	8.1	7.8	8.3	7.9	8.5
Imports f.o.b.	16.2	17.6	16.8	18.0	17.1	18.1	18.0	18.2	18.3	18.3	18.6	18.5	19.1
Energy	3.0	4.3	4.4	3.8	4.0	3.5	3.9	3.3	3.6	3.1	3.5	3.0	3.3
Non-energy	13.3	13.4	12.4	14.2	13.1	14.6	14.1	14.9	14.7	15.1	15.2	15.5	15.8
Services	0.9	1.4	1.0	1.7	1.4	1.8	1.6	1.9	1.6	2.0	1.7	2.0	1.9
Credit, *of which*	4.6	5.4	5.7	5.7	6.2	5.9	6.7	6.1	6.9	6.2	7.2	6.3	7.4
Transportation	1.5	2.1	2.0	2.2	2.2	2.3	2.4	2.3	2.5	2.4	2.5	2.4	2.6
Travel receipts	0.8	0.9	1.0	0.9	1.1	1.0	1.1	1.0	1.2	1.0	1.2	1.0	1.2
Debit	3.6	4.0	4.6	4.0	4.8	4.1	5.1	4.2	5.3	4.2	5.4	4.3	5.5
Primary income	-1.7	-1.8	-1.6	-2.2	-2.4	-2.3	-2.6	-2.4	-2.7	-2.5	-2.8	-2.5	-2.8
Credit	0.1	0.2	0.0	0.3	0.1	0.2	0.1	0.2	0.1	0.2	0.2	0.2	0.2
Debit	1.7	2.0	1.6	2.6	2.5	2.5	2.7	2.5	2.9	2.7	2.9	2.7	3.0
Secondary income, *of which*	5.6	5.8	5.7	5.9	6.1	5.9	6.3	5.9	6.4	6.0	6.4	6.1	6.5
Remittances	3.4	3.5	3.6	3.7	3.9	3.8	4.1	3.8	4.2	3.9	4.3	3.9	4.4
Capital account	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.1	0.2	0.1	0.2	0.1	0.1
Financial account [1]	-3.5	-2.9	-2.9	-3.4	-2.2	-5.4	-4.2	-5.8	-5.6	-5.6	-5.7	-5.9	-5.9
Direct investment, net	0.0	-0.6	-0.3	-0.8	-0.7	-0.9	-0.9	-1.1	-1.1	-1.2	-1.3	-1.3	-1.4
Assets	0.4	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Liabilities	-0.4	-0.7	-0.3	-0.9	-0.8	-1.0	-1.0	-1.2	-1.2	-1.2	-1.4	-1.4	-1.5
Portfolio investment, net, *of which*	0.2	0.5	0.6	0.7	0.5	0.7	0.8	0.0	0.3	0.6	0.7	0.6	0.4
Assets	1.0	0.6	0.4	0.8	0.6	0.8	0.9	0.7	0.8	0.7	0.8	0.6	0.7
Liabilities	-0.8	-0.2	0.2	-0.1	-0.1	-0.1	-0.1	-0.8	-0.5	-0.1	-0.1	-0.1	-0.3
Eurobonds (net)	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	-0.7	-0.4	0.0	0.0	0.0	-0.3
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-3.7	-2.8	-3.2	-3.2	-2.1	-5.1	-4.1	-4.7	-4.9	-5.0	-5.0	-5.1	-4.9
Assets	0.1	-0.6	-0.5	0.0	-0.2	0.4	0.4	0.4	0.4	0.3	0.4	0.2	0.2
Liabilities, *of which*	-3.8	-2.2	-2.8	-3.2	-1.9	-5.5	-4.5	-5.0	-5.3	-5.4	-5.4	-5.3	-5.1
Public sector loans (excl. official budget support) (net)	0.2	0.0	0.2	-0.5	-0.4	-0.9	-0.6	-1.1	-0.3	-1.8	-1.6	-2.0	-1.4
SDR allocation	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.5	0.0	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance ("+" indicates a surplus)	-1.1	-2.5	-2.7	-1.9	-2.4	0.2	-0.6	0.9	0.8	0.7	0.9	0.9	1.1
Financing	1.1	2.5	2.7	1.9	2.4	-0.2	0.6	-0.9	-0.8	-0.7	-0.9	-0.9	-1.1
Reserve assets [2]	-1.1	1.2	1.4	0.9	0.6	-0.9	-1.0	-0.8	-1.0	-0.5	-0.7	-0.7	-0.8
Program financing	1.7	1.3	1.3	1.0	1.7	0.6	1.3	-0.1	0.0	-0.2	-0.2	-0.3	-0.3
IMF EFF/ECF (net)	0.8	0.5	0.5	0.5	0.6	0.2	0.4	-0.1	0.0	-0.2	-0.2	-0.3	-0.3
of which , IMF EFF/ECF purchases and disbursements	0.9	0.6	0.6	0.5	0.6	0.2	0.4	0.0	0.1	0.0	0.0	0.0	0.0
2023 EFF/ECF augmentation (BOP support)	...	...	...	0.5	0.2	0.2	0.2	0.0	0.1	0.0	0.0	0.0	0.0
Budget support	0.9	0.6	0.6	0.5	0.5	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Official budget support (other)	0.9	0.8	0.8	0.5	1.1	0.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which , DSSI	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF RSF (net)	...	...	...	...	0.1	...	0.3	...	0.1	...	0.0	...	0.0
of which , IMF RSF disbursements	...	...	...	...	0.1	...	0.3	...	0.1	...	0.0	...	0.0
Memorandum items:													
Gross international reserves	8.7	6.9	7.0	5.8	6.5	6.3	7.4	6.7	7.9	6.8	8.1	7.1	8.5

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

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

[2] Negative entries reflect an increase in assets.

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

(In percent)

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Capital adequacy													
Regulatory capital to risk-weighted assets	18.5	18.5	18.2	19.2	18.8	18.9	18.8	19.6	18.9	18.8	19.0	19.0	18.4
Regulatory tier 1 capital to risk-weighted assets	16.4	16.4	16.3	16.7	16.5	16.5	16.3	16.7	16.2	16.0	16.2	16.1	15.5
Tier 1 capital to total assets	12.3	12.0	12.1	12.3	12.2	12.0	11.9	12.1	12.0	11.8	11.9	12.0	11.7
Asset quality													
Non-performing loans to total gross loans[1]	10.2	10.7	11.1	11.9	12.3	11.6	11.5	10.9	11.8	12.5	11.4	11.1	11.8
Bank provisions to NPLs	44.8	44.3	46.0	51.9	53.1	56.2	53.5	54.1	49.2	43.3	44.2	43.3	40.4
Non-performing loans net of provisions to capital	22.2	23.5	23.7	21.6	21.8	19.6	20.5	18.4	22.6	27.3	24.5	23.9	27.6
Earning and profitability													
Return on assets (ROA)	3.0	2.3	2.3	2.1	3.2	3.3	3.3	3.3	3.6	3.7	3.9	3.7	3.7
Return on equity (ROE)	20.4	15.8	15.5	14.5	22.2	23.4	23.1	22.9	25.2	26.5	27.5	26.7	27.2
Non-interest expenses to gross income	50.1	50.6	49.6	50.1	46.4	46.0	46.3	46.8	45.7	45.1	44.4	45.2	46.3
Liquidity													
Liquid assets to total assets	38.3	40.3	40.0	40.8	41.7	41.1	41.4	41.9	40.8	39.8	39.0	39.0	38.1
Liquid assets to total deposits	59.6	62.7	62.8	64.2	65.6	65.7	66.0	67.7	66.3	63.4	63.4	64.0	62.3
Total loans to total deposits	85.4	83.6	84.1	83.5	83.4	84.9	84.0	83.7	86.2	85.2	87.4	87.8	89.2
Sensitivity to market risk													
FX currency denominated liabilities to total liabilities	26.2	26.1	26.4	28.0	28.7	28.4	28.0	29.0	29.3	29.8	30.1	31.5	32.7
Spread between lending and deposit rate	5.1	5.0	5.3	5.7	5.6	5.7	5.8	5.7	5.6	5.6	5.6	5.5	5.4

Source: Kenyan authorities.

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

Table 6. Kenya: External Financing Requirements and Sources, 2021–27
(In millions of U.S. dollars, unless otherwise indicated)

		2021	2022		2023		2024		2025		2026		2027	
		Act.	4th Rev.	Act.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.	4th Rev.	Proj.
(1)	**Gross financing requirements**	**7,432**	**8,644**	**7,794**	**8,600**	**7,523**	**10,784**	**9,752**	**9,761**	**9,051**	**10,029**	**8,767**	**10,053**	**9,295**
	Current account deficit (excl. grants)	5,844	6,752	5,957	6,665	5,582	6,953	5,834	7,052	6,185	7,486	6,576	7,950	6,974
	of which: Energy imports	3,280	4,995	5,058	4,573	4,478	4,526	4,454	4,539	4,444	4,601	4,479	4,703	4,535
	Amortization of public sector loans (excl. IMF total repurchases and repayments)	1,455	1,825	1,781	1,906	1,912	1,831	1,918	2,297	2,454	1,967	1,615	1,407	1,644
	Amortization of sovereign bonds	0	0	0	0	0	2,000	2,000	300	300	300	300	300	300
	IMF total repurchases and repayments	133	67	56	29	29	0	0	111	112	276	277	397	376
(2)	**Change in reserves excluding IMF RSF (+ = increase)**	**1,159**	**-1,436**	**-1,572**	**-1,096**	**-752**	**1,088**	**818**	**1,100**	**1,084**	**762**	**877**	**1,076**	**1,082**
(3)	**Gross financing sources**	**5,569**	**5,608**	**5,336**	**6,305**	**4,778**	**11,054**	**9,089**	**10,861**	**9,970**	**10,791**	**9,645**	**11,129**	**10,376**
	FDI, net	53	700	339	996	751	1,201	1,024	1,500	1,334	1,699	1,738	1,998	1,943
	Public grants	100	135	135	135	135	135	135	135	135	135	135	135	135
	Public sector borrowing (excl. program financing)	1,899	1,853	1,607	2,549	2,369	2,919	2,652	3,828	2,792	4,666	3,716	4,471	3,615
	of which, SDR allocation	740	0	0	0	0	0	0	0	0	0	0	0	0
	Issuance of sovereign bonds	1,000	0	0	0	0	2,000	2,000	1,200	795	300	300	300	645
	Private capital flows, net	2,517	2,920	3,255	2,626	1,522	4,799	3,277	4,198	4,914	3,991	3,756	4,226	4,039
(4)	**Errors and omissions**	**569**	**0**	**-700**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
(1)+(2)-(3)-(4)	**Total financing needs**	**2,453**	**1,600**	**1,586**	**1,199**	**1,994**	**818**	**1,482**	**0**	**165**	**0**	**0**	**0**	**0**
(5)+(6)	**Total financing sources**	**2,453**	**1,600**	**1,586**	**1,199**	**1,994**	**818**	**1,482**	**0**	**165**	**0**	**0**	**0**	**0**
(5)	Program financing	1,948	1,600	1,586	1,199	1,994	818	1,482	0	165	0	0	0	0
	IMF EFF/ECF purchases and disbursements	980	682	673	603	729	218	482	0	165	0	0	0	0
	2023 EFF/ECF augmentation (BOP support)	...	...	...	...	219	...	219	...	110	...	0	...	0
	Budget support	980	682	673	603	510	218	263	0	55	0	0	0	0
	Official budget support (other)	968	919	913	596	1,265	600	1,000	0	0	0	0	0	0
(6)	Exceptional financing	505	0	0	0	0	0	0	0	0	0	0	0	0
	of which, DSSI	505	0	0	0	0	0	0	0	0	0	0	0	0
(7)	**IMF RSF disbursements**	...	...	...	...	61	218	365	0	122	0	0	0	0
(2)+(7)	**Total change in reserves including IMF RSF (+ = increase)**	**...**	**...**	**-1,572**	**...**	**-691**	**...**	**1,183**	**...**	**1,206**	**...**	**877**	**...**	**1,082**
	Memorandum Items													
	Gross financing requirements (in percent of GDP)	6.8	7.4	6.9	7.1	6.7	8.4	8.5	7.1	7.4	6.9	6.8	6.5	6.8
	Gross international Reserves	9,514	8,078	7,969	6,983	7,278	8,071	8,461	9,171	9,667	9,933	10,544	11,009	11,626
	In months of next year's imports of GNFS	4.7	3.7	3.9	3.0	3.3	3.2	3.5	3.3	3.7	3.4	3.8	3.5	3.9

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

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

I. Current Phasing (approved by the Board on December 19, 2022)

Availability Date	Condition	Available Purchases under GRA		Available Loans under PRGT		Total Available Purchases and Loans	
		SDR millions	Percent of quota	SDR millions	Percent of quota	SDR millions	Percent of quota
April 2, 2021	Approval of the 38-month EFF and ECF arrangements	141.13	26.00	75.99	14.00	217.12	40.00
June 20, 2021	Completion of the first EFF-ECF reviews and observance of continuous and end-March 2021 performance criteria.	198.12	36.50	86.85	16.00	284.97	52.50
November 7, 2021	Completion of the second EFF-ECF reviews and observance of continuous and end-June 2021 performance criteria. 1/	135.70	25.00	48.85	9.00	184.55	34.00
May 7, 2022	Completion of the third EFF-ECF reviews and observance of continuous and end-December 2021 performance criteria. 2/	141.13	26.00	38.00	7.00	179.13	33.00
November 7, 2022	Completion of the fourth EFF-ECF reviews and observance of continuous and end-June 2022 performance criteria.	135.70	25.00	200.84	37.00	336.54	62.00
May 7, 2023	Completion of the fifth EFF-ECF reviews and observance of continuous and end-December 2022 performance criteria.	181.84	33.50	43.42	8.00	225.26	41.50
November 7, 2023	Completion of the sixth EFF-ECF reviews and observance of continuous and end June 2023 performance criteria.	184.55	34.00	43.42	8.00	227.97	42.00
May 7, 2024	Completion of the seventh EFF-ECF reviews and observance of continuous and end December 2023 performance criteria.	130.27	24.00	32.56	6.00	162.83	30.00
Total		**1,248.44**	**230.00**	**569.93**	**105.00**	**1,818.37**	**335.00**

Source: IMF staff estimates.

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

2/ The third EFF-ECF reviews took place on July 18, 2022.

II. Proposal

Availability Date	Condition	Available Purchases under GRA		Available Loans under PRGT		Total Available Purchases and Loans	
		SDR millions	Percent of quota	SDR millions	Percent of quota	SDR millions	Percent of quota
April 2, 2021	Approval of the 38-month EFF and ECF arrangements	141.13	26.00	75.99	14.00	217.12	40.00
June 20, 2021	Completion of the first EFF-ECF reviews and observance of continuous and end-March 2021 performance criteria. 1/	198.12	36.50	86.85	16.00	284.97	52.50
November 7, 2021	Completion of the second EFF-ECF reviews and observance of continuous and end-June 2021 performance criteria. 1/	135.70	25.00	48.85	9.00	184.55	34.00
May 7, 2022	Completion of the third EFF-ECF reviews and observance of continuous and end-December 2021 performance criteria. 1/	141.13	26.00	38.00	7.00	179.13	33.00
November 7, 2022	Completion of the fourth EFF-ECF reviews and observance of continuous and end-June 2022 performance criteria. 1/	135.70	25.00	200.84	37.00	336.54	62.00
May 7, 2023	Completion of the fifth EFF-ECF reviews and RSF approval and observance of continuous and end-December 2022 performance criteria.	229.06	42.20	77.62	14.30	306.68	56.50
November 7, 2023	Completion of the sixth EFF-ECF and first RSF reviews and observance of continuous and end June 2023 performance criteria.	173.15	31.90	62.69	11.55	235.85	43.45
May 7, 2024	Completion of the seventh EFF-ECF and second RSF reviews and observance of continuous and end December 2023 performance criteria.	173.15	31.90	62.68	11.55	235.83	43.45
October 30, 2024	Completion of the eight EFF-ECF and third RSF reviews and observance of continuous and end December 2023 performance criteria.	78.71	14.50	43.69	8.05	122.39	22.55
March 15, 2025	Completion of the ninth EFF-ECF and forth RSF reviews and observance of continuous and end December 2023 performance criteria.	78.71	14.50	43.68	8.05	122.38	22.55
Total		**1,484.56**	**273.50**	**740.89**	**136.50**	**2,225.45**	**410.00**

Source: IMF staff estimates.

1/ The first, second, third, and fourth EFF/ECF reviews took place on June 23, 2021, December 17, 2021, July 18, 2022, and December 19, 2022 respectively.

Table 7b. Kenya: Proposed Schedule of Disbursements and Reviews Under the RSF Arrangement

Availability Date	Condition	Available Loans under RST	
		SDR millions	Percent of quota
July 17, 2023	Board approval of the arrangement	0.00	0.00
November 7, 2023	Reform measure 1 implementation review	45.2333	8.33
May 7, 2024	Reform measure 2 implementation review	45.2333	8.33
May 7, 2024	Reform measure 3 implementation review	45.2333	8.33
May 7, 2024	Reform measure 4 implementation review	45.2333	8.33
October 30, 2024	Reform measure 5 implementation review	45.2333	8.33
October 30, 2024	Reform measure 6 implementation review	45.2333	8.33
October 30, 2024	Reform measure 7 implementation review	45.2334	8.33
March 15, 2025	Reform measure 8 implementation review	45.2334	8.33
March 15, 2025	Reform measure 9 implementation review	45.2334	8.33
Total		**407.1000**	**75.00**

Source: IMF staff estimates.

Table 8. Kenya: Indicators of IMF Credit, 2021–45

(In millions of SDR unless stated otherwise)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045
			Projections																						
Existing and prospective Fund arrangements																									
Disbursements	686.6	515.7	587.8	629.7	213	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Stock of existing and prospective Fund credit [1]	1,301.4	1,766.7	2,332.9	2,962.6	3,092.8	2,888.8	2,612.6	2,207.2	1,733.3	1,287.8	936.7	662.6	482.4	407	360	319	278	237	197	156	115	74	34	4	0
EFF/ECF	1,301.4	1,766.7	2,287.7	2,645.9	2,685.7	2,481.7	2,205.5	1,800.1	1,326.2	880.7	529.6	255.5	75.3	11	0	0	0	0	0	0	0	0	0	0	0
RSF	0.0	0.0	45.2	316.7	407.1	407.1	407.1	407.1	407.1	407.1	407.1	407.1	407.1	396	360	319	278	237	197	156	115	75	34	4	0
Obligations to the Fund [2]	95.3	63.5	73.0	85.5	194.2	315.9	381.6	501.6	555.1	514.5	408.1	321.3	219.9	110.7	79.8	71.5	69.6	67.7	65.8	64.0	62.1	60.2	58.3	45.2	19.3
of which, EFF/ECF	95.3	63.5	73.0	80.4	177.0	297.1	362.9	482.9	536.4	495.8	389.4	302.5	201.1	80.7	25.7	14.7	14.7	14.7	14.7	14.7	14.7	14.7	14.7	14.7	14.7
RSF	0.0	0.0	0.0	5.1	17.2	18.7	18.7	18.8	18.7	18.7	18.7	18.8	18.7	30.0	54.0	56.8	54.9	53.0	51.1	49.3	47.4	45.5	43.6	30.5	4.6
of which, Principal (repayments/repurchases/disbursements)	91.2	50.3	21.6	0.0	82.6	204.0	276.2	405.4	473.9	445.5	351.1	274.1	180.2	75.7	47.1	40.7	40.7	40.7	40.7	40.7	40.7	40.7	40.7	29.4	4.5
Charges and interest [3]	4.1	13.1	51.5	85.5	111.6	111.9	105.4	96.2	81.2	69.0	57.0	47.1	39.6	35.0	32.7	30.8	28.9	27.0	25.1	23.3	21.4	19.5	17.6	15.8	14.8
Stock of existing and prospective Fund credit [1, 4]																									
In percent of quota	239.8	325.5	429.8	545.8	569.8	532.2	481.3	406.6	319.3	237.2	172.6	122.1	88.9	74.9	66.2	58.7	51.2	43.7	36.2	28.7	21.2	13.7	6.2	0.8	0.0
In percent of GDP	1.7	2.1	2.8	3.4	3.4	3.0	2.5	2.0	1.5	1.0	0.7	0.5	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
In percent of exports of goods and services	15.4	16.9	20.5	23.7	22.4	19.2	15.9	12.3	8.9	6.1	4.0	2.6	1.7	1.3	1.1	0.9	0.7	0.5	0.4	0.3	0.2	0.1	0.0	0.0	0.0
In percent of gross international reserves	19.1	29.5	42.7	46.6	42.6	36.5	29.9	24.1	17.5	12.1	8.1	5.3	3.6	2.8	2.2	1.8	1.5	1.2	0.9	0.6	0.4	0.3	0.1	0.0	0.0
In percent of government revenue	9.9	11.6	15.3	18.8	18.7	16.7	14.2	11.1	8.2	5.7	3.9	2.6	1.8	1.4	1.2	1.0	0.8	0.6	0.5	0.4	0.2	0.1	0.1	0.0	0.0
In percent of total external debt	5.3	6.6	8.3	9.8	10.1	9.0	7.9	6.4	4.8	3.4	2.4	1.6	1.1	0.9	0.8	0.7	0.6	0.5	0.4	0.3	0.2	0.1	0.1	0.0	0.0
Obligations to the Fund (repurchases and charges) [4]																									
In percent of quota	17.6	11.7	13.5	15.7	35.8	58.2	70.3	92.4	102.3	94.8	75.2	59.2	40.5	20.4	14.7	13.2	12.8	12.5	12.1	11.8	11.4	11.1	10.7	8.3	3.6
In percent of GDP	0.1	0.1	0.1	0.1	0.2	0.3	0.4	0.5	0.5	0.4	0.3	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of exports of goods and services	1.1	0.6	0.6	0.7	1.4	2.1	2.3	2.8	2.8	2.4	1.8	1.3	0.8	0.4	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0
In percent of gross international reserves	1.4	1.1	1.3	1.3	2.7	4.0	4.4	5.5	5.6	4.8	3.5	2.6	1.6	0.7	0.5	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.1	0.1
In percent of government revenue	0.7	0.4	0.5	0.5	1.2	1.8	2.1	2.5	2.6	2.3	1.7	1.3	0.8	0.4	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.0
In percent of total external debt service	4.8	2.2	2.6	1.9	5.2	9.7	11.0	12.2	15.5	13.2	10.0	7.5	4.9	1.6	0.9	0.6	0.5	0.4	0.4	0.4	0.3	0.3	0.2	0.2	0.2
Memorandum items																									
Quota (SDR million)	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8
Gross domestic product, baseline (USD million)	109,875	113,701	112,818	115,115	122,115	129,728	137,287	145,524	154,417	163,897	173,913	184,506	195,793	207,653	220,288	233,673	247,761	262,691	278,504	295,181	312,949	331,761	356,303	382,662	410,970
Exports of goods and services (USD million)	11,825	13,857	15,119	16,634	18,326	20,010	21,847	23,789	25,921	28,251	30,960	33,936	37,209	40,802	44,756	49,102	53,877	59,129	64,906	71,257	78,252	85,951	94,429	103,765	114,049
Gross international reserves (USD million)	9,514	7,969	7,273	8,454	9,657	10,532	11,611	12,176	13,147	14,132	15,337	16,717	18,049	19,635	21,282	23,103	25,037	27,236	29,576	32,014	34,834	37,878	41,300	45,221	49,231
Government revenue (USD million)	18,480	20,200	20,230	20,939	21,975	23,005	24,540	26,331	28,099	29,898	31,833	33,825	36,033	38,499	41,082	43,896	47,050	50,641	54,524	58,552	62,892	67,553	73,496	79,962	86,997
External debt service (USD million)	2,870	3,275	3,749	5,952	5,002	4,412	4,705	5,626	4,889	5,341	5,557	5,879	6,188	8,371	6,868	7,495	7,896	8,516	8,464	8,914	9,109	8,956	9,683	10,231	10,121
Total external debt (USD million)	34,151	35,507	37,990	40,570	41,578	43,402	45,341	47,114	49,490	51,882	54,276	56,272	58,670	59,385	61,472	62,942	64,290	65,169	66,261	67,295	68,285	69,655	70,618	71,375	72,601

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

[1] End of period.

[2] Repayment schedule based on scheduled debt service obligations.

[3] Using the GRA rate of charge of 4.854 (as of June 8, 2023).

[4] Using the USD/SDR rate of 1.330090 as of June 8, 2023 in 2023-2045 forecasts.

Table 9. Kenya: Decomposition of Public Debt and Debt Service by Creditor[1], 2022–25

	Debt Stock (end of period)			Debt Service					
	2022			2023	2024	2025	2023	2024	2025
	(In US$ mln)	*(Percent total debt)*	*(Percent GDP)* [2]	*(In US$ mln)*			*(Percent GDP)*		
Total	**74,120**	**100.0**	**66.8**	**11,228**	**11,393**	**8,913**	**10.0**	**9.9**	**7.3**
External	**37,370**	**50.4**	**34.5**	**3,356**	**5,057**	**3,531**	**3.0**	**4.4**	**2.9**
Multilateral creditors	17,474	23.6	15.4	642	638	786	0.6	0.6	0.6
IMF	2,399	3.2	2.1	-	-	-	-	-	-
World Bank	11,086	15.0	9.7	-	-	-	-	-	-
African Development Bank	3,492	4.7	3.1	-	-	-	-	-	-
European Economic Community (incl. EIB)	177	0.2	0.2	-	-	-	-	-	-
International Fund For Agricultural Development	225	0.3	0.2	-	-	-	-	-	-
Other Multilaterals	96	0.1	0.1	-	-	-	-	-	-
o/w: Arab Bank For Economic Development In Africa	45	0.1	0.0	-	-	-	-	-	-
Nordic Development Fund	23	0.0	0.0	-	-	-	-	-	-
Bilateral Creditors	10,497	14.2	9.2	1,447	1,376	1,330	1.3	1.2	1.1
Paris Club	3,793	5.1	3.3	430	398	383	0.4	0.3	0.3
o/w: Japan	1,403	1.9	1.2	-	-	-	-	-	-
France (incl. AFD)	774	1.0	0.7	-	-	-	-	-	-
Non-Paris Club	6,705	9.0	5.9	1,017	978	946	0.9	0.8	0.8
o/w: EXIM China	6,557	8.8	5.8	-	-	-	-	-	-
EXIM India	61	0.1	0.1	-	-	-	-	-	-
Bonds	7,100	9.6	6.2	515	2,444	667	0.5	2.1	0.5
Commercial creditors	1,881	2.5	1.7	680	537	698	0.6	0.5	0.6
o/w: Trade and Development Bank	1,728	2.3	1.5	-	-	-	-	-	-
China Development Bank	88	0.1	0.1	-	-	-	-	-	-
Other international creditors	418	0.6	0.4	73	61	50	0.1	0.1	0.0
o/w: Intesa SanPaolo	235	0.3	0.2	-	-	-	-	-	-
ING Bank Germany	23	0.0	0.0	-	-	-	-	-	-
Domestic[3]	**36,750**	**49.6**	**32.3**	**7,872**	**6,336**	**5,382**	**7.0**	**5.5**	**4.4**
Held by residents, total	36,493	49.2	32.1						
Held by non-residents, total	257	0.3	0.2	-	-	-	-	-	-
T-Bills	5,587	7.5	4.9	-	-	-	-	-	-
Bonds	30,076	40.6	26.5	-	-	-	-	-	-
Loans	1,087	1.5	1.0	-	-	-	-	-	-
Memo items:									
Collateralized debt	0	0.0	0.0	-	-	-	-	-	-
o/w: Related	0	0.0	0.0	-	-	-	-	-	-
o/w: Unrelated	0	0.0	0.0	-	-	-	-	-	-
Contingent liabilities	1,417	1.9	1.2	-	-	-	-	-	-
o/w: Public guarantees [4]	1,417	1.9	1.2	-	-	-	-	-	-
o/w: Other explicit contingent liabilities [5, 6]	n.a.	n.a.	n.a.	-	-	-	-	-	-

Sources: Kenyan authorities; and IMF staff calculations.

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

[2] Debt ratios are constructed by converting external debt to Ksh using end-period exchange rate and dividing by Ksh GDP.

[3] Includes CBK on-lending to the government of the Ksh-equivalent of three-quarters of the 2021 general allocation of SDRs.

[4] Loan guarantees are included in the perimeter of debt covered by the DSA and include undrawn amount of government-guaranteed loan facilities and letters of credit at high risk of being fully utilized

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

[6] Capacity constraints limit data availability on other explicit liabilities not elsewhere classified. Data is expected to become available at the time of the next review of the IMF EFF/ECF arrangements.

Table 10. Kenya: Decomposition of Public Debt, 2022–25[1]

(In US$ million unless otherwise noted)

	Actual	Projections		
	2022	2023	2024	2025
	(In US$ mln)	*(In US$ mln)*		
Creditor profile				
Total	**74,120**	**74,139**	**76,982**	**79,841**
External	**37,370**	**39,807**	**42,438**	**43,797**
Multilateral creditors	17,474	19,836	22,224	23,499
IMF	2,399	3,099	3,580	3,632
World Bank	11,086	11,335	11,067	10,771
African Development Bank	3,492	3,835	3,771	3,698
Other Multilaterals	498	513	832	908
Bilateral Creditors	10,497	10,592	11,297	11,547
Paris Club	3,793	3,975	4,481	4,768
Non-Paris Club	6,705	6,617	6,816	6,779
Private creditors	9,399	9,034	6,572	6,406
Bonds	7,100	7,100	5,100	5,595
Commercial creditors	2,299	1,934	1,472	812
Domestic	**36,750**	**34,333**	**34,545**	**36,044**
Memorandum items				
Collateralized debt	0	0	0	0
o/w: Related	0	0	0	0
o/w: Unrelated	0	0	0	0
Multilateral and collateralized debt [2]				
Multilateral debt				
Percent of external debt	46.8	49.8	52.4	53.7
Percent of GDP	15.4	17.6	19.3	19.2
o/w: IMF and WB				
Percent of external debt	36.1	36.3	34.5	32.9
Percent of GDP	11.9	12.8	12.7	11.8
o/w: African Development Bank				
Percent of external debt	9.3	9.6	8.9	8.4
Percent of GDP	3.1	3.4	3.3	3.0
o/w: Other multilateral				
Percent of external debt	1.3	1.3	2.0	2.1
Percent of GDP	0.4	0.5	0.7	0.7
Collateralized debt				
Percent of external debt	0.0	0.0	0.0	0.0
Percent of GDP	0.0	0.0	0.0	0.0

Sources: Kenyan authorities and IMF staff calculations.

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

[2] Debt ratios are constructed by converting external debt to Ksh using end-period exchange rate and dividing by Ksh GDP.

Table 11. Kenya: Proposed RSF Reform Priorities and Reform Measures (RM)

5th EFF/ECF Reviews July 2023	6th EFF/ECF Reviews November 2023	7th EFF/ECF Reviews May 2024	8th EFF/ECF Reviews October 2024	9th EFF/ECF Reviews March 2025
RSF approval	**1st RSF Review**	**2nd RSF Review**	**3rd RSF Review**	**4th RSF Review**
Reform Priority 1: Incorporating climate risks into planning and investment framework		**RM2:** National Treasury to conduct long-term fiscal sustainability analysis under different climate change scenarios and publish the results in the Fiscal Risk Statement starting in FY2024/25.	**RM5:** National Treasury to (i) develop a standardized climate change and disaster risk methodology to be integrated in project appraisal, (ii) include climate considerations in project selection criteria and (iii) reflect the use of the analysis in project concept notes, feasibility studies, and the publication of the project selection criteria.	**RM8:** National Treasury to implement a prototype of climate budget tagging in key climate sensitive sectors, develop guidelines (applied to all sectors) in the FY2024/25 MTEF circular for budget preparation with a clear definition of climate-related expenditure, and publish the results.
Reform Priority 2: Mobilizing climate-revenue and strengthening efficiency		**RM3:** Subject to Parliamentary approval, National Treasury to implement carbon pricing in line with IMF recommendations to better reflect the externalities of fossil fuel consumption and to achieve emissions reduction targets in line with the updated NDC.	**RM6**: National Treasury to adopt priority fiscal incentives in agriculture, water, and land management sectors, as listed in the draft National Green Fiscal Incentive Policy Framework. **RM7**: Cabinet to approve net metering regulation, electricity market, bulk supply, and open access regulations, including rates determination methodology to promote energy efficiency, electricity wheeling and distributed renewable power generation in the residential, commercial, and industrial sectors including Special Economic Zones and Industrial Parks.	
Reform Priority 3: Enhancing effectiveness of existing frameworks to support climate finance		**RM4:** CBK to develop a draft green finance taxonomy adapted to Kenya's updated NDC and circulate the draft for stakeholder consultation.		**RM9:** CBK to (i) adopt a green finance taxonomy adapted to Kenya's updated NDC and reflecting stakeholders' comments, (ii) issue guidelines for the implementation of climate related disclosures for the banking sector in line with international best practices, and (iii) introduce time-bound targets for the implementation of climate disclosure requirements.
Reform Priority 4: Strengthening disaster risk reduction and management	**RM1**: Cabinet to adopt the National Framework for Climate Services to enable dissemination of a digital early warning system platform for a multi-sector climate-related information to most vulnerable counties, including ASAL and coastal regions.			

Annex I. Risk Assessment Matrix[1]

Sources of Risks	Likelihood	Expected Impact on Economy	Policy Response
Potential External Shocks			
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	**High**	**High.** Higher commodity prices would increase external and domestic imbalances and weigh on economic growth.	• Keep domestic fuel prices aligned with global fuel prices while compressing expenditure to contain fiscal pressures; • If the shock is persistent, tighten monetary policy to ensure inflationary expectations remain well-anchored; • Greater exchange rate flexibility; • If the further shock is very large, consult with staff on response consistent with overarching objective of fiscal consolidation to reduce debt vulnerabilities.
Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	**High**	**Medium.** Such sanctions could disrupt imports of fertilizer and wheat and raise borrowing costs and limit options for non-concessional external financing.	• Diversify sources of imports for key inputs and staples (e.g., fertilizer, wheat); • Deploy targeted support to most vulnerable leveraging existing assistance programs; • Consider alternative financing mixes, including medium-term syndicated loans.

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

Sources of Risks	Likelihood	Expected Impact on the Kenyan Economy	Policy Response
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation. • **U.S.:** Amid tight labor markets, supply disruptions and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in dollar strengthening, a more abrupt financial and housing market correction, and "hard landing." • **EMDEs:** A new bout of global financial tightening, possibly combined with volatile commodity prices, leads to spiking risk premia, debt distress, widening of external imbalances, fiscal pressures, and sudden stops.	**High**	**High.** This could adversely impact growth, spur capital outflows from the private sector and pressure the exchange rate. Fiscal balances would worsen, including due to balance sheet scarring in the private sector, and debt vulnerabilities would rise further.	• Adopt mutually reinforcing monetary and fiscal policy stances; • Reprioritize spending to support the vulnerable while compressing overall expenditure to contain the negative fiscal-debt impact; • Greater exchange rate flexibility; • Accelerate reforms to address structural weakness affecting competitiveness.
Monetary policy miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	**Medium**	**High.** This could trigger capital outflows from the private sector and hamper capital market access by the sovereign. The exchange rate would face depreciation pressures, the fiscal balances would worsen, and debt vulnerabilities would rise further.	• Tighten monetary policy; • Greater exchange rate flexibility; • Compress expenditure to contain the negative fiscal-debt impact;
Deepening geo-economic fragmentation. Broader and deeper conflict(s) and weakened international cooperation lead to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**High**	**Medium.** This could adversely impact growth, spur capital outflows from the private sector and pressure the exchange rate.	• Reprioritize spending to support the vulnerable while compressing overall expenditure to contain the negative fiscal-debt impact; • Greater exchange rate flexibility; • Accelerate reforms to address structural weakness affecting competitiveness.

Sources of Risks	Likelihood	Expected Impact on Economy	Policy Response
Cyberthreats. Cyberattacks on critical domestic and/or international physical or digital infrastructure (including digital currency and crypto ecosystems) trigger financial and economic instability.	Medium	Medium. Such attacks can trigger financial instability or widely disrupt socio-economic activities.	• Continue reforms to strengthen cyber security capabilities at both government and private sector level.
Extreme climate events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth.	Medium	High. This would lead to slower growth, an increase in food inflation, pressures on public spending and the current account, and adversely affect vulnerable households.	• Guard against second-round effects on inflation; • Use targeted programs to help vulnerable groups and reprioritize spending.
Potential Domestic Shocks			
A resumption of adverse weather conditions or locust invasion.	Medium /Low	High/Low. Depending on the geographical area impacted this could lead to lower agricultural production and slower growth, an increase in food inflation, pressures on public spending and the current account, and adversely affect vulnerable households.	• Use targeted programs to help vulnerable groups and reprioritize spending; • As necessary, guard against second-round effects on inflation.
Systemic financial instability. Sharp swing in exchange rate, due to domestic monetary or fiscal policy miscalibration triggers capital shortfalls at some banks with large FX exposures, causing financial stress, markets dislocations and adverse cross-border spillovers.	Medium	High. This could hamper the functioning of interbank markets and further exacerbates domestic and FX liquidity conditions. The exchange rate could overshoot, and private credit severely constrained, net domestic financing will be constrained, and debt vulnerabilities would rise further.	• Deploy measures to stabilize the banking sector; • Compress primary spending to avoid accumulation of pending bills

Sources of Risks	Likelihood	Expected Impact on Economy	Policy Response
Political risks.	Medium	Medium. Unrest could reemerge in connection with protests against higher cost of living, need to raise more taxes and electoral process supported by the political opposition.	• Remain committed to reforms under the program.
Emergence of greater-than-expected weaknesses in the SOE sector.	High	Medium. This would create additional fiscal pressures, potentially leading to further crowding out of the private sector, although the magnitude would be highly uncertain.	• Continued financial evaluation of health of top SOEs; • Implement least-cost strategies to address SOE financial pressures.
Deterioration in security situation.	Medium	High. This would adversely affect recovery of the tourism sector, foreign direct investment, and portfolio inflows and, in turn, growth.	• Reprioritize fiscal spending to accommodate security needs; • Maintain policies to improve macro fundamentals (e.g., structural and governance reforms). • Strengthen and robustly implement AML/CFT framework to help prevent, detect, and disrupt the financing of terrorism.
Risks from poor implementation capacity from new government initiatives (i.e., "bottom-up approach"), and weak program ownership.	Medium	Medium. This would lead to higher budget deficits, which would increase debt ratios, crowd out private investment, and ultimately weaken growth.	• Remain committed to fiscal targets and reforms under the program.

Annex II. External Sector Assessment

Overall Assessment. The external position of Kenya in 2022 was broadly in line with the level implied by medium-term fundamentals and desirable policies.

Potential Policy Responses. Looking forward, Kenya's external position, competitiveness, and reserve coverage are expected to improve under the authorities' ambitious reform program and mutually reinforcing prudent macroeconomic policies, supported by the EFF and ECF arrangements. The programmed fiscal consolidation would help strengthen Kenya's external sector position and support private sector growth, with exchange rate flexibility allowing the economy better to absorb external shocks.

Foreign Assets and Liabilities: Position and Trajectory

Background. Kenya's net international investment position (NIIP) has turned negative since the mid-2000s and widened progressively, as the country embarked on an ambitious infrastructure investment strategy. Newly revised and updated data through 2021 show a wider NIIP than previously estimated by extrapolating preliminary IIP data through 2018 with balance of payments (BoP) financial flows. Over the last five years, the NIIP widened by 14 percentage points of GDP, driven by both the public and private sectors. The annual change has, however, on average halved since the first year of the pandemic.[1] Total external debt (loans and securities) is estimated at 69 percent of GDP at end-2022, of which 31 percent of GDP is public and 38 percent of GDP is private. Over 85 percent of external private debt is owed by the non-bank sector. Total external assets are estimated at 21.6 percent of GDP, mostly in deposits abroad and reserve assets.

Assessment. Going forward, the negative NIIP is projected to widen further to -72 percent of GDP by 2027, as per capita income converges to that of upper-middle income countries affording higher returns for international investors than in their home markets.

2022 (% GDP)	NIIP: -61	Gross Assets: 22	Debt Assets: 20	Gross Liab.: 82	Debt Liab.: 72

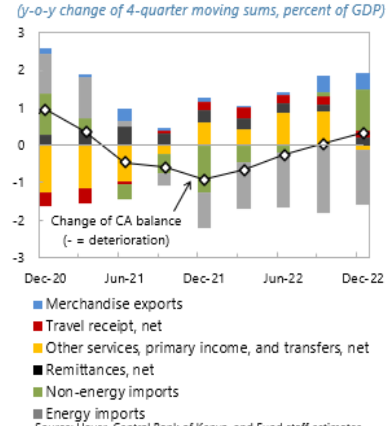
Current Account

Background. Kenya's current account (CA) deficit was 5.1 percent of GDP in 2022, close to its average value over the preceding three years. The initial widening of the current account deficit in 2022 gradually receded in the course of the year, despite the increase in the energy and food import bills, on the back of the strength of exports, tourism receipts, and remittances. The CA deficit narrowed further in 2022Q4, driven by the decline in non-energy imports, linked to the completion of some large public investment projects and under-execution of the public external borrowing plan used to finance other investments. The observed CA dynamics are more broadly supported by the fiscal consolidation under the IMF-supported ECF/EFF program, which has helped improve the public sector saving-investment balance.

Assessment. The CA balance is assessed to be broadly in line with the level implied by fundamentals and desirable policies in 2022.

Kenya: Contributions to Change of Current Account Balance, 2020-22

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



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

Note: The 4-quarter moving sum at end-year may differ from the annual BOP data published by KNSB.

- The EBA-lite CA model indicates a CA gap of –0.5 percent of GDP in 2022. It is based on a CA norm of –5.0 percent of GDP and estimated cyclically adjusted CA of -5.5 percent of GDP. The latter incorporates adjustments to reflect: 1) The temporary nature of the decline in non-energy imports in 2022, driven by the under-execution of external commercial borrowing in FY2021/22, caused by financial market dislocations in the wake of the war on Ukraine and monetary tightening in advanced countries, as well as the rationalization of capital spending in FY2022/23 (combined 1.25 percentage points of GDP increase in the CA deficit); and 2) The temporary nature of the spike in oil imports in the wake of the war on Ukraine (downward adjustment by 0.4 percentage points of GDP).
- The contribution of policy gaps to the current account gap is 1.2 percent of GDP, with private credit growth and public health expenditures being the main contributors (1.1 percent of GDP, combined). The positive relative policy gap captures: 1) the relatively more compressed private credit growth compared with its norm in Kenya than in the world as a whole; and 2) the relatively larger deviation of public health expenditures from its desirable policy level for the world as a whole than in Kenya.

Kenya: Model Estimates for 2022
(In percent of GDP)

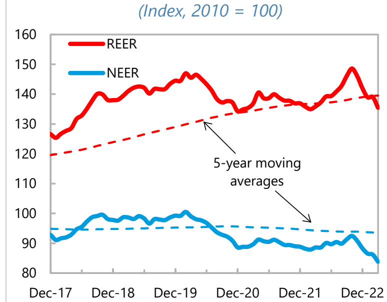
	CA model 1/	REER model 1/
	(in percent of GDP)	
CA-Actual	**-5.1**	
Cyclical contributions (from model) (-)	0.0	
COVID-19 adjustors (-) 2/	-0.2	
Additional temporary/statistical factors (-) 3/	0.9	
Natural disasters and conflicts (-)	-0.3	
Adjusted CA	**-5.5**	
CA Norm (from model) 4/	**-5.0**	
Adjusted CA Norm	**-5.0**	
CA Gap	**-0.5**	**-1.7**
o/w Relative policy gap	1.2	
Elasticity	-0.11	
REER Gap (in percent)	**4.3**	**15.3**

1/ Based on the EBA-lite 3.0 methodology
2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism and remittances (0.1 and 0.12 percent of GDP, respectively).
3/ Adjustments to reflect: 1) The temporary nature of the decline in non-energy imports due to underexecution of external commercial borrowing in FY2021/22 and rationalization of capital spending in FY2022/23 (upward adjustment by 1.25 percentage points of GDP); 2) The temporary nature of the spike in oil imports in the wake of the war on Ukraine (downward adjustment by 0.4 percentage points of GDP).
4/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The medium-term appreciation trend in Kenya's real effective exchange rate (REER) has begun to taper off, with the REER drifting in the 134–148 range since 2020Q1. The REER appreciated on average by 2.2 percent in 2022, following a depreciation of 2.6 percent in 2021, against the backdrop of the U.S. dollar's global strength coupled with less pronounced adjustment in the Ksh/US$ rate. The main driver of the trend appreciation has been the positive inflation differential with trading partners, as the nominal effective exchange rate (NEER) follows a depreciation path that has become more pronounced since the onset of the COVID-19 pandemic. In May 2023, the REER was 6.4 percent weaker than its average in 2022, falling below its 5-year moving average.

Kenya: Effective Exchange Rates, 2018-23
(Index, 2010 = 100)



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

Assessment. The EBA-lite REER model suggests a gap of 15.3 percent for 2022. Taking into account the results of the EBA-lite current account (CA) model, staff assesses the REER gap to be in the range of 4–15 percent, compared with the range of 4–12 percent in the last assessment based on 2020 data.

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2022, Kenya's current account deficit was primarily financed by debt flows. Other net investment flows amounted to 4.6 percent of GDP, reflecting government borrowing, including support under the IMF-supported program and World Bank's Development Policy Financing, as well as a decrease in private sector net foreign assets. Market pressures since the start of the war on Ukraine and the ongoing monetary tightening in advanced countries have limited government's access to commercial borrowing. Annual FDI net inflows improved relative to 2021, but on average amount to less than one percent of GDP.

Assessment. The resilience of private sector inflows in the face of tighter global financial conditions has been an important backstop of Kenya's external balance.

FX Intervention and Reserves Level

Background. In 2022, gross official reserves (7 percent of GDP) provided an adequate buffer against external shocks, covering 3.9 months of next year's imports of goods and services. They have since declined in the course of 2023 reflecting inter year dynamics of external official inflows, as well as further drawdowns, including via FX interventions (FXI) during a period of heightened volatility. Import coverage of reserves is expected to remain above the 3-month threshold, which is also close to the value of the IMF's reserve adequacy metric for credit-constrained economies, gradually strengthening over time.

Assessment. Kenya's de facto exchange rate arrangement is crawl-like.[2] The CBK engages in periodic FXI to smooth volatility in the Kenyan shilling. Unlike in prior years, FXIs have been asymmetric since 2021Q3, with CBK being a net seller. Increasing exchange rate flexibility would help the economy better absorb potential shocks.

[1] Published International Investment Position (IIP) data is available until 2021 (see the 2023 Economic Survey). It is extrapolated for 2022 with BoP financial flows.

[2] Kenya's de jure exchange rate arrangement is free floating. The bilateral nominal exchange rate against the U.S. dollar depreciated by 9 percent in 2022 and by 13.8 percent since then as of June 29, 2023.

Annex III. Enhancing Kenya's Resilience to Climate Change

Kenya is implementing a comprehensive strategy to address climate risks and enhance resilience. The country is focused on both adaptation and mitigation measures and is receiving support from various developing partners. Support under the Resilience and Sustainability Facility (RSF) will reinforce Kenya's already-strong efforts to address climate-related challenges and build resilience, while exploiting synergies with others to strengthen policy frameworks, and help catalyze private source of climate finance.

A. Climate-Related Natural Hazards, Impact, and Vulnerabilities

1. The Kenyan economy is highly exposed to climate related hazards and the implications of climate change. It is estimated that over 70 percent of natural disasters in Kenya are attributable to extreme climatic events (Table AIII.1). The agriculture sector and tourism, two key climate-sensitive sectors, comprise over 50 percent of GDP, while the agriculture sector provides employment to about 80 percent of the rural workforce. Nearly 35 percent of the electricity generated in the country comes from hydropower, which is vulnerable to climate-related events. Climate change also affects debt sustainability through the impact on the fiscal deficit of government spending on recovery and reconstruction and lower tax revenue given its negative effects on productivity in climate sensitive economic sectors.

Table AIII.1. Natural Disasters in Kenya, 1900–2023

Natural Hazard	Subtype	Events Count	Total Fatalities	Total Affected	Total Damage ('000 US$)
Drought	Drought	17	196	59,300,000	251,500
Earthquake	Ground Movement	1	0	0	0
	Tsunami	1	1	0	100,000
Epidemic	Bacterial Disease	21	1,698	67,499	0
	Parasitic Disease	5	1,595	6,807,533	0
	Viral Disease	8	514	1,356,103	0
	Other	4	1273	22,538	0
Flood	Flash Flood	9	203	305,339	500
	Riverine Flood	37	1,150	2,232,222	136,038
	Other	14	720	2,329,485	381,850
Landslide	Landslide	4	133	140	0
	Mudslide	1	20	6	0
Storm	Convective Storm	1	50	0	0

Source: EM-DAT: The Emergency Events Database – *Universite Catholique de Louvain (UCL)* – CRED, D. Guha-Sapir.

2. Flood and drought events are becoming more frequent, with drought cycles occurring every 2–3 years instead of every 5–10 years. As a result, the frequency of drought-induced food insecurity episodes has increased from every 20 years (in the 1980s) to every 2–3 years. This is adding to key development challenges, severely affecting the poor and vulnerable who depend largely on agriculture outputs and income. The number of people projected to face severe food insecurity has increased from 3.5 million in September 2022 to 5.4 million in June 2023 due to the worst drought in decades (International Rescue Committee, February 2023).

3. Repeating patterns of climate-induced hazards in the country have had high economic costs. Vulnerability from these hazards poses major challenges for economic stability and fiscal sustainability and have had adverse social and fiscal consequences. Their total cost is estimated at 2–2.4 percent of GDP per year in Kenya: while droughts are estimated to cost about 8 percent of GDP every five years, the cost of floods is estimated at 5.5 percent of GDP every seven years.[1] For example, the 1998 to 2000 drought cost an estimated US$2.8 billion, principally due to crops and livestock loss, as well as forest fires, damage to fisheries, and reduced hydropower generation, industrial production and water supplies.[2] Similarly, a severe and prolonged drought from 2008–2011 affected 3.7 million people, caused US$12.1 billion in damages and losses, and cost over US$1.7 billion in recovery and reconstruction needs.[3]

4. Agriculture, the largest of Kenya's economic sectors, is particularly vulnerable to climate change. Apart from comprising nearly a quarter of total nominal GDP, the sector constitutes the largest share in the country's exports, a significant share of foreign exchange earnings, employs about 8.5 million Kenyans, and accounts for 70 percent of rural employment. Nearly 98 percent of agriculture is rainfed, and 84 percent of land is classified as arid and semi-arid and exposed to extreme natural events. Current farming practices resulted in approximately 90 percent of the tree cover loss over 2001-2020 and is a leading cause of land degradation. Against this backdrop, climate change is expected to bear heavily on Kenya's food and nutritional security, reducing yields of key food crops (i.e., maize) and agricultural exports (i.e., coffee, cut flowers, tea). Indirect impacts, such as increased rates of runoff and soil erosion, and increased crop losses from wildlife migrations, rising and novel infestations from insects, diseases, and weeds, could further magnify production losses.

5. Despite high vulnerability to climate-related shocks, Kenya is a modest contributor to global greenhouse gas (GHG) emissions. In 2019, the country was estimated to have contributed about 0.15 percent of global GHG, becoming the world's 69th largest emitter. On a per capita basis, Kenya's emissions of 1.8 metric tons of CO_2 equivalent (MtCoe2) are below the global average of approximately 6.5 MtCoe2. Under this metric, Kenya ranks as 173rd emitter.[4] The evaluation done using the Climate Policy Assessment Tool (CPAT) shows agriculture as the largest source of greenhouse gas emissions in Kenya, contributing about 56 percent of the country's 92.8 MtCOe2 emissions in 2019. This was followed by energy-related emissions, which accounted for 32 percent of the total with buildings, transport, industry, and the power sector contributing to 14, 9, 7, and 2 percent of total GHG emissions, respectively. The relatively high share of emissions in the building

[1] National Policy for Disaster Management in Kenya, Government of Kenya, 2017.

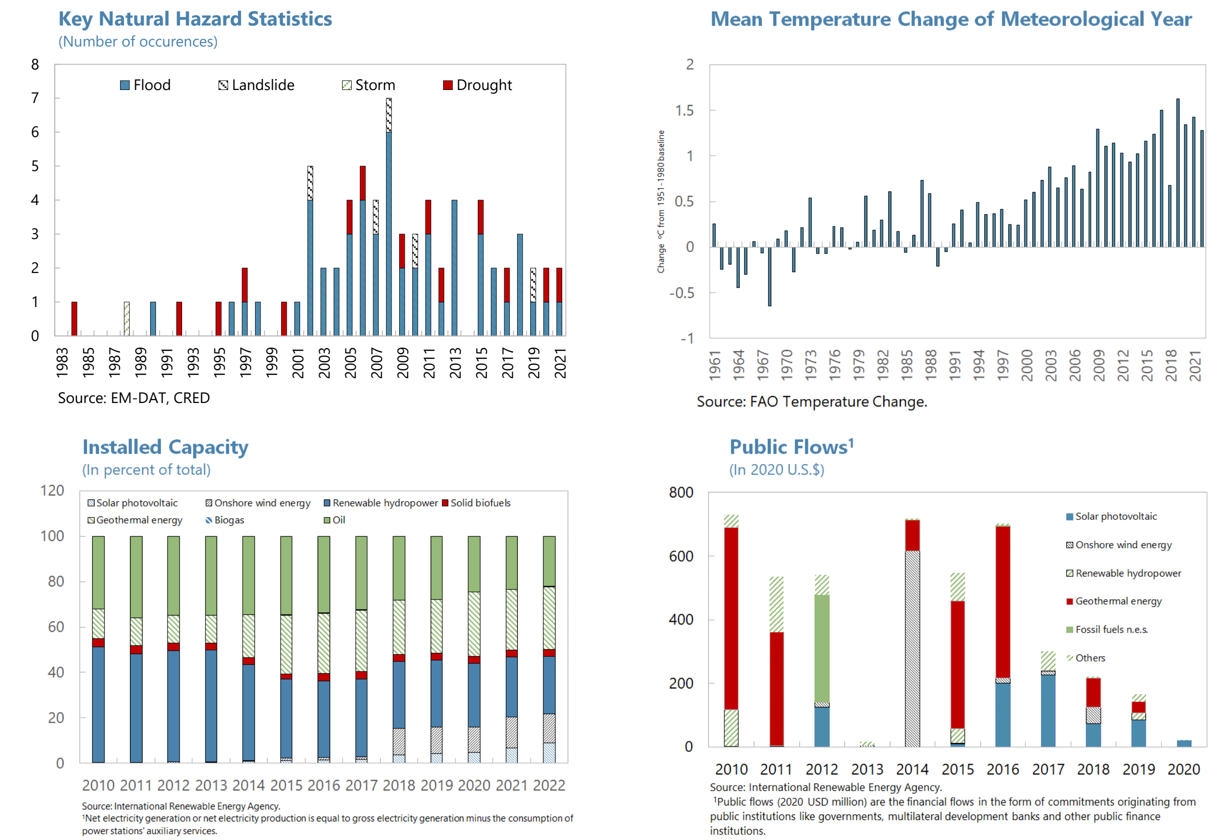
[2] National Environment Management Authority (2015). Kenya- Second National Communication to the United National Framework Convention on Climate Change.

[3] GFDRR (2020). Kenya Overview.

[4] Kenya, Climate Policy Diagnostic, IMF, May 2023.

sector is explained by a very high proportion of households that use charcoal and wood for cooking. Waste accounted for 9 percent of emissions, while industrial processes accounted for 1 percent.

Figure AIII.1. Kenya: Climate Indicators



Key Natural Hazard Statistics — Source: EM-DAT, CRED

Mean Temperature Change of Meteorological Year — Source: FAO Temperature Change.

Installed Capacity — Source: International Renewable Energy Agency.
[1]Net electricity generation or net electricity production is equal to gross electricity generation minus the consumption of power stations' auxiliary services.

Public Flows — Source: International Renewable Energy Agency.
[1]Public flows (2020 USD million) are the financial flows in the form of commitments originating from public institutions like governments, multilateral development banks and other public finance institutions.

B. Legal, Institutional and Policy Framework for Climate Change in Kenya

6. **Kenya has put climate change at the center of its sustainable development strategy.** Key strategies and policies at the national level include:

- *Kenya Vision 2030*, the country's development blueprint, which recognized climate change as a risk that could slow the country's development and presented opportunities to identify climate-related actions and priorities. The *Second Medium-Term Plan (2013–17)* identified actions to address climate change while the *Third Medium-Term Plan (2018–22)* recognized climate change as a crosscutting thematic area, and mainstreamed climate change actions in sector plans. The *Fourth Medium-Term Plan (2023-2027)* is currently being prepared.
- *Climate Change Act* (CCA, 2016) is the key legislation guiding Kenya's climate change response with the objective of enhancing climate change resilience and low carbon development for sustainable development of Kenya. In 2016, Kenya became the first African country to enact a CCA to promote climate-resilient and low-carbon economic development. The Act recognizes the *National Climate Change Action Plan (NCCAP)* as a five-year iterative

tool to mainstream and implement prioritized climate change actions across sectors of the economy, and institutionally at the national government, county governments, the public, and private entities. The second and most recent NCCAP covered the period 2018–22. It describes climate policy challenges and priorities, sets out strategies and climate action roadmaps, and outlines the governance framework and implementation arrangements across main government stakeholders. The NCCAPs are prepared according to the five-year cycle of the Medium-Term Plans (MTPs).

- The Kenyan authorities have also developed a range of climate-related policies and strategies, and sector-specific plans to enable green growth and sustainable natural resource management. These include the 2021 Guidance on Climate-Related Risk Management to the banking sector, National Adaptation Plan 2015–30, Green Economy Strategy and Implementation Plan 2016–30, Climate Smart Agriculture Strategy 2017–26, and Climate Risk Management Framework. Building on these policies and plans, the forthcoming Long Term Low Emission Development Strategy (LEDS) brings together the desire for ambitious economic growth, the country's contribution towards the global efforts to reach net zero, and food security challenges posed by the climate change.

7. The overall legal framework to support climate policy is comprehensive but there is a high risk of fragmentation (Table AIII.2). Kenya has put in place various laws and regulations that provide an enabling environment to promote climate resilient and low carbon investments. However, the CCA creates a parallel institutional framework that is not well integrated with other legal frameworks such as the PFM Act (2012) and laws that address disaster risk management and sector-specific development issues. While the CCA assigns the National Climate Change Council (NCCC) as the administrator of the National Climate Change Fund (NCCF) and to the role of allocating and approving funding under the NCCF, the draft PFM Climate Change Fund Regulations 2019 establishes the Climate Change Fund Board (chaired by Principal Secretary of NT) to carry out the same roles without a link to the NCCC and with an accounting officer of the Ministry of Environment, Climate Change, and Forestry as the administrator of the NCCF.

Table AIII.2. Kenya: Climate Legal, Institutional, and Policy Framework

Legal Framework	The Constitution of Kenya 2010, PFM Act 2012, Climate Change Act (2016, amendment 2023), Energy Act 2019, Water Act 2016, Irrigation Act 2019, Physical and Land Use Planning Act 2019, Urban Areas and Cities Act 2011, Environmental Management and Coordination Act 1999, National Drought Management Act 2016, National Disaster Risk Management Bill 2023, Forest Conservation and Management Act 2016, Fisheries Management and Development 2016, Sustainable Waste Management Act 2022, PPP Act 2021, Public Procurement and Asset Disposal Act 2015			
Institutional Framework	**Climate policy and investment** National Climate Change Council, Climate Change Directorate, Climate Change Units in State Departments and County Governments	**Climate finance** Climate Finance & Green Economy Unit, National Treasury, NEMA, MOEF	**Planning and budgeting** PIM and budget process (National Treasury and Economic Planning, Sector Ministries, Counties)	**Climate-relevant sectors** Energy: EPRA, REREC, RERAC Disaster: NDMA, NDRMA Water: WRA, WRMA,WHSA, WASREB Transport: KNHA, KURA, KRRA Other: NEMA, KIA, AFA, etc.
Policy Framework	NDC, NAP, NCCRS, NCCAP, National Climate Framework Policy, LEDS	National Policy on Climate Finance, Green Fiscal Incentives Framework Policy, Sovereign Green Bond Framework, GCF Investment Plan	Vision 2030, MTPs, Sector Plans, CIDPs, MTEF	National Spatial Plan, Least Cost Power Development Plan, Water Sector Master Plan, Water and Sanitation Investment Plan, Transport Masterplan, Energy Policy, Integrated Energy Plan, Climate Smart Agriculture Strategy, National Agriculture Investment Plan, Environmental Policy, Disaster Risk Management Policy, Climate Risk Management Framework, DRF Strategy, Sustainable Waste Management Policy
Funding Framework	National Climate Change Fund, County Climate Change Funds, Carbon Market Framework	GCF, GEF, CIF, Adaptation Fund, Donors, Green Investment Bank (concept)	National and county budgets, social programs	Drought Management Fund, National Disaster Risk Management Fund (concept), National Disaster Risk Fund (NT), Water Sector Trust Fund, Water Development Fund (concept), Fish Trust Fund Fisheries Development Fund

Source: Kenya, Climate Policy Diagnostic, IMF, May 2023.

Note: National Environment Management Authority (NEMA); Ministry of Environment and Forestry (MOEF); Energy Regulatory Commission (EPRA); Rural Electrification and Renewable Energy Corporation (REREC), National Drought Management Authority (NDMA); Water Resource Management Authority (WRMA); Water Services Regulatory Body (WASREB); Kenya National Highway Authority (KNHA); Kenya Urban Roads Authority (KURA); Kenya Rural Roads Authority (KRRA); Kenya Investment Authority (KIA); Agriculture and Food Authority (AFA); Nationally Determined Contribution (NDC); National Adaptation Plan (NAP); National Climate Change Action Plan (NCCAP); Low Emission Development Strategy (LEDS); Global Climate Fund (GCF); Medium-Term Plan (MTP0; County Integrated Development Plans (CIDP); Disaster Risk Financing (DRF); Global Environmental Facility (GEF); Climate Investment Fund (CIF).

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C. Kenya's National Determined Contribution

8. To reinforce its climate agenda, Kenya submitted its Nationally Determined Contribution (NDC) to the United Nations Framework Convention on Climate Change (UNFCCC)**.** Kenya's NDC, updated in 2020, outlined ambitious adaptation and mitigation agenda, setting a conditional target of reducing GHG emissions by 32 percent in 2030 relative to the BAU scenario of 143 million MtCO2eq, including land use, land use change and forestry (LULUCF).[5] It identified energy, industrial processes and product use, agriculture, forestry, water and irrigation, health, land use and waste management as key sectors where these reductions will be met. The updated NDC also aims to ensure a climate-resilient society through mainstreaming climate change adaptation in the Medium-Term Plans (MTPs) and County Integrated Development Plans (CIDPs). It focuses on the preparation and strengthening of institutional frameworks for responsible environmental management, improved management of climate change effects and economic development targets. To meet these goals, Kenya is investing in strategic actions such as afforestation and reforestation, geothermal energy production and other clean energy development, as well as climate smart agriculture, and drought management.[6]

- *On the adaptation side*, the updated NDC and NAP reflect priority adaptation programs from national adaptation and development plans. Adaptation is to be mainstreamed into the country's Medium-term Plan (MTP) at the national level and the County Integrated Development Plans (CIDPs) at the sub-national level with the aim of protecting public infrastructure, supporting social and economic development, and safeguarding lives and livelihoods in the short and longer term.
- *On the mitigation side*, the authority's plans reflect the implications of the economic growth ambitions and the need to contain related emissions to reach the updated NDC target. The envisaged economic growth would come with a substantial increase in energy needs, including electricity. Under the latest projections, this would lead to a substantial increase in emissions from the electricity sector. The potential for reducing emissions from the agriculture sector is seen as minimal. Mitigation actions thus focus on renewable power, energy efficiency, electrification, and reforestation.[7]

D. Climate Finance Policy Framework

9. Key strategic pillars of climate finance framework have been established. The National Climate Finance Policy (2018) aims to put in place an institutional and reporting frameworks to

[5] Compared to other East African Community (EAC) countries, Kenya's updated NDC is broadly in line with that of other countries. Kenya's updated NDC pledges to (mostly) conditionally reduce GHG emissions by 32 percent against the BAU in 2030. Reductions in other EAC countries are also conditional on international support. Emission reduction pledges in the region vary from 68 percent in Ethiopia to 12 percent in Burundi. Finally, 2019 estimated emissions in Kenya, Rwanda and Uganda are below their respective NDC, while those Tanzania, Burundi and Democratic Republic of Congo are above their NDC.

[6] Ministry of Environment and Natural Resources (2016). Kenya's Nationally Determined Contribution.

[7] National Reducing Emissions from Deforestation and Forest Degradation (REDD+) Strategy, Government of Kenya, December 2021.

access and manage climate finance, including by enhancing the implementation of public finance management (PFM) in relation to climate financing; establishing mechanisms to mobilize internal and external climate finance, tracking and reporting on financing sources, applications and impacts of climate finance; and encouraging private sector participation in climate financing opportunities. The forthcoming Green Fiscal Incentives Framework Policy to collect stakeholder comments is expected to provide guidance on priority fiscal policies and incentives that would promote climate adaptation and mitigation actions across sectors.[8] The policy is intended to help incentivize climate actions specified in the NCAPP, with the overall goal of promoting the development of a domestic green bond market.[9]

10. **However, regulatory fragmentation and inadequate coordination mechanisms prevent private sector investment in climate adaptation and mitigation.** Although the legal and institutional frameworks are robust in promoting climate policies and actions across sectors, the coordination on climate finance is relatively weak. The Climate Finance and Green Economy Unit in the NT is responsible for coordinating all climate finance activities in the country and acts as the National Designated Authority for the Green Climate Fund. Yet, key funding mechanisms, including the Adaptation Fund, the Global Environmental Facility, and the Climate Investment Funds, are coordinated by other agencies such as the National Environmental Management Agency (NEMA) and sector ministries/agencies. Various project pipelines are not coordinated from PIM perspective, as required by the PIM regulations, nor fully integrated into the budget planning and preparation processes.

11. **The authorities recognize that additional efforts are needed to incentivize large- and small-scale private investments in key sectors, such as renewable energy, water resources, agriculture, and land-use and forestry.** There is also a need to promote critical low-carbon technologies, including clean energy options to displace fossil fuels in the power generation sectors, electrifying transport with clean electricity, and scaling-up water harvesting technologies. While the draft National Green Fiscal Incentives Policy Framework provides a useful guidance to support the country's NCCAP, more needs to be done to translate the guidance into an implementation framework and put into effect the listed priority fiscal incentive measures.

E. Macro-Fiscal Implications of Climate Change Policies

12. **Exposures to recurrent natural disasters and climate change incurs repeated economic losses with fiscal implications.** Natural disasters destroy capital and reduce output in the short run. Government spending needs rise due to reconstruction costs and fiscal transfers to support those affected, while the disruptions of economic activities reduce government revenues. As a result, fiscal

[8] Draft was published in January 2023 to collect stakeholder comments. It was sent to Cabinet in May 2023 for approval and adoption.

[9] Kenya's Sovereign Green Bond Framework was prepared to set guidelines on the characteristics of the sovereign green bond, including use of proceeds, the process for project selection and evaluation, green bond taxonomy, management of proceeds, and reporting progress and impact requirements. The Framework is aligned with the Green Bond Principles, Climate Bonds Standards, European Union Green Bond Standards, and International Capital Market Association Standards.

deficit deteriorates and public debt increases. Additionally, large reconstruction needs worsen BoP balance and put significant pressure on reserves and external sustainability. Overtime, the multifaceted impact of climate change is particularly challenging, where higher frequency and intensity of disasters aggravate the disaster-related macroeconomic and fiscal implications and result in a gradual permanent reduction in productivity. Kenya is assessed as being at a high risk of overall and external debt distress; adverse impacts of natural disasters and climate change could pose significant fiscal risks to Kenya (see DSA).

13. Accelerating investment in adaptation infrastructure could help mitigate the negative impact of natural disasters while reducing macroeconomic and fiscal risks. The potential benefit of adaptation investment is illustrated through model simulations using the IMF DIGNAD model (Annex IV). Simulations show that investing in adaptation infrastructure, while stepping up efforts to mobilize climate finance and improve public investment efficiency could reduce output losses when disaster hits. Public debt would stabilize significantly below the level in the baseline scenario, while adaptation investment would contribute to a declining debt trajectory over the long run, due to smaller and less persistent output losses and lower post-disaster reconstruction costs.

14. Improved PIM efficiency could further mitigate the growth-debt tradeoff for adaptation investment. DIGNAD model simulation results illustrate that improving Kenya's public investment efficiency could strengthen output resilience against natural disasters and put the debt path on a downward trajectory. The results underscore the importance of PIM reforms that could help amplify the benefits of adaptation investment. Reaping the full benefits of public adaptation projects will require institutional reforms and capacity building to enhance the quality and efficiency of public investments.

F. Costs of Climate Mitigation and Adaptation Investment

15. Climate-related physical risks negatively affect both supply and demand sides of Kenya's economy. On the supply side, natural disasters destroy physical capital and disrupt labor and supply chains. On the demand side, natural disasters damage household and corporate balance sheets, reduce consumption and investment, in addition to disruption to tourism activities, these negative shocks can lead to lower growth and employment, interruption in capital accumulation, and slower poverty reduction. Further, post-disaster spending increases public debt and can threaten fiscal sustainability and financial stability.

16. To mitigate these risks and adapt to climate change is estimated to require investments in the order of US$ 62 billion through 2030. Kenya's updated NDC estimates that climate-related investment needs amount to US$62 billion by 2030 (about 7.4 percent of the 2022 GDP per year over 2023–30). On mitigation, Kenya committed to cover 21 percent of the US$17.7 billion of estimated mitigation requirements between 2020 and 2030 from domestic sources, while the remaining 79 percent is subject to international support in the form of finance, technology development and transfer, and capacity building. The total estimated cost of adaptation actions up to 2030 is estimated at US$43.9 billion, of which 90 percent will require international support in form of finance, investment, technology development and transfer, and capacity building support, while 10 percent is to be financed from domestic sources.

G. Financing Needs

17. Current commitments for climate financing have fallen short of projected financing requirements. The latest audited data show that only US$2.4 billion was directed to climate related investments in 2018 (about ⅓ of Kenya's annual finance gap to achieve its updated NDC), of which nearly 80 percent for mitigation purposes.[10] While the updated NDC identifies that over 70 percent of climate related spending would be needed for adaptation and less than 30 percent for mitigation, a major part of public financing (55 percent) and almost 100 percent of foreign private climate-related investment financed mitigation activities, mostly renewable energy projects. No private investment was channeled towards adaptation efforts.

18. It is estimated that Kenya could mobilize a total of US$3.3 billion per year in climate finance over the prospective RSF program duration, of which US$1.3 billion per year in private climate finance and additional US$2 in official climate finance.[11] However, this would require addressing multiple challenges that prevent scaling up of climate finance flows to Kenya, including patchy climate data and information architecture; regulatory framework that lacks uniformity, consistency, and effectiveness; overlapping climate finance standards, compliance, and reporting practices; and inadequate implementation capacity, especially on county level.

19. Several possible causes for market failure potentially holding back private adaptation investment in Kenya could be addressed by the government. Kenya has been engaged in managing climate change and successfully engaged in climate and green investment (e.g., government work with Green Climate Fund (GCF), and private issuance of the first green bond). While financial resources for climate investment seem to be in principle available to the Kenyan economy, this financing does not seem to reach the private sector for financing adaptation. This could have several reasons that would need to be addressed with appropriate government interventions:

- *Mismatch in the supply and demand of financing instruments*. There could potentially be a mismatch between the design of financing products offered by the market and the form of

[10] The analysis by the Climate Policy Initiative, The Landscape of Climate Finance in Kenya, estimated public climate finance at US$1.4 billion, including funding from own revenue (US$0.33bn), state enterprises (US$0.4 billion), external funding outside the budget ($0.4 billion) and external inside the budget (US$0.3 billion). The analysis also estimated private climate finance at US$1 billion, including foreign investors (US$0.6 billion) and Kenyan investors (US$0.3 billion).

[11] The report highlights that Kenya's funding gap constraints its response to climate-induced challenges over the short term. However, the report's assessment is more salient over the long term, contingent on several assumptions with a high level of uncertainty, including that (i) climate-spending levels will be maintained at the current level of 10 percent of total expenditure; (ii) there will be an underlying "natural growth" in private climate finance in Kenya that follows the average global growth trends prior to COVID-19; and (iii) the underlying 'natural growth' in private climate finance to Kenya will accelerate from the current 10 percent to 15 percent due to the authorities' robust reforms to mobilize climate finance. (Kenya Climate and Nature Financing Options Analysis, World Bank, 2022).

financing needed for adaptation investment. For example, while small farmers and households would require micro credits to finance their adaptation investment needs, the external financing coming in the form of large-scale bonds or loans might not be suitable and would need to be repacked through the banking sector.

- *Cost of financing for adaptation investment*. The financing costs depend on the risk the lender perceives from providing the loan. If lenders lack experience with the specific nature of adaptation projects, they do not have sufficient information for fully assessing the risk and for pricing the risk efficiently, leading to higher risk premia.
- *Lack of borrowing capacity*. The private borrower might not have the capacity to borrow due to lack of secure income or collateral. Insecure land tenure and land fragmentation can be one factor undermining the availability of collateral and thus the borrowing capacity of households and small hold farmers.

H. RSF Support and Related Reforms

20. To meet its ambitious climate goals, additional efforts will need to focus on addressing outstanding institutional, regulatory, and structural challenges. This includes enhancing climate data and information architecture, strengthening effectiveness and coordination of Kenya's regulatory frameworks, streamlining government systems and processes, realigning spending priorities, motivating large- and small-scale investments in adaptation, and integrating public project pipelines into budget planning and preparation processes. Reform measures (RMs) underpinning the 20-month RSF-supported program will address some of these challenges while supplementing development partners' active involvement in Kenya's climate agenda (see the next section and Text Table 5 in the main report).

21. RMs implemented under the RSF will seek to support reforms that facilitate large-scale climate investments, reduce barriers and risks, and enhance the investment environment, thereby stimulating alternative financing sources beyond the scope of the government budget. They are expected to improve expenditure composition by prioritizing climate investment, including in disaster risk mitigation, and promoting critical low-carbon technologies. They are also expected to help enhance public investment efficiency mobilize large- and small-scale adaptation investments in key sectors, including by developing a green finance taxonomy to attract private climate finance and scale up climate investments.

22. The RSF resources are expected to bolster Kenya's pressing climate financing requirements, while reinforcing the authorities' ambitious climate reform agenda and helping mobilize additional climate finance. Given Kenya's susceptibility to macro-critical risks stemming from climate change and natural disasters, the RSF arrangement will furnish the necessary resources to address climate-related vulnerabilities within the country and its resources will serve as a substitute for costlier domestic financing options, such as the issuance of national saving certificates with high interest payments. By doing so, it will foster an improved expenditure composition that prioritizes green development and social spending. Consequently, this will contribute to a sustainable green economic growth while ensuring an adequate level of foreign exchange reserves to mitigate the impact of multifaceted external shocks.

I. Collaboration with Multilateral Partners

23. Kenya actively engages with its developing partners to advance its ambitious climate agenda. For example, the World Bank support is focused on enhancing the country's social safety nets, implementation of climate-smart agriculture practices, developing climate-resilient infrastructure (such as water management systems and renewable energy projects), strengthening climate risk management and disaster preparedness, including early warning systems and contingency planning. The assistance by the USAID and the African Development Bank (AfDB) focuses on developing a carbon market framework. The European Union, through its Climate Change Directorate, and in collaboration with the Financial Sector Deepening (FSD), Nairobi Securities Exchange (NSE), and Kenya Bankers Association (KBA), is supporting the Kenyan authorities in updating Kenya's sovereign green bond framework. This includes developing a robust green finance taxonomy, strengthening methodologies and data collection practices, and helping implementing budget tagging as recommended by the 2022 Public Expenditure and Financial Accountability (PEFA) assessment. Similarly, UK and Kenya have agreed to fast-track six green investment projects worth US$ 4.1 billion spanning energy, agriculture, and transport sectors. Development partners are also playing an instrumental role in helping the Kenyan authorities bolster the country's climate resilience through the Financing Locally Led Climate Action (FLLoCA) project, which aims to enhance the channeling of climate finance to the county level through the national government's PFM systems. With support from the World Bank, Denmark, Sweden, the Netherlands, and KFW, FLLoCA prioritizes county and community-focused initiatives, allocating a significant share of funds through performance-based grants.

Annex IV. Illustration of Macro-Fiscal Implications of Climate Change Adaptation in Kenya

1. **The Debt, Investment, Growth, and Natural Disaster (DIGNAD) model is a dynamic stochastic general equilibrium (DSGE) model designed to study the effects of public investment on economic growth and debt sustainability.** Through its simulations, the model presents macro-fiscal outcomes associated with public adaptation investment, economic growth, and debt, relative to those at steady state. In the model, natural disasters are expected to affect the economy through five channels: (i) damages to public capital, (ii) damages to private capital, (iii) a temporary productivity loss, (iv) a decline in public investment efficiency, and (v) a loss in credit worthiness. The model incorporates considerations of inefficiencies in public investment and the limitations posed by absorptive capacity constraints.

2. **The model is calibrated specifically to the Kenyan economy.**[1] The model's steady state aligns the level of standard capital infrastructure investment with projected values for 2023, amounting to 4.2 percent of GDP. Data on public debt level, constituting 68.4 percent of GDP at end-2022, are sourced from the latest DSA. Kenya, having access to international capital markets, possesses a public external debt divided between concessional debt at 26.2 percent of GDP and commercial debt at 8.3 percent of GDP. Grants and remittances are derived from a ten-year average utilizing historical data from the IMF.

3. **To illustrate the macro-fiscal implications of climate change adaptation for Kenya, the following scenarios are considered**:

- **Scenario 1:** *No policy change*. The steady-state scenario assumes the authorities continue investing in standard capital infrastructure and do not scale up investment for adaptation infrastructure during years 1–5. A natural disaster is simulated to occur in year 6 and is calibrated to yield 9 percentage decline in GDP, in line with Kenya's historical losses from natural disasters.[2] Recovery is assumed to start in the same year the shock occurs, and to be completed in five years.
- **Scenario 2:** *Some adaptation investment along with moderate improvements in mobilizing climate finance and increasing public investment efficiency (PIE)*. Scenario 2 assumes 0.5 percent of GDP per year is spent on adaptation investment, 2.5 percent of GDP in total over five years. This is financed through concessional public borrowing of about 0.5 percent of GDP of concessional debt corresponding to the RSF request amount, comprising four disbursements until 2025. In addition, the authorities are assumed to enhance their ability to attract climate financing and raise in total 2.5 percent of GDP in grants over the five years.

[1] Francine Nyankiye (AFR), Cian Ruane and Azar Sultanov (both RES) provided valuable support in calibrating DIGNAD model to the Kenyan economy.

[2] The model's calibration assumes one-off 9 percentage points decline in real GDP growth, pro-rated from the 2008–11 drought, which caused widespread losses and damages creating a need for recovery and reconstruction public spending estimated at US$ 1.8 billion and slowed real GDP growth by an average of 2.8 percent a year (see Kenya: Post Disaster Needs Assessment).

Finally, the scenario assumes improvements in PIE of 9 percentage points, allowing Kenya's PIE levels to reach the average PIE for Sub-Saharan Africa (SSA) economies, 61 percent.[3]

- **Scenario 3:** *Robust adaptation investment along with significant improvements in mobilizing climate finance and increasing PIE*. Scenario 3 assumes adaptation investment scale-up by 1.5 percent per year (7.5 percent of GDP in total over five years), financed through concessional public borrowing of about 0.5 percent of GDP of concessional debt corresponding to the RSF request amount (4 disbursement until March 2025). In addition, the authorities are assumed to significantly step up their efforts in attracting climate financing, raising 10 percent of GDP in grants in years 2-5. This scenario also assumes that Kenya's PIE improves by 25 percentage points, reaching SSA's PIE frontier set by Ghana (80 percent).

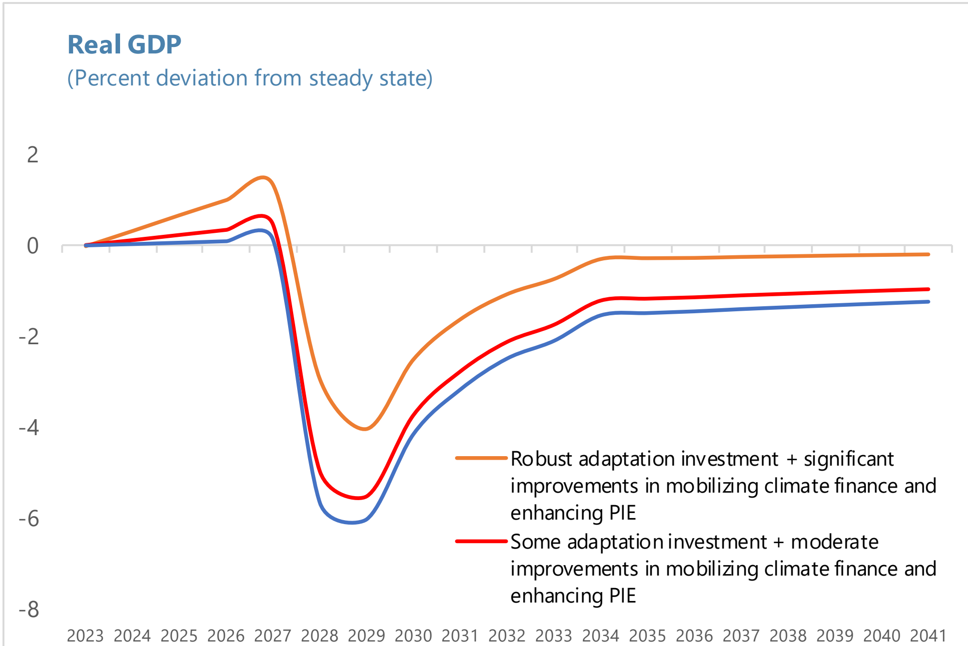
4. DIGNAD simulations illustrate the importance of pursuing adaptation investments while mobilizing climate finance and improving public investment efficiency (Figure AIV.1). Investing an additional 1.5 percent of GDP in adaptation infrastructure while continuing to mobilize climate finance and strengthen PIE over the next five years could save Kenya nearly 3 percent of GDP in output loss when disaster hits. While investing in adaptation infrastructure would result in higher public debt in the three years preceding the shock, it would stabilize at 75.1 percent of GDP by the end of the 5-year post-shock recovery, significantly below the level in the baseline (80.8 percent of GDP). In addition, adaptation investment would contribute to a declining debt trajectory over the long run, due to smaller and less persistent output losses and lower post-disaster reconstruction costs.

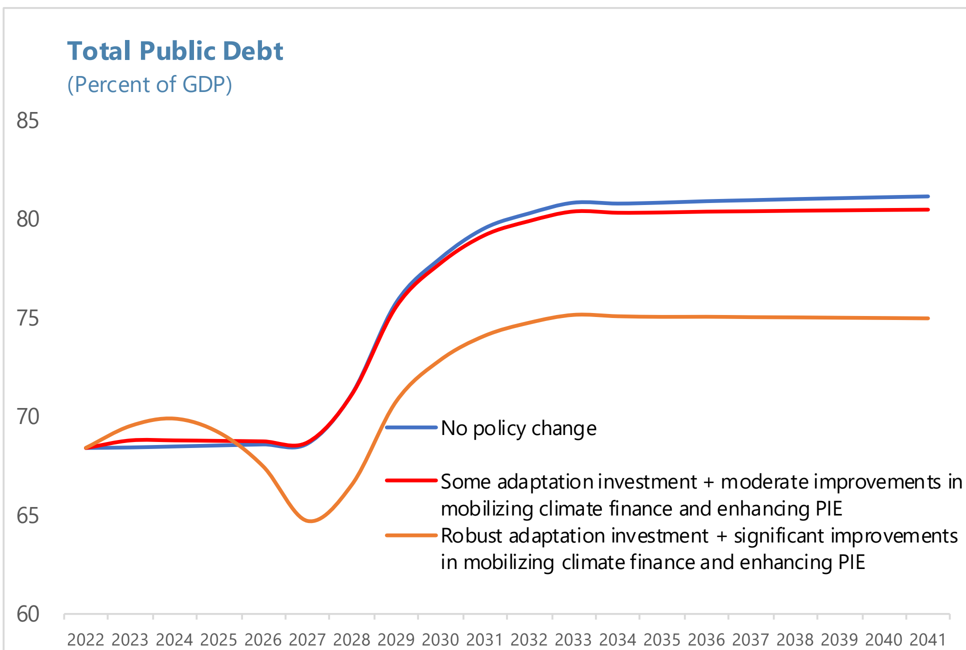
5. Simulations also show how adaptation investments could enhance the economy's ability to withstand climate-related shocks. For instance, increased public investment in climate-resilient infrastructure would safeguard Kenya from adverse impacts of climate change. Similarly, greater public expenditure in sustainable agriculture and forestry practices could help shield the agricultural sector from the negative impacts of climate-induced crop failure and livestock loss. Likewise, augmenting investments in early warning systems and disaster risk management would enable Kenya to prepare for and respond more effectively to climate-related disasters. Recognizing the current limitations of Kenya's fiscal space, increasing adaptation investment should go in hand with stronger efforts in mobilizing additional climate financing from official and private sources.

6. While investing in adaptation will increase the resilience to climate change, it is neither cost-efficient nor even possible to eliminate all climate related risks. In this regard, additional efforts will need to focus on improving the design of and preparing for the implementation of contingency plans and social safety nets to alleviate residual risks and reduce total climate change costs.

[3] The World Bank's Public Investment Management Assessment database shows varying levels of public investment efficiency in SSA countries in 2022. Efficiency ranged from as low as 30 percent in countries like the Central African Republic, Angola, Burundi, and Somalia, to as high as 80 percent in Ghana.

Figure AIV.1. Kenya: DIGNAD Model Simulation Output





Appendix I. Letter of Intent

Nairobi, Kenya, June 29, 2023

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

Dear Ms. Georgieva:

The Kenyan economy has remained resilient despite a challenging external and domestic environment. Following the COVID-19 pandemic, Kenya has over the past year suffered a series of devastating shocks, including the worst drought in decades as well as negative spillovers from the war in Ukraine and tighter global financial market conditions. These shocks entailed considerable hardship for our population, including from higher prices of essential commodities. Nevertheless, reflecting the remarkable resilience of the Kenyan economy, real GDP growth remained robust at 4.8 percent in 2022. With the recent rains having been adequate, a rebound in agricultural production is underway and food price inflation has started to come down.

Our economic policies are anchored on the new administration's bottom-up economic transformation agenda. The aim is to move from public sector investment led growth to dynamic private sector led growth. The agenda prioritizes support to high-impact areas, including agricultural transformation; micro-, small- and medium-sized enterprises; housing; healthcare; digital superhighway and creative industry. It places special focus on employment, equitable distribution of income, and social security while expanding the tax base and increasing foreign exchange earnings. Key initiatives include establishment of a Financial Inclusion (“Hustler”) Fund that provides low-cost micro-loans; increased contribution to the National Social Security Fund to strengthen the social safety net and raise national savings; enhanced provision of water infrastructure and affordable housing through public-private partnerships; and privatization of some state-owned enterprises.

The government remains fully committed to the policies and reforms underpinning the objectives of the IMF-supported program. The administration intends to continue bolstering economic resilience by pursuing prudent policies geared at ensuring macroeconomic stability, reducing debt vulnerabilities, and supporting sustainable and inclusive development. In the face of a challenging environment, we have taken resolute actions to protect macroeconomic stability, including by tightening both fiscal and monetary policy. To this end, the Supplementary II Budget for FY2022/23 and the Budget for FY2023/24 are expected to reduce deficit levels from what was originally planned under the program. In addition, the central bank policy rate has been increased by a total of 350 basis points since May 2022.

Despite the difficult environment, Kenya's program continues to perform toward its objectives. The end-December 2022 quantitative performance criteria (PC) for tax revenue, primary balance, and net international reserves were all met by substantial margins, as was the indicative target (IT) on priority social expenditure. However, the IT on exchequer requests outstanding for more than 90 days was missed due to liquidity constraints, and the end-December 2022 monetary policy consultation clause (MPCC) was triggered as inflation was above the target band (see Attachment II). The structural benchmarks (SBs) for the period January-April 2023 were met. But for end-December 2022, the SB on action plan for Kenya Power and Lighting Company was completed with a delay, while the SB on review of the fuel pricing mechanism remains outstanding and we propose to reset it to end-July 2023. We have already constituted a task force to review the fuel pricing mechanism. The end-June 2023 SB on submission to the National Assembly of draft AML/CFT amendments is on-track.

Looking ahead, given the balance of payments pressures resulting from the challenging external environment, we request an extension of the EFF/ECF arrangements from the current 38 months to 48 months (to April 1, 2025) and augmentation of access amounting to 75 percent of quota (SDR407.10 million) for balance of payments support as well as modification of program conditionalities. We request the augmentation of access to be split between GRA resources (43.5 percent of quota; SDR236.12 million) and PRGT resources (31.5 percent of quota; SDR170.98 million). The request to extend the duration of EFF/ECF is to allow sufficient time to meet program objectives with a rephasing of the budget support under the EFF/ECF arrangements over the extended duration. We also request modification of the end-December 2023 PCs on net international reserves and its adjustors (see Attachment III). In addition, for the end-June 2023 quantitative performance criteria under the EFF arrangement, based on preliminary information, we request waiver of nonobservance on the tax revenue target and waiver of applicability for all other end-June 2023 PCs. We have taken corrective tax revenue measures to ensure that this nonobservance is temporary and does not impact the performance under the FY2023/24 targets.

Given Kenya's vulnerability to climate change, building a more climate resilient economy is of the utmost importance to us. We have stepped up our climate adaptation and mitigation efforts to support a transition to a low carbon growth trajectory. To support our climate change efforts and catalyze additional climate finance from other official and private partners, we are also requesting support under a 20-month Resilience and Sustainability Facility (RSF) with access totaling SDR407.1 million (75 percent of quota) to be provided to the government as budget support.

We consider that our policies described in the attached Memorandum of Economic and Financial Policies are adequate to achieve the program objectives under the ECF/EFF and the RSF. We remain committed to a multi-year fiscal consolidation, supported by domestic revenue mobilization and expenditure rationalization, to put the ratio of overall public debt to GDP on a downward trajectory. With inflation having risen above the target band, our monetary policy actions will remain focused on maintaining price stability by resisting second-round effects from higher food and fuel prices and keeping inflationary expectations well anchored while ensuring external sustainability, including building up of FX reserves consistent with program objectives. Exchange rate flexibility will work as a shock absorber in the face of frequent external shocks to help support our competitiveness, protect reserves, and facilitate efficient functioning of our foreign exchange market. We are also committed to advancing the reforms under the RSF to build a climate resilient economy. We will ensure that these policies are mutually reinforcing in support of maintaining macroeconomic stability and resilience, ensuring fiscal and debt sustainability, and enhancing buffers against shocks.

We stand ready to take additional measures to meet the objectives of the program, and we will consult with the IMF in advance of any necessary revisions to the policies contained in this letter and attached memorandum, in line with Fund policies on consultations. We will provide Fund staff timely with all the data and information needed to monitor the economic situation and implementation of policies relevant to the programs, as agreed, under the attached Technical Memorandum of Understanding, or at the IMF's request. We have also finalized a Memorandum of Understanding (MOU) between the CBK and National Treasury that clarifies the responsibilities for timely servicing of the financial obligations to the IMF under the RSF arrangement.

We authorize the publication of this Letter of Intent, the attached Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding, and the related staff report and supplements, after approval by the Executive Board of the IMF.

Sincerely yours,

/s/	/s/
Prof. Njuguna Ndung'u	**Dr. Kamau Thugge**
Cabinet Secretary	Governor
National Treasury & Economic Planning	Central Bank of Kenya

Attachments (3):

I. Memorandum of Economic and Financial Policies (MEFP)
II. Consultation with the IMF Executive Board on the Missed Inflation Target Under the MPCC
III. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies

Nairobi, Kenya, June 29, 2023

I. BACKGROUND

1. **The Kenyan economy remains resilient despite a multitude of shocks over the past year.** While the 2023 long rains have been good, the country continues to recover from the worst drought in decades. Before the onset of the long rains in 2023, agricultural activities and livestock production had been adversely affected leading to food insecurity. On the global front, Kenya was adversely affected by the war in Ukraine, which led to increased costs of essential imported commodities such as food, fuel, and fertilizer. In addition, the rapid pace of monetary policy tightening in the advanced economies led to a significant increase in borrowing costs, shutting frontier economies out of the market. As a result, Kenya had to defer plans for a US$1.1 billion Eurobond issuance in FY2021/22. On the positive side, following the peaceful transition to the new administration after the August 2022 elections, the government has started to implement measures to maintain stability and confidence in the economy.

2. **The economy expanded by 4.8 percent in 2022.** On the supply side, growth was supported by the services sector, with post-COVID-19 recovery in the hospitality sub-sector continuing, and strong growth recorded in the areas of transport and storage, information and communication, and financial, professional, administrative, and support services. However, agriculture recorded negative growth for the second consecutive year due to the drought, which also contributed to a slowdown in growth in manufacturing and in wholesale and retail trade. On the demand side, private consumption slowed, and total investment declined, particularly in the public sector. The contribution from net exports to growth went up, as exports rose while non-oil goods imports declined, reflecting the completion of large, import-intensive infrastructure projects and rationalization of the pipeline of public investments projects. High frequency indicators point to continued resilience of the economy into the first half of 2023.

3. **Headline inflation has remained above the target range of 2.5–7.5 percent since June 2022.** Inflation increased from 5.4 percent y/y in January 2022 to peak at 9.6 percent y/y in October 2022. Inflation stayed above 9 percent through March 2023 before decelerating to 7.9 percent in April and 8 percent in May on the back of easing food price inflation as rains set in. Inflation over the past year has been largely driven by higher food prices. The removal of fuel subsidies, which was largely accomplished last September, as well as cost-based upward adjustments in electricity prices, including the broad-based upward adjustment in base prices for electricity tariffs that came into effect in April, have also contributed. On May 14, the energy regulator announced new fuel prices eliminating cross subsidization across fuel products. Non-food, non-fuel (NFNF) inflation has inched up as well but remained below 4.5 percent amid some slowdown in demand last year. NFNF inflation declined to 4.3 percent in May 2023 from 4.4 percent in February. To anchor inflation expectations, we have tightened monetary policy by increasing the Central Bank Rate (CBR) by 350 basis points cumulatively between May 2022 and June 2023.

4. The current account deficit in 2022 remained stable to the negative spillovers from the war on Ukraine. Despite the upward pressure on the import bill from the elevated global prices of essential commodities, such as oil derivatives, cereals, and fertilizers, the merchandize trade balance remained broadly unchanged at 10 percent of GDP in 2022, as a result of the higher prices for Kenya's main agricultural exports (tea, horticulture, and coffee) and consumer and intermediate goods exports in 2022, and a slowdown in capital goods imports. The latter reflects the completion of large, import-intensive infrastructure projects and the rationalization of the pipeline of public investments. Tourism receipts rebounded faster than anticipated to their pre-COVID-19 level and remittances remained robust.

5. A Supplementary FY2022/23 Budget was approved by Parliament in February 2023. The Supplementary targets an overall fiscal deficit of 5.7 percent of GDP (against 5.8 percent of GDP under the original budget and 6.2 percent of GDP in FY2021/22). This reflects efforts to enhance revenue mobilization and reprioritize expenditures while protecting social spending and recognizing financing constraints. On the revenue side, the Supplementary reflects increased efforts to mobilize non-tax revenues, especially related to trade transactions (IDF fee). On the expenditure side, the Supplementary aims to contain spending by continued rationalization of non-priority projects, while recognizing unbudgeted outlays that emerged during the election period. On the financing side, the Supplementary reflects the upscaling of the FY2022/23 World Bank Development Policy Financing (DPF), which has reduced reliance on more expensive sources of financing.

6. Debt vulnerabilities remain high despite a narrower than previously anticipated fiscal deficit. As at end-December 2022, the PV of overall public and publicly guaranteed debt (in gross terms and as defined in the accompanying IMF-WB debt sustainability analysis) stood at 63 percent of GDP, which is higher than the planned medium-term debt anchor of 55 percent of GDP but is projected to decline further to 60 percent in 2025.

7. The banking sector has remained stable and resilient. Core and total capital adequacy ratios as of March 2023 were 15.5 and 18.4 percent, respectively—above the statutory minimum of 10.5 and 14.5 percent, respectively. At the same time, the liquidity ratio stood at 49.9 percent, well above the statutory minimum of 20 percent. Growth in private sector credit stood at 11.6 percent in March 2023 compared to 12.7 percent in December 2022, with strong credit growth observed in manufacturing, transport and communication, and trade and consumer durables.

II. MACROECONOMIC OUTLOOK

8. The outlook remains positive, despite the challenging global economic landscape.

- We expect real GDP to grow at 5.0 percent in 2023 under the program baseline. A recovery in agriculture will contribute positively, even as a tighter policy environment will offset some of the positive momentum. Private consumption will strengthen as inflation eases and government initiatives support incomes at the bottom of the pyramid. Private investment will benefit from political stability and focus on public-private-partnership (PPP) projects. Finally, contributions from net exports will rise.

- Inflation has peaked and is projected to come back within the target band by no later than 2023Q3 but there are downside risks. Arrival of the rains and a recovery in agriculture as well as easing of global food and fertilizer prices will help lower domestic food price inflation. Energy price inflation is expected to ease from 2023Q3 on base effects even as cost-reflective adjustments in fuel and electricity prices and as passthrough from adjustments in the exchange rate continues. Nonfood, nonfuel inflation is projected to remain stable, with the tighter monetary policy expected to limit second-round effects.
- The current account deficit is projected at 4.8 percent of GDP in 2023, compared to 5.1 percent of GDP in 2022. The expected narrowing of the current account deficit in 2023 is driven by stronger goods exports growth than goods imports as the latter reflects impact from a) lower oil prices and exchange rate adjustment in 2023; b) level effect of the low capital imports last year in an environment of continued tight financial conditions and c) further rationalization of capital spending in the FY2023/24 budget. The services sector net balance is projected to improve on robust growth of tourism, and private remittances will continue growing.
- Over the medium term, growth is expected to converge toward 5.4 percent, with 2024 growth now projected at 5.2 percent under the program baseline. With fiscal consolidation measures implemented, private consumption and investment are expected to be the main growth drivers in the medium term. Inflation will return to the mid-point of the target band, and the current account deficit will stabilize around 5 percent of GDP.

9. The near-term economic environment is subject to unusually high uncertainty. The Kenyan economy, due to its large agricultural sector, is vulnerable to weather and climate conditions. Any adverse weather development (e.g., lower than expected rainfall or impact from the developing El Niño after a break of about three years) could worsen food insecurity, slow growth, and push food prices higher. Inadequate policy responses to shocks could undermine market confidence, exacerbate exchange rate and balance of payments pressures, and dampen private credit and consumption. This would have negative implications for growth and public debt. Materialization of public sector contingent liabilities and higher spending on security needs would also affect public debt dynamics. Kenya remains exposed to elevated uncertainty in the outlook for major economies— including from recent banking sector concerns—as well as to spillovers from developments in the region, including from Sudan. On the upside, rapid resolution of global uncertainty could support a stronger rebound in confidence, investment, and market access.

III. PROGRAM PERFORMANCE AND POLICIES

A. Program Objectives

10. Our primary policy objective is to maintain robust and inclusive growth. Our economic policy plans—supported by our EFF/ECF arrangements with the IMF—place a special focus on (i) promoting sound macroeconomic management through prudent debt policies and reforms to improve the efficiency of public spending and support competitiveness, and (ii) fostering good governance in public resource management. Our key policy priorities for the IMF-supported program remain. These include:

- ***Fiscal policy.*** Undertake growth-friendly fiscal consolidation to preserve debt sustainability by bolstering revenue primarily through broadening of the tax base and curtailing overall spending while prioritizing high-impact social and investment expenditure.
- ***COVID-19 response.*** Vaccinate all adults, ensure provision of required health services, address urgent needs of vulnerable groups, and support economic activity.
- ***Public financial management.*** Decisively increase the efficiency and transparency of public spending, including by SOEs, to eliminate waste and achieve better value for money.
- ***Governance.*** Enhance institutional oversight arrangements, strengthen preventive frameworks to improve accountability and foster good governance, and boost transparency.
- ***Monetary policy.*** Continued proactive approach to achieve Kenya's inflation objective in the face of persistent global shocks while strengthening the monetary policy framework by refining policy operations to keep short-term interest rates stable and close to the policy rate and supporting vibrant interbank markets.
- ***Access to affordable finance.*** Transform the banking sector to one that works "*for and with Kenyans*" and is anchored on pillars of customer centricity, risk-based credit pricing, transparency, and ethical banking.
- ***Financial stability.*** Safeguard financial stability by enhancing prudential regulation and supervision, strengthening operational tools in the context of increasing financial sector complexity and risks and ensuring smooth functioning of financial markets.
- ***Structural reforms.*** Deepen structural reforms to improve the business environment and boost investment, employment creation, and potential growth.
- ***Statistics.*** Improve data quality in line with international best practices to support economic policymaking, transparency, and accountability.

B. Program Performance

11. Most quantitative targets were met but structural reforms faced delays amid elections and political uncertainty ahead of the formation of the new government.

- *Quantitative performance criteria (QPCs, Table 1):* All end-December 2022 and continuous PCs since the last review were met. Tax collection and the primary balance overperformed by 0.3 and 1.3 percentage points of GDP, respectively. NIR overperformed the adjusted target by US$226 million.
- *Indicative targets (ITs, Table 1):* End-December 2022 target on priority social expenditure was met while the target on exchequer requests outstanding for more than 90 days was missed by 0.2 percentage points of GDP on tight liquidity conditions that constrained spending below budgeted levels.

- *Monetary policy consultation clause (MPCC, Table 1):* The MPCC was triggered for end-December 2022 as the three-month average of inflation (9.4 percent) was outside the inflation target band of 2.5–7.5 percent.
- *Structural benchmarks (SBs, Table 2):* The SBs for January-April 2023 were met while of the two SBs for end-December 2022, one was not met but implemented with a delay and the other one is outstanding. The SB for end-June 2023 is on-track.
  - A FY2022/23 supplementary budget (***end-January 2023 SB***) and a FY2023/24 Budget (***end-April 2023 SB***) consistent with program objectives were submitted timely to parliament.
  - A draft action plan to restore Kenya Power and Lighting Company (KPLC) medium-term profitability (***end-December 2022***) was implemented with a delay, with an action plan submitted to Cabinet in May 2023.
  - The review of the fuel pricing mechanism and establishment of a task force to oversee progressive elimination of the fuel subsidy (***end-December 2022 SB***) has been delayed and is now expected to be fully implemented by end-August 2023. Fuel subsidies, which had largely been removed in September 2022, were fully eliminated in May 2023 (i.e., no cross-subsidization). A taskforce to review the fuel pricing mechanism and ensure that fuel prices are at all times aligned to the approved budget has been constituted and its findings will be publicly communicated in August 2023.
  - We are on-track to submit by end-June 2023, the draft amendments to the POCAMLA and POCAMLR, to be in line with FATF standards addressing the legal and regulatory gaps identified in the Kenya Mutual Evaluation Report (MER) 2022 to support anti-corruption efforts to the National Assembly (***end-June 2023 SB***).

C. Fiscal Policy

12. Our fiscal policy path balances the near-term need to support the economy against the imperative of reducing debt vulnerabilities over the medium term. We remain focused on meeting the needs of the population as we recover from a devastating drought and continue to face several domestic and external challenges. Our policies cater to these needs while recognizing the difficult tradeoffs demanded by Kenya's limited fiscal space and continued financing constraints. Response efforts have therefore been carefully prioritized to limit further buildups in public debt. The focus of fiscal policy rests on reducing the deficit with a view to putting firmly the debt-to-GDP ratio on a downward path within the program period. This will help lower financing risks and facilitate an expansion of credit to the private sector, thus supporting economic growth. The fiscal consolidation path will be supported by revenue mobilization anchored on the medium-term revenue strategy (MTRS) that we are developing (¶28).

13. Revenue mobilization efforts have been affected by the slowdown in economic activity and the slow execution of the FY2022/23 Budget. Data to end-April 2023 suggests that revenue collection may fall short of the end-June 2023 target by about 0.7 percent of GDP on weaker than anticipated economic activity and slow execution of budgeted spending that directly affect VAT and

PAYE collection. Starting from April, the Kenya Revenue Authorities (KRA) has in response adopted several Rapid Revenue Initiatives (RRIs) to sustain collection and limit any potential revenue shortfall. We expect the RRIs to yield 0.4 percent of GDP in FY2022/23 by fast-tracking ongoing compliance checks and audits at the Large Taxpayer Office; settling well-identified disputes on tax debt; and providing incentives for timely tax payment. We expect this will contain the potential tax shortfall at end-June.

14. The persistence of tight financing conditions is affecting our cashflow and constraining our ability to execute the budget in a timely manner. On the external side, monetary and financial developments in advanced economies precluded many emerging and frontier economies—including Kenya—from accessing international capital markets. On the domestic side, we have observed lower investor appetite for government paper especially at longer maturities. This, alongside the slowdown in economic activity, has constrained our ability to execute the approved budget and delayed clearance of outstanding expenditure obligations. As a result, we missed the end-December 2022 target on non-accumulation of Exchequer requests outstanding for more than 90 days.

15. We have submitted the FY2022/23 Supplementary II Budget to maintain the primary deficit in line with the consolidation path envisaged under our program. The Supplementary II Budget, which we submitted to Parliament on June 14, 2023, targets a primary deficit of Ksh.158 billion (Ksh.148 billion in Supplementary I budget). On the revenue side, Supplementary II recognizes the ongoing efforts that we are making to reverse the emerging slowdown in tax mobilization and contain the deviation from the end-June tax target within 0.2 percent of GDP (¶13). On the expenditure side, while protecting social spending, Supplementary II introduces savings on non-essential primary expenditures for Ksh.30 billion (0.2 percent of GDP), mainly affecting undisbursed funds of development projects with low absorption.

16. The Supplementary II was approved by Parliament on June 22. While broadly in line with program objectives, it presented a slightly wider primary deficit compared to the proposal submitted to Parliament. The small deviation reflected reinstatement of some expenditure items amounting to Ksh.5.7 billion (0.04 percent of GDP) by Parliament. This change notwithstanding, the Government remains fully committed to the program target. In this regard, the National Treasury will ensure that the end-June 2023 primary balance outturn will not exceed the programmed deficit target of Ksh.158 billion through strict control of expenditure commitments and execution without adding to unpaid bills.

17. We are strongly committed to ensuring that current cashflow difficulties do not result in accumulation of arrears at end-June 2023. To this end, we will: i) take the necessary steps to ensure efficient operation of the government securities market to support liquidity (¶28); ii) prioritize clearance of exchequer requests submitted in our payment system (IFIMIS) prior to end-March 2023; iii) limit any potential carryover to FY2023/24 of exchequer requests introduced in IFIMIS after April 1, 2023, and having a corresponding budget appropriation in the FY2023/24 budget, consistent with the "first charge" principle enshrined in our Public Finance Management Regulations, 2015, Section 42(a) and the National Treasury Implementation Guidelines issued at the beginning of the execution of budget each year; iv) instruct Ministries, Departments, and Agencies (MDAs) to carefully prioritize execution of FY2023/24 commitments with a view to clear any potential carryover within end-September 2023; and v) submit to Parliament by end-October 2023 a Supplementary FY2023/24 Budget (***proposed SB***) to ensure that clearance of any potential carryovers from FY2022/23 does not undermine achievement of our fiscal targets for this and next fiscal years. Moreover, to demonstrate our strong commitment to avoid accumulation of arrears, we propose to broaden the scope of the indicative target on exchequer requests under the program to include also transfers to Counties, State Corporations (SCs), Semi-Autonomous Government Agencies (SAGAs) and private sector for the purpose of any subsidies (***proposed revised IT***, TMU¶27). Our efforts will be further supported by the adoption of a comprehensive strategy to deal with the long-standing issue of pending bills and address weaknesses in PFM systems to avoid future accumulation (¶26, ***proposed SB***). In this connection, we also propose to monitor net accumulation of arrears (TMU¶30) under the program (***proposed IT***).

18. On April 27, we submitted to Parliament a FY2023/24 Budget proposal targeting a stronger improvement in fiscal balances than previously. The proposal envisages an overall fiscal deficit and a primary balance surplus at respectively 4.1 and 0.7 percent of GDP (previously 4.4 and 0.3 percent of GDP). The stronger projected outturn reflects the adoption of a comprehensive revenue package for 1.6 percent of GDP (Text Table). Besides introducing new tax measures for 0.9 percent of GDP consistent with the achievement of our tax objectives under the Fund-supported program, this package contains several other revenue measures to ensure that the slowdown in tax collection experienced in FY2022/23 does carry over to the following fiscal year. On the expenditure side, the proposal carries forward our efforts to rationalize primary expenditures, especially related to slow-moving/stalled projects and transfers to public sector institutions, while protecting resources for priority social programs.

Text Table 1. Kenya: Revenue Package Underpinning the FY2023/24 Budget Proposal

In Percent of GDP	Projected Yield
Total Revenue Package	**1.6**
2023 Finance Bill	**1.5**
Tax measures	0.8
Income	0.2
VAT	0.4
Excise	0.2
Other revenue measures	0.7
Administrative	0.6
Non-tax	0.1
Custom Taxes	**0.1**
Memorandum:	
Total Tax Policy Measures (Finance Bill and Custom Measures)	***0.9***

19. Going forward, we remain committed to the program path for fiscal consolidation over the medium term, with a view to reducing debt vulnerabilities. A key priority will be to raise the ratio of revenue-to-GDP to well above pre-COVID-19 levels to create space for growth-enhancing investments and priority social spending. To achieve this, we plan to introduce additional tax policy measures to yield 0.3 percent of GDP in FY2024/25. We will also continue to contain recurrent expenditure as a ratio to GDP, by limiting the growth in the wage bill and transfers to public companies, while protecting priority social spending and keeping development spending close to 5 percent of GDP.

20. Uncertainties associated with global and domestic shocks entail high risks to our fiscal program and reinforce the need for contingency planning. The uncertainty is particularly pronounced for government revenues, as rapid changes in the macroeconomic context—including from further ramifications of the war in Ukraine and social opposition to change could depress tax receipts. To ensure that program performance objectives are met, any tax revenue shortfall relative to program targets will be compensated for by taking additional tax policy measures, drawing from the work done in the context of the MTRS with the support of the IMF. In this regard, should the approved 2023 Finance Bill result in a weakening of the revenue package (1.6 percent of GDP) underpinning the Budget proposal and/or FY2022/23 tax underperformance is larger than anticipated at the time of the submission of Supplementary II FY2022/23 Budget (¶13), we will take a number of corrective tax measures with a view to ensuring achievement of our FY2023/24 tax targets. These measures could include: i) streamlining by end-July 2023 the VAT apportionment ratio of allowable inputs VAT on exempt supplies to align it with international practices and reduce VAT exemptions; and ii) submitting to Parliament by end-October 2023, along with a Supplementary FY2023/24 Budget, a package of legislative changes to strengthen tax collection (***proposed SB***)—including but not limited to the adoption of a motor vehicle circulation tax and the reduction of tax exemption on interest income. We also stand ready to further curtail non-critical spending, if this should become necessary, to offset further spending pressures.

21. We attach high priority to management of fiscal risks. The recently established Fiscal Risk Committee (FRC)— within the National Treasury (NT)—will help monitor and assess fiscal risks, including risks related to contingent liabilities from PPPs. The inaugural meeting of the FRC took place on December 2022 and will be holding quarterly meetings consistent with the approved FRC meeting calendar.

D. Fiscal Structural Reforms

22. We will continue to reform our tax system to improve revenue collection, building on our MTRS. The MTRS will strengthen tax compliance to achieve our objective of increasing revenue mobilization by 8 percentage points of GDP by 2030, while supporting global competitiveness and prosperity consistent with Kenya's Vision 2030. We will submit to Cabinet for approval the draft of the MTRS with an implementation plan and mechanisms to oversee its implementation by end-October 2023 (***proposed SB***). We expect the MTRS to be submitted to Parliament by end-December 2023 with a view to start implementation in early 2024.

23. Revenue administration reforms at the Kenya Revenue Authority (KRA)—aimed at improving compliance and taxpayer services—will continue to play a major role in our fiscal strategy. Key objectives include:

- **Developing and implementing risk-based compliance strategies.** Compliance risk management capacity has improved significantly over recent years—including by restructuring our Compliance Risk Management Committee in November 2022. Going forward we plan to monitor and evaluate the compliance improvement strategies and report the status of implementation to the committee on quarterly basis. The following initiatives will also be undertaken (i) full roll-out of risk-differential framework (RDF) and risk profiling tool in the selection of cases for compliance reviews and audits by June 2024; and (ii) full roll-out and use of case management tool in processing all cases in the system.
- **Strengthening KRA's audit function.** Several actions have been taken to rebuild audit capacity, including to refresh and upgrade staff skills, strengthen feedback loops between the disputes and audit areas, and initiate process changes and capability enhancements to improve quality and establish mechanisms for assessing the impact of the audit function on compliance (by end-June 2023). The following initiatives will be undertaken: (i) training of computer audit specialists and equipping them with advanced MS Excel technique by June 2024; and (ii) set up audit quality review teams for all Nairobi Tax Service Offices by June 2024.
- **Strengthening data analytics to support compliance risk management (CRM).** We are making good progress in enhancing the use of data to improve taxpayer compliance. In FY2021/22, the inaugural data management strategy was approved and is currently in its second year of implementation. The strategy aims to increase the usage of data and analytics for compliance risk management through (i) integration with key third party sources for revenue assurance and risk management. Integration with telecommunication companies has commenced and will be finalized by June 2024. (ii) Implementation of advanced analytics and expert models of fraud detection and risk management (iii) reconciliation and migration of taxpayer ledgers from the legacy system will be completed by June 2024. The iTax data cleaning committee and the working group to oversee its implementation were established in November 2022. By end-August 2023, we will develop credible and reliable taxpayer register of the Large Taxpayer Office, Medium Taxpayer Office, and deregistered companies' data. By June 2024, the team will have cleaned the data for all taxpayers with other incomes except employment income.
- **Managing exemptions.** Building on our efforts to improve tax compliance for exemptions (VAT, import duty, import declaration fee, railway development levy, excise duty), we have completed verification of 27 provisions on VAT exercises. We monitor on-going projects and will broaden VAT exemption verification at customs to new areas, including those administered under the East African Community Customs Management Act, by end-June 2023.
- **Avoiding delays in payment of tax refund claims.** We will introduce administrative procedures to facilitate timely tax refunds audits process by March 2024 and work with the

National Treasury to review current process on VAT refund processing. In the Finance Bill 2023, the Tax Procedures Act has also been proposed for amendment to provide predictability on when the VAT refund will be paid and, if not paid, automatically offset with other tax liabilities or future tax liabilities.

24. We are working diligently to strengthen our public procurement system. We are in the process of acquiring an e-Government Procurement System that will be end-to-end where all public procurement and assets disposal transactions are undertaken online and are fully compliant with PPADA 20215 and its attendant Regulations 2020. The developed e-GP system will be interfaced with our Integrated Financial Management Information System (IFMIS) to process payments of contracted suppliers. We intend to pilot Phase 1 of the new e-GP system in eleven (11) MDACS from July 2023. Roll-out to of the entire system (Phase I and II) to all MDACs will be from July 2024. We are looking forward to necessary support from the World Bank especially in the area of capacity building of the system users in procuring entities automate application of the Procurement Act and regulations. In the meantime, we have updated the IFMIS, procuring entities will continue using the IFMIS e-Procurement module until the new e-GP system is implemented, tested, piloted, and fully rolled out to allow for seamless transition.

25. We expect significant savings from controlling the government wage bill. We continue pursuing our objective of reducing the ratio of the government wage bill to GDP by 0.7 percentage points between FY2020/21 and FY2023/24 with a view to free much-needed resources for priority social and development spending. To this end, we implemented a wage freeze for FY2021/22 and FY2022/23, and we have maintained our policy of limiting new employment to priority areas. Further actions planned in relation to controlling the wage bill include:

- **Harmonize and rationalize the categories, rates, and rules for allowances.** Consistent with the Salaries and Remuneration Commission (SRC) objectives of containing allowances to no more than 40 percent of gross pay overtime, the SRC has implemented changes to the remuneration of state officers, including to link rewards to performance, and to review bonus and allowances requests from public institutions. The SRC plans to substantially reduce the number of allowances (from the current 247) to ensure that these are well-targeted and reflect specific job circumstances and skills.
- **We will implement a common payroll system linked to IFMIS across MDAs and Counties by end-July 2023.** Building on the results of pilots undertaken in 11 State Departments, we have rolled the Unified Human Resource (UHR) system—which will consolidate Human Resource and Payroll data in the Public Service for access through a single warehouse. To actualize this, using three modules Payroll Administration module has been finalized and rolled out Ministries, Departments and Counties. Other modules such as Leave Management; Pensions Claim; Selection and Recruitment; establishment control; training and development; and third-party deduction management have been prototyped. The UHR system will also be linked to Kenya Revenue Authority i-Tax to facilitate filing of PAYE tax element associated with individual employees and total monthly PAYE tax obligation from the State Departments.

- **We intend to roll out the UHR system for the entire Public Service by July 2024.** The roll out of the UHR will be carried out in phases. Phase 1 entailed rolling out the system to all MDAs and Counties. Phase 2 involved the roll out to all State Agencies that have adopted the Unified Payroll Numbering (UPN) System—including to Teachers Service Commission (TSC). The 349,000 teachers under TSC have been issued with UPN. Phase 3 will entail issuing the UPN to all Commissions and Independent Offices, State Corporations, Public Universities, and Agencies by July 2024.
- **Ensuring that Collective Bargaining Agreements consider available resources.**

26. We continue improving Public Investment Management (PIM) to deliver value for money in public capital expenditure. To this end, we are:

- *Rationalizing existing projects.* Based on a Cabinet decision to thoroughly review 437 stalled or underperforming projects, each MDA has established a dedicated task force responsible for conducting physical audits and verification of these projects. NT will then review these submissions and prioritize the projects for inclusion in the FY2024/25 budget and beyond in line with debt sustainability analysis. NT will seek legal instructions from the Office of the Attorney General and Department of Justice on projects proposed for suspension awaiting a decision to either continue or cancel.
- *Operationalizing the recently developed Public Investment Management Information System (PIMIS) to automate public investment management process*. By end-October 2023, the PIMIS will be piloted in Roads, infrastructure, Health, and Education sectors. Informed by the piloting phase, we intend to populate the PIMIS with all ongoing and new projects, including PPPs.

27. Strengthening Public Finance Management (PFM) remains a priority going forward. We intend to strengthen expenditure control and improve the efficiency and effectiveness of public spending by pursuing the following milestones:

- By end-December 2023, enhance IFMIS to enable registration of all multi-year commitments in IFMIS. Submit to Cabinet and update PFM regulations 2015 (article 56) that requires MDAs to register multi-year commitments in IFMIS.[1] NT will issue guidelines requiring MDAs to submit their planned commitments for the FY2024/25 Budget in line with the 2024 Budget Policy Statement ceilings.

[1] In Kenya, budgets are appropriated on an annual basis. Commitments within a Financial Year are reversed at the end of the Financial Year and recaptured at the beginning of the subsequent FY as opening balances. The Government of Kenya (GoK) currently uses cash basis of accounting. Multi-year commitments are effectively accounted for in an accrual accounting system. Currently, IFMIS captures annual commitments which lapse at the end of a FY. The proposed SCOA migration based on GFSM 2014 supports accrual accounting. IFMIS has implemented commitment controls based on annual cash plans, consistent with appropriated budgets. IFMIS Cash Planning module enables entities to manage expenditures and provides visibility of monthly commitments within a fiscal year. Implementation of budget reforms such as budget costing and planning module in IFMIS will enhance realistic medium-term budgeting and expenditure commitments through the cash plans. The Hyperion Planning module will also be able to lock in the medium-term projections and commitments.

- By end-December 2023, ensure that all MDA budget proposals for FY2024/25 have been prepared using a common costing approach based on the Hyperion system—which is being improved to develop costing tools for vendors. This was previously envisaged to be in place for FY2023/24. The new date accommodates training of system users. We finalized the Budget Manual (including costing guidelines), which will be validated by end-July 2023, previously targeted for end-December 2022.
- By end-September 2023, complete a review of the number of extra-budgetary units with a view to consolidating them and, where appropriate, bring them within the perimeter of the budgetary central government. This was previously targeted for June 2023.
- By end-September 2023, submit to Cabinet a comprehensive, timebound strategy to i) validate the stock of pending bills outstanding at end-June 2023; ii) propose measures to address the shortcomings in the PFM systems—including related to multi-year procurement procedures—that enabled the accumulation of pending bills, including the definition of expenditure arrears; and iii) propose criteria for clearing validated arrears over an identified period consistent with our overarching objective to reduce debt and debt vulnerabilities (***end-September 2023 SB***).

28. We are taking decisive steps to ensure that decisions on domestic fuel prices are aligned with budgeted resources. We eliminated overall subsidies on March 15, 2023, and cross-subsidies on May 15, 2023. Consistent with the new administration's priorities and program commitments, we have established a taskforce—comprising members from NT, Ministry of Energy and Petroleum and the Energy and Petroleum Regulatory Authority (EPRA)—to ensure that fuel pricing actions are at all times aligned with the approved budget, which was *end-December 2022 SB*. The taskforce will review the fuel pricing mechanism and in August 2023 recommend measures to ensure that fuel pricing actions are at all times aligned with the approved budget. The taskforce has now met twice and its key recommendations, which will be made public within the coming weeks, are in the process of being distilled. Consistent with our requests for access under the IMF's Resilience and Sustainability Facility (RSF), we are committed to transitioning to low-carbon economy by avoiding fossil fuel subsidies going forward.

29. Implementation of the 2023 Medium-Term Debt Management Strategy (MTDS) will strengthen public debt management. Key components of this strategy are:

- **Reducing domestic refinancing risks.** The ratio of Treasury bonds to Treasury bills rose from 82:18 in December 2021 to 85:15 in December 2022, despite the observed lower investor interest in longer dated T-bonds since the second quarter of 2022. The average time to maturity of outstanding Treasury bonds has remained stable at 8.9 years. Going forward, we will continue to pursue lengthening of the maturity profile of public debt, with the issuance of liquid benchmark domestic government bonds across all maturities.
- **Primary reliance on concessional external financing.** We will continue our efforts to increase the utilization of committed external concessional financing. Since the start of the war in Ukraine and the rapid tightening of monetary policy in advanced economies, the international capital markets have remained generally closed for frontier economies. In

FY2022/23, we were, nevertheless, able to meet our external financing needs by negotiating an upsizing of the World Bank DPF to US$1 billion, on the strength of our reform agenda. In addition, we successfully raised most of budgeted external commercial bank loans. In FY2023/24 and FY2024/25, we expect access to additional budgetary support via the IMF's RSF. In preparation for the rollover of the Eurobond maturing in 2024, the National Treasury issued an Expression of Interest in April 2023 to procure an international lead manager to assist us in finding a solution with optimal cost-risk balance. The hiring process is expected to be completed by-end June 2023, which would place the government in a good position to tap the international bond market at an opportune time. We are also actively considering alternative sources of financing from multilateral and bilateral lenders and the syndicated loans market.

- **Strengthening the legal framework for PFM:**
  - The amendments to the 2012 PFM Act that transposes in primary law the definition of public debt from the constitution and replaces the nominal debt limit with a debt anchor set at 55 percent of GDP in present value (PV) terms were submitted to Parliament in April 2023, following a country-wide public participation exercise. The proposed amendment vests the Public Debt Management Office (PDMO) with responsibility to advise the Cabinet Secretary and Parliament on the sustainable levels of debt, further enhancing the delegated functions of PDMO.
  - Following the passage of the amendment, the taskforce of experts from the Attorney General's Office, the Central Bank of Kenya (CBK), and NT will present recommendations through PFM regulations on the revamped operational framework for public debt management by end-December 2023. The regulations will help clarify responsibilities relating to debt management and enhance the transparency of followed processes.
- **We are committed to broadening the reporting of State-owned entities' non-guaranteed debts** (excluding debt to government which is already captured in existing metrics). In the FY2021/22, the Public Debt Management Report (PDMR) presented data for 26 out of a total of around 260 such entities, including those considered to pose the highest fiscal risk. To this end, the National Treasury has operationalized the new Government Investment Management Information System (GIMIS) module (see para 42), which allows for digital data submission and processing. In preparation for the FY2023/24 PDMR, the PDMO will evaluate the quality of the collected data, with the view of extending the coverage to the majority of State-owned entities.
- **Reforms to deepen the domestic debt securities market:**
  - We will further enhance the market infrastructure through automation of processes via the deployment of the new Central Securities Depository System (CSD) later in the year. The new CSD will allow investors to transact directly in the primary and secondary markets and will also enable the launch of an active horizontal repo market, which would drive increased market liquidity.

- Necessary steps will be undertaken to ensure efficient operation of the government securities market to support liquidity and transmission along the entire yield curve, and to this end we've remained in close engagement with bond market institutional investors.

30. Public Private Partnerships (PPPs). We remain fully committed to carefully evaluate cost and risks associated with PPPs. To this end, the PPP Directorate is expanding its staff to further strengthen its capacities by attracting critical talent in project origination and structuring, safeguards, and legal support by December 2023. To ensure that only projects with the highest socio-economic returns are undertaken and integrated into the PIM planning and monitoring framework and further to the provisions of the PFM (PIM) Regulations, 2022, by December 2023, NT will develop a joint PIPM-PPP Framework to streamline the decision-making process of determining whether projects should be procured through the traditional on-budget public procurement method or through the PPP framework.

31. The PPP Directorate will continue to strengthen its reporting on risks. To this end, a quantification and likelihood of fiscal risks associated to PPPs, as well as information on climate-related risks, informed by the Fiscal Commitments and Contingency Liability (FCCL) framework, will be included in the Fiscal Risk Register and discussed within the Fiscal Risk Committee. In line with the reporting requirements under section 88 of the PPP Act 2021, the PPP Directorate submitted to Parliament, the 1st Annual Report on the State of Public Private Partnerships in Kenya for Financial Year 2021/22. The report includes Fiscal Commitments and Contingent Liabilities for PPP Projects. Further, as part of managing fiscal risks from PPP Projects, we will ensure to include in the annual budget for approval by the National Assembly, costs associated with PPP Projects (both ongoing and new), and which have impact on the exchequer.

32. Pension reform. To ensure sustainability of the public service pension system, we introduced, on January 1, 2021, a funded contributory pension scheme for public sector employees (Public Service Superannuation Scheme (PSSS)). To sustain and strengthen the pension reforms, we will monitor and completely separate and delink the governance of the PSSS from that of the non-contributory scheme. Furthermore, we will revamp the public service pension administration through digitization and re-engineering of the pension management system, expected to be completed by December 2024. Digitization will streamline processes, improve accuracy, and enable better monitoring and management of pension-related matters while re-engineering will complement the digitization by availing an end-to-end Enterprise Resource Planning (ERP) solution that takes advantage of the modern IT technologies.

E. State-Owned Enterprises

33. The Kenya Kwanza administration has identified its policy priorities for the state-owned enterprises (SOEs). The new SOE policy priorities of the government include a more accelerated privatization process; more streamlined governance structures with clear roles and responsibilities among the entity stakeholders (boards, management, employees); more efficient utilization of budgetary resources; better management of fiscal risks; and enhanced accountability.

34. The SOE sector continued to require extraordinary support in FY2022/23 but the cumulative support over FY2021/22 and FY2022/23 remained within the space provided for in the program. In FY2022/23, such supports were related to the needs at Kenya Airways (KQ) and the Kenya Power and Lighting Company (KPLC). At present, KQ has a negative equity and KPLC was having a liquidity gap of Ksh.64 billion as of FY2021/22.

- The Supplementary Budget for FY2022/23 proposed a provision for KQ at Ksh.19 billion, a decline of Ksh.11 billion compared to the original budget. As of mid-May 2023, KQ received Ksh.10 billion of the FY2022/23 allocation. In addition, the government is currently servicing the debt service payments on KQ's guaranteed senior external debt, which the airline failed to service, and has so far paid US$95 million as of end-April 2023 on KQ's behalf. The government is evaluating various strategies and options to turn around the airline with minimal budgetary implications and the least fiscal impact.
- In FY2022/23, KPLC would receive Ksh.3.525 billion in extra-ordinary budgetary support to address part of the liquidity gap that had been generated by the January 2022 electricity tariff reduction. On April 1, 2023 the energy regulator announced a base adjustment to electricity tariffs across all demand segments that KPLC could charge (first such change since 2018). Together with this new tariff structure, timely passthrough of variable costs, and implementation of the Cabinet approved Action Plan (see below), it is envisaged that KPLC's liquidity position will improve and there will be no need for extraordinary support for the company.
- Both KQ and KPLC enjoy moratorium on debt service for the amounts owed to the government.

35. We continue to make progress in assessing, monitoring, and addressing vulnerabilities in the SOE sector, in line with our staged approach. Our financial evaluations had earlier identified a cumulative Ksh.383 billion liquidity gap over five years for 18 SOEs involving the largest financial and fiscal risks (excluding Kenya Airways). This gap is expected to be primarily covered via SOEs' cost-saving measures, which partially materialized and were reflected in the FY2021/22 financial results. In light of the economic developments over the past one year, NT will update this financial evaluation by end-June 2024 for fifty State Corporations (SCs), using their FY2022/23 audited accounts, to quantify fiscal risks emanating from SOEs. The outcome of the financial evaluation exercise will be reported by NT to the FRC by end-June 2024 (***proposed SB***).

KPLC

36. The Action Plan to restore KPLC's medium-term profitability and cover liquidity gaps (end-December 2022 SB) was approved by the Cabinet on May 16, 2023. The SB has now been implemented with a delay. In line with the Action Plan, KPLC will (i) by the end-December 2024, transfer all transmission assets/lines to Kenya Electricity Transmission Company (KETRACO) and pay through the use of on-lent loans from the government upon valuation, (ii) by end-December 2024, settle the outstanding Rural Electrification Schemes (RES) operations and maintenance cost deficit of Ksh.19.4 billion (assessed as of June 2022) and ensure that KPLC and Rural Electrification and

Renewable Energy Corporation (REREC) enter into a commercial contract for the future RES maintenance cost, (iii) develop and implement a turnaround strategy which includes the reduction of system losses from the current 22.4 percent to 14.4 percent by end-June 2025 (broken down into reduction of 5 percent on commercial losses, 2 percent on technical losses and 1 percent on transmission losses), and (iv) by end-December 2024, establish a new governance structure at KPLC to give private shareholders fair representation, reflecting the company's shareholding structure. Further, the preliminary restructuring undertaken so far, and the review of the tariffs is expected to generate a positive trajectory in the financial performance of KPLC as shown in the table below. We estimate that with support from the new tariff structure, continued passthroughs of variable costs, and effective and timely implementation of the Action Plan, KPLC's liquidity gap will see an accelerated reduction by FY2025/26, excluding any major investments in new assets, and its quick ratio will improve to unity. We do not envisage any risks occasioned by KPLC's restructuring on the other entities in the energy sector (i.e., KETRACO and REREC).

Text Table 2. Kenya: Projected Company's Financial Performance as Estimated by KPLC Following Tariff Review

Profit and Loss Account (Ksh. Millions)	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Net Revenue	157,353	174,968	207,524	208,983	217,715
Operating Expenses	38,026	42,586	45,206	42,741	43,720
Operating Income	4,119	102	16,672	14,806	14,258
Other Operating Income	13,296	10,778	7,295	6,755	5,403
Earnings Before Interest & Tax	17,415	10,880	23,967	21,561	19,661
Interest Expenses	-5,715	-5,235	-4,362	-3,658	-3,887
Financial Expenses	-12,292	-16,430	-13,398	-9,528	-8,431
Profit Before Tax	5,123	-5,550	10,569	12,033	11,230
Memorandum item					
Current Ratio	**0.5**	**0.55**	**0.61**	**0.63**	**0.68**

Kenya Airways PLC

37. Commercial performance paired with initiatives under the restructuring plan and governmental support, including on servicing the guaranteed external debt, have had a marginally positive impact on KQ's financial results. KQ recorded a lower operating loss in 2022 of Ksh.5.6 billion driven primarily by growth in revenues and despite increases in direct operating costs. Quite notably, the passenger numbers increased by 68 percent to 3.7 million in 2022, with capacity increasing by 75 percent, although both were yet to reach the pre-Covid-19 levels. However, increased fuel prices and forex losses on account of a depreciating Kenyan Shilling, resulting in a huge provision on the dollar-denominated loans, adversely impacted KQ's balance sheet. As a result, KQ's net losses rose from Ksh.16 billion in 2021 to Ksh.38 billion in 2022.

38. KQ's indebtedness remains very high. As of end-December 2022, KQ had total outstanding liabilities of Ksh.277 billion, including outstanding claims on KQ by the government on account of its past and ongoing support, of which Ksh.160 billion was long-term liabilities. Of the Ksh.117 billion of short-term liabilities, Ksh.43 billion comprises outstanding trade and other payables. These arrears include fuel (11 percent), landing fees (24 percent), leases (10 percent), payroll (10 percent) and taxes/statutory dues (11 percent). The company is in a negative equity position of Ksh.108 billion.

39. **The detailed business restructuring action plan, prepared in May 2022, has been put on hold to reassess the least-cost approach for budget.** It is the stated objective of the government that KQ should be weaned off budgetary support by December 2023. In this regard, the government, in November 2022 directed the Ministry of Roads and Transport and NT to review the current and other restructuring strategies for KQ and recommend the optimal strategy with the least fiscal impact to the government. A draft Cabinet Memorandum with strategic options and recommendations has been submitted to the Cabinet for discussion. It is expected that a decision will be ready by end-July 2023. Once the government gives direction on the way forward, a new plan will be implemented, and financial resources committed to the same if needed. Meanwhile, government financial support in 2023 has been limited to the payments under the guaranteed senior external debt, while discussions continue on novating the debt.

SOE Governance and Oversight Arrangements:

40. **Rationalization of the SCs portfolio will be prioritized going forward and we remain committed to strengthening SCs' governance and oversight.** We will revise our ongoing strategy (Blueprint) to align it with the new policy priorities, with the aim of efficiently integrating and sequencing reform measures considering the broader reform agenda for the SCs.

- By end-July 2023, we will secure Cabinet approval and publication of an updated inventory and a new classification of SCs that will apply across the government.
- We continue to upload on the NT website the audited financial statements and annual reports of SCs as we receive them from the Auditor General. By end-August 2023, we aim to upload audited financial statements and annual reports for FY2020/21of an additional 20 SCs and FY2021/22 reports of the 40 largest SCs and ensure continuous disclosure thereof.
- We have also uploaded the FY2020/21 Annual Performance Evaluation Report of the SCs. By end-July 2023 we will publish the FY2021/22 Annual Performance Evaluation Report. Going forward, we will continue to upload such annual reports.
- Under the Government Investment Management Information System (GIMIS), we have developed a loans module to allow capturing of disbursements and repayments of SC loans data. We plan to develop, by end-June 2024, the analytical framework for Financial Evaluation and Risks Analysis and integrate it as an additional module to GIMIS that will facilitate the identification, quantification, monitoring, reporting, and management of fiscal risks stemming from SCs, including guarantees and contingent liabilities. However, technical assistance support will be needed for this action.

- We have developed draft regulations (currently undergoing internal reviews) to adjust organizational arrangements within NT for financial oversight of SCs and ensure that the role and functions for government investments as a core function is fully provided for in the legislative framework by end-December 2023.
- An Ownership Policy for SCs, describing a new governance architecture and legal ecosystem to enable enhanced performance and transparency is under consultations with intra-governmental stakeholders. It will be submitted to Cabinet for its approval and publication by end-October 2023 (***proposed SB***). Moreover, with Fund TA, we will begin work on the legal reforms necessary to anchor the new ownership arrangements, corporate governance requirements and other measures outlined in the Ownership Policy and the SOE Blueprint with a view of submitting draft amendments to Parliament by end-February 2024. We will also secure technical assistance for the design of a new performance contracting and monitoring framework for Government owned enterprises (GOEs).
- We plan to complete a comprehensive assessment of the national government's continued involvement or investment in, or funding of, SCs and government-linked corporations (GLCs), starting with 50-100 SCs, based on selection criteria. To this effect, NT will prepare a report that will (i) include specific recommendations for privatization and/or divestment, as well as for mergers, liquidations or dissolutions, transfers to counties and reversions to government departments, (ii) identify and propose solutions for the main legal and operational challenges and bottlenecks to implement the recommendations, and (iii) establish a time-bound action plan for execution. The report will be published and submitted to the National Assembly by end-October 2024 (***proposed SB***). We will continue to conduct, on a triennial basis, such assessments as mandated by Section 89(3) of the PFM Act.

41. Government investments regulations. To provide a legal framework for more effective oversight of government investments by NT, we will prepare regulations to, among others, govern budgetary resource allocation to government investments; monitoring the performance of such investments; and management of fiscal risks emanating from those investments. By end-June 2024, the regulations will be submitted to the National Assembly for approval.

42. Privatization Efforts. A need has arisen to have a privatization law that is more aligned to the 2010 Constitution of Kenya and other laws than the Privatization Act 2005. In this regard, the Privatization Bill 2023, which seeks to repeal the Privatization Act 2005 and streamline privatization processes, has been approved by the Cabinet and submitted to the National Assembly in May 2023.

F. Monetary Policy

43. Policy objectives. Our primary policy objectives remain to: (i) maintain headline inflation within our target range (5±2.5 percent); (ii) maintain a flexible exchange rate regime; and (iii) further improve the monetary policy framework. A monetary policy consultation clause (MPCC) with a 5 percent ±2.5 percent band helps monitor inflation performance, with a consultation with the IMF Executive Board to be triggered if inflation falls outside the band (TMU ¶25).

44. Our monetary policy stance has been tightened over the course of the past year with the overall objective of maintaining price stability by bringing inflation within the target band. Inflation has remained outside our target band since June 2022, mainly driven by food and fuel prices. This led to non-observation of the program's Monetary Policy Consultation Clause (MPCC) as of end-2022, triggering a consultation with the IMF Executive Board. A separate statement to this effect is being issued (see Annex II). After staying above 9 percent between September 2022 and March 2023, headline inflation decelerated to 7.9 percent in April and 8 percent in May, mainly driven by lower domestic food price inflation following the onset of the rains and by the easing of global food prices. We have tightened monetary policy in five steps since May 2022 by increasing the Central Bank Rate (CBR) by 350 basis points cumulatively. In 2023 so far, we have raised the CBR by 175 basis points.

45. We remain committed to continue to adjust the monetary policy stance decisively as needed, in order to ensure that we keep inflationary expectations well anchored and in line with maintaining external sustainability. Since 2022Q2, headline inflation has been driven by supply side factors (worst drought in decades and spikes in global commodity prices since the onset of war in Ukraine). Nevertheless, we remain committed to mitigating the second-round effects of these shocks, including from exchange rate adjustments, and risks from any future shocks, ensuring that inflation expectations are always well anchored. We are committed to adjusting the monetary policy stance proactively to achieve this objective. The impact of the recent further tightening of monetary policy is still transmitting in the economy. We expect inflation to come back within the target band no later than 2023Q3 but there are downside risks. In addition to our inflation objectives, we will ensure that the monetary policy stance and central bank policy operations are mutually consistent at all times with policy package envisaged under the program to support confidence in macroeconomic stability, meeting government's financing needs, maintaining Kenya's external sustainability, and ensuring adequacy of FX reserves.

46. We will support a flexible exchange rate system to act as an absorber of external shocks. To address the challenges of pricing and liquidity, the CBK issued the Kenya FX code in March 2023. The code is aligned to best practices adopted in leading jurisdictions and incorporates relevant elements of the Global FX Code. The leading principles include practices on Execution, Governance, and Risk Management and Compliance which foster a robust, fair, open, liquid and appropriately transparent market. This was complemented by concerted efforts to reactivate the interbank FX market, including intermediation by two foreign exchange inter-dealer brokers to support price discovery and more frequently scheduled engagements with market participants to increase transparency. The banks have already submitted a self-assessment of their current practice against the requirements of the FX code and will then submit their board approved implementation plans by June 30, 2023, with full compliance of the Kenya FX code expected by December 31, 2023. In August 2023, we intend to issue a statement of the CBK's own commitment to the Global FX code, in line with global best practice. We will, in close engagement with authorized foreign exchange dealers, enhance the smooth operation of the wholesale inter-bank market by publishing updates to previous banking circulars on inter-bank standards and operational conventions to support efficient and effective market-making, interbank liquidity and price discovery, in line with global best practice. The CBK commits to maintaining adequate reserves buffers consistent with program objectives. These measures, supported by mutually consistent monetary, exchange rate, and fiscal policies, are essential to maintain competitiveness, support the interbank FX market, protect FX reserves, and ensure continued financial stability.

47. We have continued to push ahead with our monetary policy reform agenda. Since the removal of interest rate caps in late 2019, which had hindered monetary policy effectiveness, we have made further progress in strengthening our monetary policy framework, anchoring on our July 2021 white paper on *"Modernization of the Monetary Policy Framework and Operations"*. The reforms are ongoing and focus on:

- Refining macroeconomic modeling and forecasting frameworks. The CBK has continued to strengthen the forecasting framework and information content of MPC surveys in line with the recommendations of the IMF AFRITAC East FPAS scoping mission. The CBK hosted IMF TA missions on Kenya's FPAS, mainly focusing on improvement of the quarterly projection model, refining business surveys, and developing a nowcasting framework. We will continue to review the analytical tools, including the strengthening of the forecast processes.
- Implementation of measures to improve the functioning of the interbank market including the rollout of a Centralized Securities Depository System (CSD) by July-August 2023. The launch has been delayed enabling completion of adequate system performance assurance testing.
- Improving communication of monetary policy decisions to make them more effective.

G. Financial Sector

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

49. The banking sector remains stable and resilient, although some risks are emerging. Helped by our proactive policies, credit to the private sector expanded at a broadly steady pace throughout the pandemic and accelerated with the economic recovery, though it has moderated recently with the tightening of financial conditions. Under the Credit Guarantee Scheme (CGS), launched in December 2020, to expand access to affordable financing to micro-, small, and medium-sized enterprises, (MSME), total loans extended stood at KSh.4.6 billion as March 2023. The ratio of gross non-performing loans (NPLs) to gross loans in the banking sector remained unchanged at 14 percent in March 2023 compared to March 2022. The outstanding restructured loans amount to about 8 percent of gross loans with about 90 percent of the restructured loans performing as per the restructured terms. Credit risk is expected to remain elevated in the short and medium term as the domestic and regional economies recover from recent shocks, and banks are also exposed to interest rate and FX risks from the rising interest rates and exchange rate depreciation pressures. Currently, CBK stress test focuses on credit risk and climate change risk emanating from drought shock. The results show banking sector resilience to major shocks from credit and climate change risks. The banking sector's current capital, liquidity and provisioning levels are adequate, and we continue to enforce compliance based on onsite and offsite surveillance reports.

50. We will continue to stress preservation of capital and liquidity buffers, and closely monitor FX exposures, to strengthen the resilience of the financial system. We are cognizant of the heterogeneity of the impact of the pandemic on different categories of banks. Correspondingly, we remain committed to enhanced surveillance while encouraging banks to strengthen their governance frameworks and business models, embark on mergers and acquisitions, and other capital strengthening efforts. We will continue the monitoring of FX loans, deposits, and on-and off-balance sheet exposures in the banking system, with a view to, identifying any potential liquidity risks and strengthening resilience and contingency policies should these risks materialize. We received IMF TA in June 2023 to develop Internal Liquidity Adequacy Assessment Program (ILAAP) Guidelines. The Guidelines are intended to strengthen banks' liquidity management frameworks.

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

- **Banking Sector Resilience.** The need to build resilience and exploit emerging opportunities has led to increased consolidations and combinations among several players. Additionally, Kenyan banks have continued to expand regionally through acquisitions, including in the Democratic Republic of Congo, Rwanda, and Tanzania. Further, the microfinance banking sector has been undergoing transformation, with acquisitions that have mobilized additional capital that has enhanced the sustainability of the sector. The CBK will continue with the focus of building a resilient banking sector with strong business models and governance frameworks that will support Kenya's post-pandemic recovery.
- **The Central Bank of Kenya (Amendment) Act, 2021 on Digital Credit Providers (DCPs).** The Central Bank of Kenya (Amendment) Act, 2021, which became effective on December 23, 2021, empowered CBK to license, regulate and supervise digital credit providers (DCPs) to ensure a fair and non-discriminatory marketplace for access to credit. Subsequently, the CBK Digital Credit Providers Regulations, 2022, were issued and operationalized on March 18, 2022. Accordingly, unregulated DCPs were required to apply for a license from the CBK by September 17, 2022; or cease their operations. As of the March 2023, 32 DCPs had been granted licenses.
- **Greening Kenya's Banking Sector.** In October 2021, we issued Guidance on Climate-Related Risk Management to the banking sector helping banks better understand and manage climate-related risks, invest in climate-friendly activities, and mobilize finance for climate action, thus contributing to Kenya achieving its Nationally Determined Contribution (NDC). The Guidance was aimed at enabling banks to integrate climate-related risks into

their governance, strategy, risk management and disclosure frameworks. It is also intended to enable banks leverage on business opportunities from efforts to mitigate and adapt to climate change. These include the adoption of low emission energy sources, development of new products and services, access to new markets, housing, and resilient infrastructure. CBK's guidance incorporated the TCFD framework, which aims to help organizations disclose climate-related risks and opportunities effectively. The CBK is working closely with banks on building capacity and integrating climate-related risk management in their day-to-day operations. Capacity building workshops for banks' and CBK staff in risk management and compliance were conducted between February and March 2022. Subsequently, all banks submitted to CBK at end June 2022, their board approved Climate-Related Risk Management Implementation Plans focusing primarily on strategy and governance-related aspects, with plans to address climate risk management and disclosure components over the medium-term. Banks started submitting quarterly progress reports to CBK in end-September 2022, supporting the participation of global investors to finance Kenyan climate-related initiatives, and helping position Kenya as a premier green finance hub.

52. We have taken steps to strengthen AML/CFT risk-based supervision for banks. Using our AML/CFT offsite supervision tools, we have conducted risk assessments on all commercial and microfinance banks to determine their ML/TF risk profiles. Results from this risk assessment have been used to inform the formulation of risk-based AML/CFT onsite inspection plans for banks for the period of November 2022 to June 2023. The CBK has commenced independent AML/CFT onsite inspections since January 2023 based on the plans developed. In addition, the operational onsite manual for banks has been enhanced to incorporate a risk-based approach to AML/CFT onsite inspections. Moving forward, the AML/CFT risk assessment will be carried out annually to inform our risk-based supervision. Supervisory actions and sanctions will be imposed on any non-compliances by banks. We will continue to implement measures to enhance effectiveness of our AML/CFT risk-based supervision informed by the recommendations of the Kenya Mutual Evaluation Report 2022 and the findings of the National Risk Assessment.

H. Governance

53. Full and effective implementation of the access to information framework will be prioritized as a pillar for enhanced transparency and accountability. The Access to Information Regulations went through the required public consultations process, were finalized with inputs from all relevant government stakeholders, and as of May 2023 are before Parliament and subject to the usual Parliamentary process. Moving forward, we will be vigilant in ensuring that MDA's, SCs and Counties are taking effective actions towards comprehensive operationalization in this area. In this regard, we will develop with an initial focus on strategic areas like debt, budget, tax expenditures, PPPs, and procurement (i) a methodology to monitor implementation progress at the national and county levels, and (ii) information standards to guide proactive provision of information and processing information requests. In addition, we will focus on developing Standards for the Digitization and Automation of Records and work with county governments to advance legislative actions needed to give full force and effect to the access to information framework.

54. We continue to take steps to enhance transparency of beneficial ownership in public procurement. To enhance compliance, National Treasury issued the Circular No.12/2022 reiterating the requirements for public procuring entities to publish beneficial ownership information as part of the publication of contract awards in the Public Procurement Information Portal (PPIP). The Public Procurement Regulatory Authority (PPRA) will prepare and publish quarterly compliance reports on status of compliance by reporting entities, commencing with first quarter of 2023, to further improve compliance level. As at end-May 2023, a total of 1,476 contracts worth Ksh.77.9 billion, have beneficial ownership information published through the PPIP. PPRA also conducted a one-off review exercise in January 2023 to assess compliance with the beneficial ownership disclosure requirements by public procuring entities. The review revealed a low level of compliance by public procuring entities despite various interventions by the authorities. As such, PPRA has been conducting on-going training for procuring entities to further improve their understanding of their disclosure obligations and beneficial ownership requirements, in addition to reiterating the need to comply with policy requirements. With these measures being put in place, we expect compliance to improve as we approach the end of FY2022/23 by the end of June 2023.

55. We will prioritize continuous enhancement of our monitoring and data analysis capabilities of procurement-related information, including identification of red flags and corruption-related trends and risks. This will be supported by the development of a central repository of data on public procurement, mandated under the Public Procurement and Asset Disposal Act, 2015 (section 9-1-m), and facilitated by the planned rollout of e-procurement and its integration with the PPIP and other government databases, such as IFMIS (¶22). In addition, the PPRA will coordinate with and provide continuous training to procuring entities, law enforcement agencies and other relevant stakeholders, to facilitate data sharing and develop functionalities tailored to their specific information and analysis needs, including generation of relevant reports.

56. Convinced that ensuring timely action to address audit findings and recommendations is a critical element in the state's accountability framework, we will take steps to enhance follow up and implementation of the Auditor-General's audit findings and recommendations, including from the completed audits of COVID-19 spending. The efficacy of these audits rests largely on sound legal frameworks, efficient institutional arrangements and robust transparency requirements geared towards effective implementation of audit recommendations. To that end, we will explore measures to (i) promote greater coordination and collaboration among state institutions involved in the overall audit and accountability cycle, including law enforcement agencies (ii) strengthen follow up and implementation systems and consolidate monitoring capabilities and structures, including integrating them with social accountability and participatory frameworks, and (iii) enhance public reporting in this area, including publishing a summary of NT's Internal Auditor-General Department's annual reports. In addition, we will enhance coordination during the Parliamentary review process of audit reports in order to strengthen follow up and implementation of Parliamentary recommendations.

57. We have finalized the review process to align our asset declarations and conflict of interest legal framework with international standards and best practices. A draft Conflict of

Interest Bill was approved by Cabinet and was submitted to Parliament in March 2023. The reform will, among others, (i) consolidate the wealth declarations and interest declarations of public officials into one uniform disclosure regime, (ii) rationalize the responsibility of analyzing and verifying the disclosures and imposing adequate sanctions for false declarations or failure to declare in a single agency, and (iii) enhance the role, responsibilities and capability of enforcement agencies to investigate, prosecute and sanction perpetrators of illicit enrichment and other corruption offenses. Going forward, we will work to achieve full automation of asset declarations for all public officials.

58. We are also making progress in strengthening the Judiciary's capacities to efficiently adjudicate corruption-related criminal cases. In October 2022, 127 principal magistrates with mixed jurisdiction were appointed to oversee corruption and economic crimes cases at the lower level to address backlog, and appropriate training remains a top priority. Delays in court cases are being addressed through the applicable Court Users Committee and Bar Bench and, while we are still experiencing considerable shortages in digital equipment and infrastructure, we have been working towards putting in place video conference and filming capabilities in courtrooms.

59. We will provide proper accountability and transparency on the supplementary budget spending by the various MDAs with a view to ensure greater consistency between expenditure plans and outcomes for the year. We further commit to facilitate the Auditor-General with the necessary support and access to all the relevant records for the requisitions (demand) and disbursements (supply) to conduct a special audit on the mechanism, efficiency, and effectiveness of the supplementary budgeting, including under Article 223 of the Constitution, to establish trends and potential risks. The report will be published by end-September 2023 **(*SB*)**.

60. We are taking steps to enhance our AML/CFT tools to support the fight against corruption through the following measures:

- **Strengthening the AML/CFT legal framework in line with FATF standards to support anti-corruption efforts.** A multi-stakeholder working group led by the Kenya Financial Reporting Center (FRC) has prepared the proposed legal drafting to amend the existing Proceeds of Crime and Anti-Money Laundering Act 2009 (POCAMLA), Proceeds of Crime and Anti-Money Laundering Regulations 2013 (POCAMLR) and other relevant legal instruments, aimed to address the legal deficiencies identified in the 2022 MER. The proposed legal drafting involving 17 legal instruments was submitted to the Cabinet in May 2023 for review as part of the legislative process. Thereafter, the proposed draft amendments to the POCAMLA and POCAMLR to bring them in line with the FATF standards and to address the legal and regulatory deficiencies in the existing AML/CFT framework, will be submitted to the National Assembly in June 2023 for deliberation and approval, allowing us to timely complete the structural benchmark for end-June 2023.
- **Enhancing beneficial ownership transparency of companies and other legal persons.** Kenya Business Registration Services (BRS) has continued to take steps to ensure existing companies submit their beneficial ownership information to the electronic register since the e-register commenced operation in October 2020. Since its commencement, 41 percent of companies have submitted beneficial ownership information to the BRS as at end-April

2023. We are targeting full compliance and to this end, BRS will be conducting outreach activities in the first quarter of FY2023/24 to reiterate the obligations of companies, which amongst others include submission of beneficial ownership information. Following the outreach activities, BRS will strike off companies from the company register for non-compliances. Further, BRS has designed its system to prevent companies from accessing any online services offered by the BRS until the compliance requirements, including beneficial ownership information, are complied with. BRS is also currently preparing draft amendments to the Companies Act to provide administrative sanctioning power to the BRS for failure by companies to timely submit beneficial ownership information, as currently only criminal sanction is permitted under the law which limits the range of sanctions that can be imposed. Proposed legal amendments to the Beneficial Ownership Regulations and the Limited Liability Partnership Act to address legal gaps identified in the Kenya Mutual Evaluation Report have been submitted to Cabinet for approval. These amendments will in part provide access to beneficial ownership information by financial institutions for purpose of fulfilling AML/CFT requirements.

- **Proactively addressing key deficiencies in the AML/CFT framework highlighted in the 2022 Mutual Evaluation Report.** We have developed a high-level action plan to address the deficiencies highlighted in the 2022 MER. Apart from taking steps to address the technical deficiencies, as part of the high-level action plan, we have also conducted AML/CFT sectoral risk assessment for legal persons and legal arrangements and increased engagement with relevant counterparts to expedite the implementation of the POCAMLA (Amendment) Act 2021 which designates lawyers as reporting persons. To enhance domestic coordination and cooperation, the mandates and power of the National Taskforce on AML and CFT have been strengthened through the Gazette Notice issued in April 2023. We have established a monitoring and evaluation mechanism to track the implementation of the action plan and ensure accountability by all implementing agencies. We have continued to carry out capacity building initiatives to enhance awareness of AML/CFT risks and resulting obligations of both private sector and competent authorities in an effort to improve the effectiveness of Kenya's AML/CFT regime.

I. Building Resilience to Climate Change

61. Our economy is highly exposed to climate-related hazards and the implications of climate change. The agriculture sector contributes more than 25 percent of GDP and employs nearly 40 percent of total work force and about 70 percent of rural workforce. Approximately 90 percent of Kenya's land area is classified as a fragile arid and semi-arid ecosystem. Yet, despite our best efforts, the economy loses between 2 and 2.4 percent of its annual GDP to climate-related disasters, in particular floods and droughts. The increasing intensity and magnitude of weather-related disasters in Kenya are major factors contributing to large scale land degradation, with changes in soil properties that reduce the soil's ability to sustain peculiar quality and quantity of plant growth. Indeed, following four consecutive failed rain seasons, we are currently nearing the end of the worst droughts in the past 40 years, which has pushed nearly

10 percent of Kenyans to face severe food insecurity, and led to significant water shortages, livestock losses, and disease outbreaks.

62. To enhance our capacity to address devastating challenges posed by the climate change, we have developed ambitious long-term policy and legislative frameworks. Through the National Climate Change Act of 2016, we have established a framework for climate change management, set out our objectives for climate change adaptation and mitigation, and provided the roadmap for the development of a five-year National Climate Change Action Plan (NCCAP) to guide the mainstreaming of adaptation and mitigation actions into the sector functions of the national and county governments. We have also adopted the National Climate Finance Policy (2018) to set out how our ministries, departments, and agencies (MDAs) would finance the NCCAPs. We have also updated our Nationally Determined Contribution (NDC) in 2020 and submitted it to the United Nations Framework Convention on Climate Change (UNFCCC), targeting reduction of greenhouse gas (GHG) emissions by 32 percent below business-as-usual levels by 2030. In addition, we have also developed a range of climate-related policies and strategies, and sector-specific plans to enable green growth and sustainable natural resource management. These include the 2021 Guidance on Climate-Related Risk Management (¶50), National Adaptation Plan 2015-2030, draft Green Fiscal Incentive Policy Framework and Disaster Risk Financing Strategy.

63. We are also working closely with our development partners to advance our climate change agenda. We have received support from the German Agency for International Cooperation (GIZ) to develop National Climate Change Action Plan 2023-27, a successor to the current National Climate Change Action Plan 2018-22. We have also engaged the African Development Bank's (AfDB) through the Kenya Green Growth Development Policy Financing (DPF) Project to receive technical assistance in developing national green growth strategy, mobilize investments in renewable energy and energy efficiency projects, and raise awareness of climate change and its impacts by conducting public awareness campaigns, training teachers and other stakeholders. The 2023 World Bank Development Policy Operation (DPO) helped us develop and implement agricultural policies that promote green and inclusive growth, while enhancing the institutional framework for climate policy discussions and implementation. The Financing Locally Led Climate Action (FLLoCA) project, a joint initiative of the national and county governments, the World Bank, and several development partners, is helping us mobilize climate finance at the national scale and channel those flows to counties through PFM systems. The project is enhancing our efforts to translate climate commitments into scaled-up actions on the ground, while ensuring that climate finance is used effectively and efficiently.

64. Despite the vibrant enabling environment for climate action, we are facing significant climate financing gaps. In our updated NDC, we have committed to reducing Kenya's greenhouse gas emission by 32 percent by 2030 relative to business-as-usual (BAU) scenario. This will require mobilizing significant resources—estimates show that over US$62 billion will be required for mitigation and adaptation actions across sectors between 2020-30. We have also committed approximately 13 percent of our total budget (US$8 billion) to meet updated NDC targets by 2030, while the remaining 87 percent is conditional on international support (in the form of finances, technology development and transfer, and capacity building). However, climate finance commitments have fallen short of projected financing requirements—only US$2.4 billion was directed to climate related investments in 2018, of which nearly 80 percent for mitigation purposes.

65. **These needs are exacerbated by outstanding institutional and regulatory challenges, including those in attracting climate finance.** Faced by increasingly more impactful and frequent climate-induced shocks, we recognize the need to realign spending priorities to prioritize green development, and to improve public investment efficiency. We are also facing institutional capacity gaps in climate finance fiduciary management skills, which impede planning, tagging, disbursement, absorption, reporting and management of climate-related projects and mobilizing funds in a transparent and accountable manner.

66. **Improving resilience to natural disasters and climate crisis vulnerabilities is an essential component in Kenya's low-carbon growth and macroeconomic stabilization strategy.** Reform measures to be pursued under the RSF reflect recommendations of the recently completed climate diagnostic mission conducted by the IMF's Fiscal Affairs Department (FAD), including Climate Policy Diagnostics and C-PIMA, and climate finance expert from Monetary and Capital Markets (MCM) with a view to support long-term structural climate resilience and adaptation objectives, and meaningfully strengthen macroeconomic stability by helping improve public investment efficiency and our capacity to mobilize additional climate finance as the economy fully transitions towards renewable energy. Each reform priority has reform measures (specified below) to be achieved with target dates under this program.

- **Reform priority 1**: *Incorporating climate risks into fiscal planning and investment framework.* We will seek IMF TA to improve our technical capacity needed to (i) conduct long-term fiscal sustainability analysis under different climate change scenarios; and (ii) develop a prototype of climate budget tagging in key climate sensitive sectors that is operable within the context of Kenya's institutions on a sustainable basis. We expect this assistance to focus on the necessary conceptual underpinnings, including defining climate-related expenditure, and preparation of recommendations to guide the reform process. Based on this knowledge and IFMIS implementation capacity, NT will be fully in charge of operationalizing the climate budget tagging framework that is fully integrated into decision-making, including by publishing results in the budget.
    - By the 2nd review, we will conduct long-term fiscal sustainability analysis under different climate change scenarios and publish the results in the Fiscal Risk Statement starting in FY2024/25.
    - By the 3rd review, we will (i) develop a standardized climate change and disaster risk methodology to be integrated in project appraisal, (ii) include climate considerations in project selection criteria and (iii) reflect the use of the analysis in project concept notes, feasibility studies, and the publication of the project selection criteria.

- By the 4th review, we will implement a prototype of climate budget tagging in key climate sensitive sectors, develop guidelines (applied to all sectors) in the FY2024/25 MTEF circular for budget preparation with a clear definition of climate-related expenditure and publish the results.

Reform priority 2: *Mobilizing climate-revenue and strengthening climate-spending efficiency.*

- By the 2nd review, we will implement carbon pricing in line with IMF recommendations to better reflect the externalities of fossil fuel consumption and to achieve emissions reduction targets in line with the updated NDC. We will request IMF TA support in assessing the overall impact of carbon pricing measures on emissions reduction targets.
- By the 3rd review, we will adopt priority fiscal incentives in agriculture, water, and land management sectors, as listed in the draft National Green Fiscal Incentive Policy Framework. By the same target date, Cabinet will approve net metering regulation and electricity market, bulk supply, and open access regulations, including rates determination methodology to promote energy efficiency, electricity wheeling and distributed renewable power generation in the residential, commercial, and industrial sectors including Special Economic Zones and Industrial Parks. We will request IMF support to conduct impact assessment of incentive measures listed in the draft Framework, facilitate their prioritization, and develop an implementation framework to put into effect priority fiscal measures supportive of the NCCAP and Kenya's updated NDC.

- **Reform priority 3:** *Enhancing effectiveness of existing frameworks to support climate finance.*
  - By the 2nd review, CBK will develop a draft green finance taxonomy adapted to Kenya's updated NDC and circulate the draft for stakeholder consultation.
  - By the 4th review, we will (i) adopt a green finance taxonomy adapted to Kenya's updated NDC, (ii) issue guidelines for the implementation of climate related disclosures for the banking sector in line with international best practices, and (iii) introduce time-bound targets for the implementation of climate disclosure requirements.
- **Reform priority 4:** *Strengthening disaster risk reduction and management.*
  - By the 1st review, we will adopt the National Framework for Climate Services to enable dissemination of a digital early warning system platform for a multi-sector climate-related information to most vulnerable counties, including ASAL and coastal regions.

67. These reforms will further strengthen our institutional capacity to more efficiently mobilize and allocate additional resources. We consider our plans for climate-sensitive PIM (Reform Priority 1) and to strengthen climate-spending efficiency (Reform Priority 2) should facilitate green financing from DPs and the private sector, by helping internalize climate-change considerations in the allocation of government resources and improving transparency and accountability in their use to deliver on ambitious climate measures. In addition, reforms related to development of green finance taxonomy and climate-related disclosures for the banking sector (Reform Priority 3) are a part of the broader capital market development effort to help mobilize climate financing. With already active involvement of DPs in the climate-related agenda in Kenya, RSF-supported reforms can provide assurances that DP climate funds will be well-spent. In turn, additional DP resources to finance public or public-private partnerships or to de-risk climate change projects will help attract private financing by raising risk-adjusted returns.

J. Other Initiatives

68. As an interim measure to help ease FX pressures, we introduced a new oil import arrangement on a temporary basis. The new arrangement, based on a master framework agreed between Kenya and three national oil exporters from the Gulf and currently effective until end-2023, provides for six-month credit for oil imports, backed by letters of credit issued by participating commercial banks. Under the previous open tendering system, oil import dues were payable upon delivery. We are using the resulting window of smoothed demand for foreign exchange to reactivate the effective functioning of the FX market. The temporary oil import arrangement will be allowed to lapse, as we are cognizant of the accompanying increase in rollover risk of the private sector financing facilities supporting it and remain committed to private market solutions in the energy market. We expect our efforts to reactivate the effective functioning of the FX market will ensure demand for foreign exchange from the scheme is met. Nonetheless, we commit that the exchange rate that will be used for purchasing FX under the scheme, and the rate at which the government will provide access to US$ should the need arise, would not deviate from the prevailing market rate by more than 2 percent. We will also amend regulations on the fuel pricing formula to specify passthrough of the exchange rate risk component and any other risks that may materialize.

K. Data Quality

69. Policy objectives. We view the production and dissemination of high-quality economic statistics as the foundation for evidence-based decision making for good policy formulation, monitoring and evaluation. To this end, we will continue to improve on the availability, quality, coverage, and timeliness of our statistics.

70. Data coverage, quality, and timeliness. We have enhanced macroeconomic statistics with a range of new statistical censuses and sample surveys, including the Integrated Survey of Services, Study of Trade Margins, Study of Underground Economy, Study of Informal Transportation, Micro, Small and Medium Enterprises Survey, Survey of Non-Profit Institutions, and the 2020 Census of Commercial Farms and Green Houses. In September 2021, we released national accounts statistics updated to a base period of 2016 and in May 2023, we launched our inaugural release of Kenya's International Investment Position for the period of 2015 to 2021. We are preparing to undertake the next Household Expenditure Survey, which was delayed due to COVID-19. We continue to work toward resolving delays in achieving Government Finance Statistics (GFS) milestones by strengthening the coordination of the interdepartmental committee on GFS. These actions, although delayed due to capacity constraints, are expected to lead to the reporting of (i) general government fiscal outturns on a quarterly basis by February 2024; (ii) annual fiscal data of the public corporations' sector (including financial and non-financial corporations) by February 2024; and (iii) migration of the fiscal framework to GFSM 2014 based concepts, starting with the QEBR for fourth quarter of FY2022/23. These actions will improve transparency and ensure that all stakeholders have easy and reliable access to information. Additionally, the CBK introduced a new survey of agriculture sector in July 2022 aimed at generating high frequency agriculture sector data to support monetary policy decision process, and to complement the existing CEOs, market perception, and hotel industry surveys.

L. Program Monitoring Under EFF/ECF and RSF

71. The program will continue to be monitored based on periodic performance criteria, continuous performance criteria, Monetary Policy Consultation Clause, and indicative targets as set out in Table 1. Structural benchmarks set out in Table 2 will be used for monitoring progress on structural reforms. Detailed definitions and reporting requirements for all performance criteria are contained in the Technical Memorandum of Understanding (TMU) attached to this memorandum, which also defines the scope and frequency of data to be reported for program monitoring purposes. During the program period, the government will not introduce or intensify restrictions on payments and transfers for current international transactions or introduce or modify any multiple currency practice without the IMF's prior approval, conclude bilateral payments agreements that are incompatible with Article VIII of the IMF's Articles of Agreement, or introduce or intensify import restrictions for balance of payments reasons. The sixth, seventh, eighth, and ninth reviews of the program will take place on or after November 7, 2023, May 7, 2024, and October 30, 2024, and March 15, 2025, respectively.

72. Under the RSF arrangement, progress in the implementation of the policies will be monitored through reform measures. These are detailed in Table 3.

Table 1. Kenya: Quantitative Performance Criteria and Indicative Targets, 2022–24

(In billions of Kenyan Shillings, unless otherwise indicated)

	2022				2023			2024
	End Dec.				End Jun.	End Dec.		End Jun.
	4th Rev.	Adjusted (prel.)	Outturn	Status	4th Rev.	4th Rev.	Proposed	Proposed
Quantitative performance criteria								
Fiscal targets								
Primary budget balance of the national government (- = deficit; floor)[1]	-110.2	...	99.3	Met	-158.0	63.9	63.9	55.1
Tax revenue (floor)[1, 2]	862.3	...	913.4	Met	2,035	1,058	1,058	2,428
Monetary targets								
Stock of central bank net international reserves (floor, in millions of US$)[3]	4,984	4,761	4,987	Met	4,393	3,270	3,575	3,375
Public debt targets								
Public and publicly-guaranteed external payment arrears (in millions of US$, ceiling)[4,5]	0	0	22.98	Not Met	0	0	0	0
New domestic guarantees granted by the central government (ceiling)[1]	5	...	0	Met	5	5	5	5
PV of contracting or guaranteeing of new external debt (ceiling,in millions of US$)[6]	9,905	4,905	1,539	Met	11,766	13,340	13,340	14,471
Indicative targets								
Priority social expenditures of the national government (floor)[1]	205	...	206	Met	421	211	211	426
Change in the stock of national government exchequer requests outstanding for 90 days or more (ceiling)[1]	0	...	25	Not met	0	0	0	0
Ceiling on non-accumulation of net domestic arrears (ceiling, on a cumulative basis within the fiscal year)[7]	...	...	...		...	...	0	0
Monetary policy consultation clause								
Upper band (annual, percentage points)	7.5	...			7.5	7.5	7.5	7.5
Center inflation target (annual, percentage points)[8]	5.0	...	9.4	Not met	5.0	5.0	5.0	5.0
Lower band (annual, percentage points)	2.5	...			2.5	2.5	2.5	2.5
Memorandum items for adjustors								
Programmed amount of new debt issuance for PV-reducing, debt management operations[9]	5,000	...	0	...	5,000	5,000	5,000	5,000
Memorandum items (other)								
Nominal value of contracting or guaranteeing of new external debt under new PV ceiling (in millions of US$)[9]	14,521	9,521	4,215	...	16,963	19,474	19,474	21,275

Note: For program performance prior to the December 2022 test date, please see IMF Country Report Nos. 2022/232 and 2022/382.

[1] Targets are cumulative flows from July 1 of each year to June 30 of the following year except for national government exchequer requests outstanding for 90 days or more that are cumulative since July 1, 2020.

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

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

[4] Continuous.

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

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

[7] Calculated since end-December 2022.

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

[9] Cumulative from program approval.

Table 2. Kenya: Current and Proposed Structural Benchmarks Under the EFF/ECF Arrangements

Measure	Target Date	Status	Macro-Criticality
State-Corporations (SCs) Restructuring and Governance			
Submit to the Cabinet Sub-Committee on KPLC an action plan to restore KPLC's medium-term profitability and fully cover any financing gaps (pre-existing and new) through end-2023, as identified by the updated 2022 financial evaluation.	End-December 2022	Not met. Implemented with delay	Reduce fiscal risks related to SOEs.
National Treasury (NT) to complete financial evaluation for fifty SCs, using their FY2022/23 audited accounts, to quantify fiscal risks emanating from SOEs and report the outcome to the Fiscal Risk Committee.	End-June 2024	Proposed	Reduce fiscal risks related to SOEs.
Cabinet approval and publication of an Ownership Policy for SCs describing a new governance architecture and legal ecosystem to enable enhanced performance and transparency	End-October 2023	Proposed	SOE governance
NT to submit to Parliament and publish a report comprising a comprehensive assessment of the national government's continued involvement or investment in, or funding of, SCs and government-linked corporations, that will (i) include specific recommendations for privatization and/or divestment, as well as for mergers, liquidations or dissolutions, transfers to counties and reversions to government departments, (ii) identify and propose solutions for the main legal and operational challenges and bottlenecks to implement the recommendations, and (iii) establish a time-bound action plan for execution.	End-October 2024	Proposed	Reduce fiscal risks related to SOEs.
Budget and Revenue Collection			
Submit to Parliament a supplementary budget for FY2022/23 consistent with programmed deficit and revenue targets.	End-January 2023	Met	Ensure fiscal consolidation consistent with program objectives.
Submit to Parliament a budget and finance bill for FY2022/23 consistent with programmed deficit and revenue targets.	End-April 2023	Met	Ensure fiscal consolidation consistent with program objectives.
NT to submit to Parliament a supplementary budget for FY2023/24 along with tax measures to safeguard achievement of the FY2023/24 deficit and revenue targets.	End-October 2023	Proposed	Ensure fiscal consolidation consistent with program objectives.

Table 2. Kenya: Current and Proposed Structural Benchmarks Under the EFF/ECF Arrangements (Concluded)[1/]

Measure	Target Date	Status	Macro-Criticality
Complete a review of how the fuel pricing mechanism has been applied to date; publicly announce and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget.	End-December 2022	Not met. Proposed to be reset to end-August 2023	Provide clarity on fuel pricing policy and avoid unfunded subsidy costs.
NT to submit to Cabinet a comprehensive, timebound strategy to validate the stock of outstanding pending bills, address public financial management shortcomings that gave rise to pending bills, and clear the verified pending bills over the medium term consistent with the consolidation path under our program.	End-September 2023	Proposed	Strengthen budget practices and address issues with outstanding arrears
Submit to Cabinet for approval the draft of the MTRS with an implementation plan and mechanisms to oversee its implementation	End-October 2023	Proposed	Increase compliance and tax revenue
Governance, Anti-Money Laundering, and Anti-Corruption			
Submit to the National Assembly, the draft amendments to the POCAMLA and POCAMLR, to be in line with FATF standards addressing the legal and regulatory gaps identified in the Kenya Mutual Evaluation Report 2022 to support anti-corruption efforts.	End-June 2023		Strengthen AML preventive tools to fight corruption.
Conduct and publish a special audit on the mechanism, efficiency, and effectiveness of the supplementary budgeting, including under Article 223 of the Constitution, with a view to provide proper accountability and transparency on the supplementary budget spending by the various MDAs and to establish potential risks.	End-September 2023		Reduce fiscal risks and strengthen budget controls.

[1/] The list of all previously assessed structural benchmarks is available in IMF Country Report Nos. 2021/275, 2022/232, and 2022/382.

Table 3. Kenya: RSF Reform Measures

Reform Measure (RM)		EFF/ECF Review and RM Target Date
Reform Priority 1: Incorporating climate risks into planning and investment framework		
RM2:	National Treasury to conduct long-term fiscal sustainability analysis under different climate change scenarios and publish the results in the Fiscal Risk Statement starting in FY2024/25.	7th EFF/ECF Reviews (April 7, 2024)
RM5:	National Treasury to (i) develop a standardized climate change and disaster risk methodology to be integrated in project appraisal, (ii) include climate considerations in project selection criteria and (iii) reflect the use of the analysis in project concept notes, feasibility studies, and the publication of the project selection criteria.	8th EFF/ECF Reviews (September 30, 2024)
RM8:	National Treasury to implement a prototype of climate budget tagging in key climate sensitive sectors, develop guidelines (applied to all sectors) in the FY2024/25 MTEF circular for budget preparation with a clear definition of climate-related expenditure and publish the results.	9th EFF/ECF Reviews (February 15, 2025)
Reform Priority 2: Mobilizing climate-revenue and strengthening efficiency		
RM3:	Subject to Parliamentary approval, National Treasury to implement carbon pricing in line with IMF recommendations to better reflect the externalities of fossil fuel consumption and to achieve emissions reduction targets in line with the updated NDC.	7th EFF/ECF Reviews (April 7, 2024)
RM6:	National Treasury to adopt priority fiscal incentives in agriculture, water, and land management sectors, as listed in the draft National Green Fiscal Incentive Policy Framework.	8th EFF/ECF Reviews (September 30, 2024)
RM7:	Cabinet to approve net metering regulation, electricity market, bulk supply, and open access regulations, including rates determination methodology to promote energy efficiency, electricity wheeling, and distributed renewable power generation in the residential, commercial, and industrial sectors, including Special Economic Zones and Industrial Parks.	8th EFF/ECF Reviews (September 30, 2024)
Reform Priority 3: Enhancing effectiveness of existing frameworks to support climate finance		
RM4:	CBK to develop a draft green finance taxonomy adapted to Kenya's updated NDC and circulate the draft for stakeholder consultation.	7th EFF/ECF Reviews (April 7, 2024)
RM9:	CBK to (i) adopt a green finance taxonomy adapted to Kenya's updated NDC and reflecting stakeholders' comments, (ii) issue guidelines for the implementation of climate related disclosures for the banking sector in line with international best practices, and (iii) introduce time-bound targets for the implementation of climate disclosure requirements.	9th EFF/ECF Reviews (February 15, 2025)
Reform Priority 4: Strengthening Disaster Risk Reduction and Management		
RM1:	Cabinet to adopt the National Framework for Climate Services to enable dissemination of a digital early warning system platform for a multi-sector climate-related information to most vulnerable counties, including ASAL and coastal regions.	6th EFF/ECF Reviews (October 7, 2023)

Attachment II. Consultation with the IMF Executive Board on the Missed Inflation Target Under the MPCC

Nairobi, Kenya, June 29, 2023

Consultation on Breach of MPCC Target in December 2022.

Central Bank of Kenya

The three-month average of inflation for end-December 2022 was 9.4 percent, which was outside the inflation target band of 2.5–7.5 percent, agreed under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) Arrangements. This letter explains firstly the reasons why inflation has breached the upper limit of the inflation consultation band, and then discusses the policy responses and the outlook of inflation.

I. INFLATION DEVIATION FROM THE CONSULTATION BAND

1. **The overall 12-month inflation has remained outside the target band since June 2022, mainly driven by food and fuel prices due in part to developments in global prices of key commodities particularly fuel, wheat, edible oils, and fertilizers, which rose sharply due to supply disruptions exacerbated by the war in Ukraine (Figures AII.1 and AII.2).** Food inflation rose significantly in 2022, peaking at 15.8 percent in October, with its contribution to overall inflation rising to 5.7 percentage points from 4.5 percentage points in May 2022. Food inflation moderated slightly to 13.8 percent in December, contributing 5.1 percentage points to overall inflation. The main drivers of food inflation were edible oils, milk products, wheat products, and maize products, which collectively account for 12.4 percent of the total CPI basket (translating to 37.7 percent of the food basket) and contributed 2.5 percentage points to overall inflation in December 2022 compared to 2.3 percentage points in May 2022. The prices of maize and milk products rose sharply following reduced supply attributed to depressed rains, while those of edible oils and wheat products increased due to supply chain disruptions exacerbated by the war in Ukraine.

2. **Fuel inflation increased to 12.7 percent in December from 9.0 percent in May and contributed 2.7 percentage points to the overall inflation compared to 1.3 percentage points in May 2022.** The main fuel items driving fuel inflation were kerosene, diesel, and petrol, which collectively account for 1.9 percent of the total CPI basket. These increased mainly due to the winding down of the Government subsidy program amid elevated international oil prices.

3. **Non-food, non-fuel (NFNF) inflation has remained below 5 percent reflecting the impact of monetary policy measures and consistent with muted demand pressures in the economy.** The NFNF inflation increased to 4.1 percent in December from 2.9 percent in June, and contributed 1.3 percentage points to overall inflation, partly due to the tax measures in the FY2022/23 Government Budget and impact of international developments on imported goods.

II. POLICY RESPONSES

4. **In May 2022, the CBK proactively tightened monetary policy by increasing the CBR by 50 basis points to 7.50 percent.** Due to sustained inflationary pressures, elevated global risks, and their potential impact on the domestic economy, CBK tightened monetary policy further by increasing the CBR by additional 75 basis points in September 2022, 50 basis points in November 2022, 75 basis points in March 2023 and 100 basis points in June 2023. Since May 2022, CBK has cumulatively increased the CBR by 350 basis points to 10.50 percent, the most recent being a decisive action on June 26, 2023. Noting that the headline inflation is driven by supply side factors, the CBK remains committed to mitigating the second-round effects and ensuring inflation expectations are well anchored. Exchange rate depreciation has exerted some upward pressure on prices of imported goods.

5. **The CBK's monetary policy measures have been complemented by fiscal measures implemented by the Government to moderate the prices of specific commodities and enhance food production, including subsidy on fertilizer prices.**

6. **The CBK continues to monitor the drivers of inflationary pressures and stands ready to implement additional measures when necessary.**

III. INFLATION OUTLOOK

7. **The most recent data shows that inflation has been easing since December 2022.** In May 2023, overall inflation stood at 8.0 percent year-on-year, a decline from the 9.1 percent in December 2022, largely reflecting lower food prices attributed to favorable weather conditions and easing global prices of key commodities particularly crude oil, wheat, and edible oils. Sugar prices rose sharply in May 2023, and contributed 0.7 percentage points to overall inflation, partly reflecting low cane deliveries attributed to reduced production, while some farmers had switched from sugar cane to maize farming due to better prices, as well as global rise in sugar prices owing to lower production. Food inflation stood at 10.2 percent in May compared to 13.8 percent in December 2022. However, fuel inflation remained elevated, mainly due to the removal of the fuel subsidy and increases in electricity prices following upward adjustment of tariffs in April. It stood at 13.6 percent in May compared to 12.7 percent in December 2022. The NFNF inflation stood at 4.3 percent in May compared to 4.1 percent in December 2022, reflecting the impact of monetary policy measures and easing prices of some imported goods.

8. **The monetary policy measures adopted by CBK will continue to moderate demand-driven inflationary pressures.** On the fiscal side, the package of policy measures announced by the Government to increase food supply through imports particularly of sugar and maize, and production through fertilizer subsidy and irrigation are expected to provide relief in the short and medium term.

9. Considering these factors, CBK expects overall inflation to decline in the coming months, and its return to the target band is imminent. The rate of decline will, however, depend on how food and fuel prices evolve in the period.

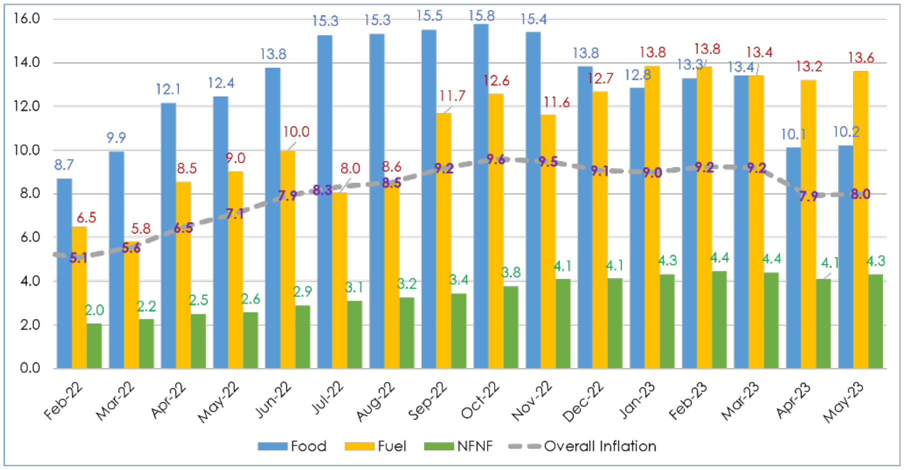
10. The CBK will continue to monitor the impact of the policy measures, as well as developments in the global and domestic economy, and stands ready to take additional measures as necessary, in fulfilment of the price stability objective.

/s/

Dr. Kamau Thugge
Governor, Central Bank of Kenya

Figure AII.1. Kenya: Inflation by Broad Category

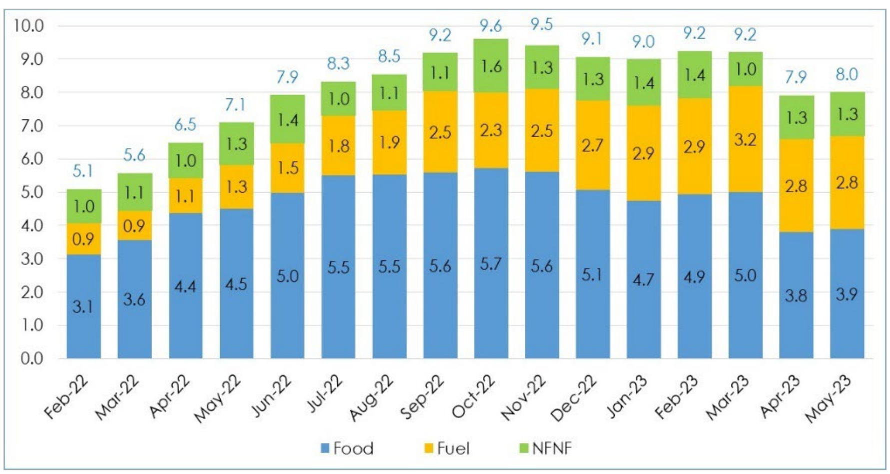
(Y/Y, Percent)



Source: Kenya National Bureau of Statistics and CBK

Figure AII.2: Kenya: Contributions to Overall Inflation by Broad Category

(Percentage Points)



Source: Kenya National Bureau of Statistics and CBK

Attachment III. Technical Memorandum of Understanding

Nairobi, Kenya, June 29, 2023

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

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

I. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

3. The program establishes quantitative performance criteria for December 31, 2023, and June 30, 2024, with respect to:

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

4. The program sets indicative targets for December 31, 2023, and June 30, 2024, with respect to:

- the change in the stock of national government exchequer requests outstanding for 90 days or more (**ceiling**);
- zero accumulation of national government's net domestic payment arrears on a cumulative basis within the fiscal year (**ceiling**), and
- priority social spending of the national government (**floor**).

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

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

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

6. **For program purposes, the national government primary balance** on a cash basis will be measured from the financing side as the sum of the following: (a) the negative of net domestic financing of the national government; (b) the negative of net external financing of the national government; and (c) domestic and external interest payments of the national government. The national government primary balance will be measured cumulatively from the beginning of respective fiscal year until the test date: July 1, 2022, to June 30, 2023 (for end-June 2023 test date), from July 1, 2023, to December 31, 2023 (for end-December 2023 test date), and July 1, 2023, to June 30, 2024 (for end-June 2024 test date).

The above items are defined as follows:

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

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

- The floor will be adjusted downward (upward) by half of any SOE support in excess (falling short) of the amounts set out in TMU Table 1 below for FY2022/23, provided that the cumulative SOEs support reported in Table 1 below plus any overage does not exceed Kh.127.36 billion (1.0 percent of the FY2021/22 GDP) since FY2021/22. The floor will not be adjusted to reflect any SOE support for all reviews with test dates subsequent to end-June 2023. For the purpose of monitoring execution of the SOEs amounts indicated in Table 1 throughout the fiscal year, the fiscal outturn tables (BOT) will be amended to show explicitly the amounts paid in each month as well as the targeted levels for the month.

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

	2023
	Jun.
Extraordinary support to SOEs	37,268

Source: Kenyan authorities.
[1/] Cumulative from July 1, 2022.

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

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

- **Gross official international reserves** are defined as the sum of:
  - the CBK's holdings of monetary gold (excluding amounts pledged as collateral);
  - holdings of Special Drawing Rights (SDRs);
  - the CBK's holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments); and
  - Kenya's reserve tranche position with the IMF.
- **Gross official international reserves** exclude:
  - pledged, swapped, or any encumbered reserve assets, including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities;
  - deposits with Crown agents; and
  - precious metals other than gold, assets in nonconvertible currencies and illiquid foreign assets.
- **Gross official reserve liabilities** are defined as:
  - the total outstanding liabilities of the CBK to the IMF, excluding the SDR allocations;
  - convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year; and

- commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

9. The following **adjustors** will apply to the target for NIR (see Table 2 for details):

- If the total of (i) program loans, (ii) the revenue component of project loans, and (iii) external commercial and semi-concessional borrowing (excluding for payments of principal of existing debt with the proceeds from newly issued debt for debt management purposes (¶20) exceeds (falls short) the programmed amounts set out in TMU Table 2 below, the target for NIR will be adjusted upward (downward) by the difference;
- If program grants or the revenue component of project grants falls short of the programmed amounts set out in TMU Table 2, the target for NIR will be adjusted downward by the difference;
- If foreign exchange outflows related to financial support provided to Kenya Airways exceeds (falls short) the programmed amounts set out in TMU Table 2 below, the target for NIR will be adjusted downward (upward) by the difference;
- Downward adjustments (measured cumulatively from end-June 2023) in the NIR floor will be capped at: US$325 million for the end-December 2023 test date and US$575 million for the end-June 2024 test date.

Table 2. Kenya: Projected Program and Project Loans, Grants, Commercial Borrowing, and Foreign Exchange Outflows Related to Budget Support to Kenya Airways[1]

(US$ millions)

	2023 End-Jun.	2023 End-Dec.	2024 End-Jun.
Program grants and loans (excl. IMF)	638	86	1,086
Program loans (excl. IMF)	638	86	1,086
Program grants	0	0	0
Project loans and grants	693	416	1,156
Project loans (revenue component)	603	357	1,021
Project grants (revenue component)	90	59	135
Commercial and Semi-concessional borrowing	896	0	2,000
Foreign exchange outflows related to KQ support	161	68	131

Source: Kenyan authorities.

[1] Cumulative from July 1, 2023, for FY2023/24 ending in June 2024.

10. **NIR is monitored in U.S. dollars,** and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar equivalent values, using the exchange rates as specified in TMU Table 3.

Table 3. Kenya: Program Exchange Rates
(Rates as of February 4, 2021)

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

Source: Central Bank of Kenya.

IV. CEILING ON ACCUMULATION OF THE PUBLIC AND PUBLICLY GUARANTEED EXTERNAL PAYMENT ARREARS

11. Public external debt arrears to official and private external creditors arise when obligations on external debt are not paid on the due date specified in the underlying agreement, taking into account any applicable contractual grace periods. The definition excludes arrears relating to debt subject to renegotiation (dispute or ongoing renegotiation) or rescheduling. External debt is defined on a currency basis.

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

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

Definition of Debt

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

14. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of financial and nonfinancial assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms; the primary ones being as follows:

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

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

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

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

Coverage of Debt

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

- Public sector external debt includes foreign-currency denominated obligations of the GoK, and foreign-currency denominated obligations of the CBK contracted on behalf of the national government (excluding newly contracted financing from the IMF and the General SDR allocation).
- The definition of debt is presented in the above sub-section, with the exception noted in the previous bullet.
  (i) For program purposes, a 'guaranteed debt' is an explicit promise by the public sector to pay or service a third-party obligation (involving payments in cash or in kind).
- External debts in currencies other than the U.S. dollar will be converted in U.S. dollars at program exchange rates (Table 3).

Contracting of Debt and Treatment of Credit Lines

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

Definition of Debt Ceiling

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

Present Value Calculation

19. For the purposes of the ceiling on the contracting or guaranteeing of new external debt, the present value (PV) of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[3] For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt.[4] The discount rate used for this purpose is the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97). The grant element of external debts in currencies other than the U.S. dollar will be calculated in U.S. dollar terms at program exchange rates (Table 3). For any debt carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month US$ Secured Overnight Financing Rate (SOFR) is 0.04 percent and will remain fixed for the duration of the program as will the spreads over six-month US$ SOFR for interest rates in other currencies as follows: (1) the spread of six-month Euro EURIBOR over six-month US$ SOFR is -56 basis points; (2) the spread of six-month JPY Overnight Indexed Swap (OIS) over six-month US$ SOFR is -8 basis points; (3) the spread of six-month GBP Sterling Overnight Interbank Average (SONIA) over six-month US$ SOFR is 1 basis point; and (4) For interest rates on currencies other than Euro, Japanese Yen, and GBP Sterling, the spread over six-month US$ SOFR is 15 basis points.[5] Where the variable rate is linked to a benchmark interest rate other than the six-month US$ SOFR, a spread reflecting the difference between the benchmark rate and the six-month US$ SOFR (rounded to the nearest 50 basis points) will be added.

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

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

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

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

Debt Management Operations

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

Adjustors to Debt Ceiling

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

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

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

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

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

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

VII. MONETARY POLICY CONSULTATION CLAUSE

25. The bands around the projected 12-month rate of inflation in consumer prices, as measured by the headline consumer price index (CPI) published by the Kenya National Bureau of Statistics, are specified in the TMU Table 4 below.

- If the observed average of the 12-month rate of CPI inflation for the three months preceding the test date falls outside the lower or upper bands specified in the TMU Table 4 below, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) proposed remedial actions if deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources will be interrupted until the consultation takes place.

Table 4. Kenya: Monetary Policy Consultation Clause, 2023–24

(Percent values)

	end-Jun. 2023 Target	end-Dec. 2023 Target	end-Jun. 2024 Target
Upper band	7.5	7.5	7.5
Center point	5.0	5.0	5.0
Lower band	2.5	2.5	2.5

Source: Kenyan authorities.

VIII. FLOOR ON THE TAX REVENUE OF NATIONAL GOVERNMENT

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

IX. INDICATIVE TARGET ON THE CEILING OF THE CHANGE IN THE STOCK OF THE NATIONAL GOVERNMENT EXCHEQUER REQUESTS OUTSTANDING FOR MORE THAN 90 DAYS

27. For the purposes of the program, national government outstanding exchequer requests are defined as invoices for goods or services provided to the national government, as well as national government's transfer obligations to counties (including for pension and equitable share), State Corporations (SCs) and Semi-autonomous Governmental Agencies (SAGAs), and private sector with the purpose of providing a subsidy for which requisitions for payment have been received in the

Integrated Financial Management Information System (IFMIS) but corresponding funds from the exchequer account have not been released.

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

X. INDICATIVE TARGET ON CEILING OF NON-ACCUMULATION OF NET DOMESTIC PAYMENT ARREARS

29. For the purposes of the program, national government's domestic payment arrears are defined as the stock of pending bills of MDAs and SAGAs/SCs outstanding at end-June of each financial year (as reported in the National Government Budget Implementation Review Report from the Office of the Controller Budget) not inclusive of the national government exchequer requests (¶27) received in the IFIMIS system on and after April 1 of the same financial year (i.e., requests outstanding for less than 90 days at end-June). At end-December of each financial year, the stock of arrears is computed as the sum of the stock of pending bills as reported in the National Government Budget Implementation Review Report from the Office of the Controller Budget and exchequer requests from the current fiscal year outstanding for more than 90 days (TMU Table 5).

Table 5. Kenya: Stock of Arrears
(Ksh. billions)

	2022	
	Jun.	Dec.
Total stock of arrears at MDAs and SCs	435.9	506.5
Memorandum:		
Pending bills at MDAs	*49.2*	*80.3*
Pending bills at SAGAs/SCs	*448.6*	*400.7*
Pending bills at counties	*153.0*	*159.9*
Exchequer requests outstanding for less than 90 days	*61.9*	*60.1*
Exchequer requests outstanding for more than 90 days	*61.9*	*25.5*

Source: Kenyan authorities

30. The program ceiling for zero accumulation of net domestic payment arrears requires that in any given fiscal year the stock of such arrears does not rise above the end-June level of the previous fiscal year.

XI. INDICATIVE TARGET ON THE FLOOR OF THE PRIORITY SOCIAL EXPENDITURES OF THE NATIONAL GOVERNMENT

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

- cash transfers to orphans and vulnerable children,

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

The floor on priority social spending of the national government is defined as the programmed amounts set out in TMU Table 6.

Table 6. Kenya: Priority Social Spending[1]
(Ksh. millions)

	2023		2024
	Jun.	Dec.	Jun.
Priority social spending	420,777	210,979	426,171

Source: Kenyan authorities.

[1] Cumulative from July 1, 2022, for FY2022/23 ending in June 2023 and from July 1, 2023, for FY2023/24 for end-December 2023.

XII. DATA REPORTING

32. 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 7. The authorities will transmit promptly to Fund staff any data revisions. For any information (and data) that is (are) relevant for assessing performance against program objectives but is (are) not specifically defined in this memorandum, the authorities will consult with Fund staff. The authorities will transmit promptly to IMF staff any data revisions, as well as other information necessary to monitor the arrangements with the IMF.

Table 7. Kenya: Summary of Data to Be Reported

Information	Frequency	Reporting Deadline	Responsible Entity
1. Primary balance of the national government			
Net domestic bank financing (including net commercial bank credit to the national government and net CBK credit to the national government broken down in their main components)	Monthly	Within 20 days after month end.	CBK
Net nonbank financing of the national government	Monthly	Within 20 days after month end.	NT
Proceeds from privatization	Monthly	Within 20 days after month end.	NT
Debt service paid and coming due on domestic debt	Monthly	Within 20 days after month end.	CBK
Debt service paid and coming due on external debt	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of external concessional and non-concessional project loans, including securitization	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of budget support loans	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of on all external loans	Monthly	Within 20 days after month end.	NT
Net proceeds from issuance of external debt	Monthly	Within 20 days after month end.	NT
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 20 days after month end.	NT
Net changes in the stock of short-term external debt	Quarterly	Within 45 days after quarter end.	NT
Change in external arrears, including interest and principal, and penalties	Monthly	Within 20 days after month end.	NT
Stock and movements in pending bills accumulated by MDAs, counties, SAGAs for prior fiscal years	Monthly	Within 20 days after month end.	NT
Stock of exchequer requests made after the start of July 2020 and unpaid for 90 days or more	Monthly	Within 20 days after month end.	NT
Execution of Extraordinary SOE support	Monthly	Within 20 days after month end.	NT
National government transactions with and on behalf of SOEs broken down in main categories	Quarterly	Within 20 days after the end of the quarter.	NT
2. Public debt			
Stock of Treasury Bills and Bonds	Quarterly	Within 45 days after quarter end.	NT
Auctions of T-bills and T-bonds via primary dealers, including the number and value of submitted and accepted bids, minimum, maximum and weighted average interest rates and maturity dates	Weekly	Within 7 working days after the end of the week.	NT
Total new other domestic debt contracted or guaranteed	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK
Total new contracted external project loans	Monthly	Within 20 days after the end of the quarter.	NT
Total other new contracted or guaranteed external concessional debt	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK
Total new Eurobond issuances	Monthly	Within 20 days after the end of the quarter.	NT
Total new other non-concessional external debt contracted or guaranteed	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK

Table 7. Kenya: Summary of Data to Be Reported (Concluded)			
Information	**Frequency**	**Reporting Deadline**	**Responsible Entity**
3. Gross official international reserves			
CBK's holding of monetary gold (excluding amounts pledged as collateral)	Monthly	Within 20 days after the end of the month.	CBK
Holdings of SDRs	Monthly	Within 20 days after the end of the month.	CBK
CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments)	Monthly	Within 20 days after the end of the month.	CBK
4. Official reserve liabilities			
Total outstanding liabilities of the CBK to the IMF excluding the SDR allocations	Monthly	Within 20 days after month end.	CBK
Convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year	Monthly	Within 20 days after month end.	CBK
Commitments to sell foreign exchange arising from derivatives	Monthly	Within 20 days after month end.	CBK
5. Other indicators			
Currency in circulation	Monthly	Within 20 days after month end.	CBK
Required and excess reserves	Monthly	Within 20 days after month end.	CBK
Concessional and non-concessional medium- and long-term external debt contracted or guaranteed by the national government and CBK	Monthly	Within 20 days after month end.	NT
Accumulation of national government external debt arrears	Monthly	Within 20 days after the end of the quarter.	NT
Social priority spending of the national government	Quarterly	Within 45 days after quarter end.	NT
Grants to national government entities and total subsidies	Quarterly	Within 20 days after month end.	NT
Guarantees issued by the national government to counties, public enterprises, and all parastatal entities	Monthly	Within 20 days after the end of the quarter.	NT
Stock of guarantees extended by the national government	Monthly	Within 20 days after the end of the quarter.	NT
12-month CPI inflation	Monthly	Within 15 days after the end of the month.	KNBS
Financial Soundness Indicators (core and expanded) for other depository corporations	Quarterly	Within 20 days after quarter end.	CBK
Balances in domestic currency and US$ held in escrow accounts, and exchange rates used to purchase US$, under the government-to-government fuel importation scheme in the domestic banking system	Monthly	Within 20 days after the end of the month.	EPRA

INTERNATIONAL MONETARY FUND

KENYA

June 30, 2023

FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS AND REQUEST FOR A 20-MONTH ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY; REQUESTS FOR EXTENSION, REPHASING, AND AUGMENTATION OF ACCESS, MODIFICATION OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA AND WAIVER OF NONOBSERVANCE FOR A PERFORMANCE CRITERION, AND MONETARY POLICY CONSULTATION CLAUSE—DEBT SUSTAINABILITY ANALYSIS

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

Kenya's public debt is sustainable. While overall and external ratings for risk of debt distress remain high, debt dynamics are being bolstered by the fiscal consolidation under the IMF-supported program.[1] High fiscal deficits in the past and pandemic-related export and output losses in 2020 had resulted in deterioration of solvency and liquidity debt indicators. Market pressures since the start of the war in Ukraine and the monetary tightening in advanced countries have limited access to commercial borrowing. Compared to the last DSA assessment,[2] the projections of debt burden metrics have been revised up, reflecting lower

[1] The DSA analysis reflects a debt carrying capacity of Medium considering Kenya's Composite Indicator Index of 2.98, based on the IMF's April 2023 *World Economic Outlook* and the 2021 World Bank Country Policy and Institutional Assessment (CPIA), published in July 2022.

[2] See IMF Country Report No. 2022/382 published in December 2022.

2022 GDP outturn, REER depreciation in 2023:H1, increased access to program financing, recording of the SDR on lending to the government at face value, and higher projected interest expenses on loans with variable interest rates. Going forward, Kenya's debt indicators are forecasted to improve, as the primary balance turns into a surplus reflecting the strong commitment by authorities to fiscal consolidation, albeit gradually for the external debt service-to-exports ratio. The DSA suggests that Kenya is susceptible to export, exchange rate, natural disaster and primary balance shocks; more prolonged and protracted shocks to the economy would also present downside risks to the debt outlook. The natural disaster shock illustrates the very limited scope for meeting additional financing needs in a stress scenario without jeopardizing debt sustainability, underscoring the importance of existing mitigation and adaptation strategies to curb and cushion climate risks, as well as putting in place the necessary regulatory framework to tap private sector solutions and enable access to concessional green financing.

PUBLIC DEBT COVERAGE

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

- The external DSA covers the external debt of the central government and the central bank, including publicly guaranteed debt, as well as of the private sector.
- The public DSA covers both external and domestic debt incurred or guaranteed by the central government. It does not cover the entire public sector, such as extra-budgetary units and county governments.[3] Debt coverage excludes legacy debt of the pre-devolution county governments,[4] estimated at Ksh 53.8 billion (0.4 percent of GDP), which is included in the contingent liabilities stress scenario (see below).
- The DSA uses a currency-based definition of external debt. There is no significant difference between a currency-based and residency-based definition of external debt, as nonresidents' direct participation in the domestic debt market is small, at below one percent of total outstanding government securities (Text Table 2).

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

- 3.1 percent of GDP to capture reported non-guaranteed debt of state-owned enterprises (SOEs) and extra-budgetary units and Public Private Partnerships (PPPs):
  - With the view of establishing a comprehensive picture of non-guaranteed debt (excluding intergovernmental obligations) of public entities outside the central government, the National Treasury carried out a survey of all 260 state corporations in June 2022.[5] Survey results showed that 19 of them had non-guaranteed loan obligations (excluding vis-à-vis the government), including overdrafts, equal to KSh.99.3 billion (0.8 percent of GDP) as of end-June 2022. Out of this sum, 85 percent were foreign currency denominated. The National Treasury has since operationalized the new Government Investment Management Information System (GIMIS) module, which allows for digital data submission and processing of data by State-owned entities, which will be used for regular updates of the data going forward. Taking a

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

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

[5] The authorities' efforts in this area were supported by a Policy and Performance Action (PPA) under the IDA Sustainable Development Finance Policy (SDFP).

conservative approach, the standard calibration of 2 percent for non-guaranteed SOE debt is retained in the stress test;[6]

  - The calibration of the exposure to PPP-related contingent liabilities is the default one, set at 35 percent of the country's PPP capital stock shock, as reported in the World Bank Database on PPPs.

- 0.5 percent of GDP to cover legacy debt of the pre-devolution county governments (see above);
- 0.4 percent of GDP to account for government contingent liabilities stemming from letters of support issued to participants in the government-to-government mechanism for importation of fuel products launched in April 2023.[7] Reviews of the legal arrangements of the new mechanism by the Attorney General of Kenya and IMF staff have established that they do not give rise to government guarantees of private debt under domestic law and as defined in the Technical Memorandum of Understanding under the IMF EFF/ECF arrangements. The government is, nevertheless, exposed to calls on the national budget in case prices at the pump are not adjusted to fully passthrough any FX valuation losses under the mechanism to final consumers. It may further have to raise US dollar financing to cover any shortfalls of FX, needed to repay exporters, in the domestic market.
- 5 percent of GDP for a financial market shock—a value that exceeds the existing stock of financial sector nonperforming loans of about 4 percent of GDP.

3. **Kenya maintains a high standard of debt transparency.** Debt statistics bulletins with public and publicly guaranteed (PPG) coverage and medium-term debt management strategies are regularly published, and the Budget Policy Statement and Annual Public Debt Management Report include information about contingent liabilities. Moreover, the External Public Debt Register provides loan-level information about contracted and drawn amounts, interest rate, and currency denomination.

[6] Guaranteed State-owned enterprise (SOE) debt and amounts borrowed directly by the Kenyan government and on-lent to SOEs are included in the public debt stock (see above) and thus not included in the calibration of the contingent liabilities stress test.

[7] The scheme, which has an initial duration of nine months, includes the issuance of letters of support by the government to domestic oil marketing companies (OMCs) that also benefit the banks, financial institutions, credit insurance providers, lenders and any hedging counterparties providing financing, insurance, refinancing or hedging to the OMC. The fuel is imported on 6-month credit, backed by commercial letters of credit (LOCs) issued by domestic banks, and confirmed by international banks. A reasonable estimate of the government contingent liabilities stemming from the new fuel import scheme is around 10 percent of the maximum private sector obligation to fuel exporters or around US$400 million (0.4 percent of GDP).

Text Table 1. Kenya: Public Debt Coverage and Magnitude of Contingent Liability Stress Test

Public Debt Coverage

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

Public Debt Coverage and the Magnitude of the Contingent Liability Tailored Stress Test

1	The country's coverage of public debt	The central government plus social security, central bank, government-guaranteed debt	
		Default	Used for the analysis
2	Other elements of the general government not captured in 1.	0.9 percent of GDP	0.9
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2
4	PPP	35 percent of PPP stock	1.1
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5
	Total (2+3+4+5) (in percent of GDP)		9.0

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

BACKGROUND ON DEBT

4. **Kenya's overall public debt has increased in recent years.** Gross public debt increased from 45.7 percent of GDP at end-2015 to 68.4 percent of GDP at end-2022 (Table 1), reflecting legacy high deficits, partly driven by debt-financed spending on large infrastructure projects, and in 2020–21 by the impact of the COVID-19 global shock. External public debt amounts to about half of Kenya's overall public debt (Text Table 2).

5. **Most of Kenya's external public debt remains on concessional terms.** Nominal PPG external debt at end-2022 amounted to 34.5 percent of GDP, corresponding to 27.8 percent of GDP in present value terms (Text Table 2 and Table 1):

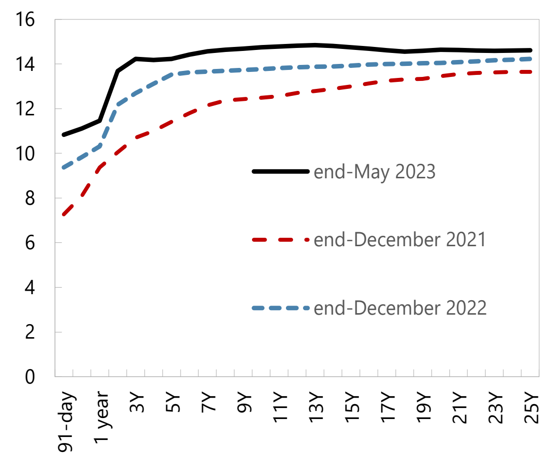
- Kenya has benefited from sizeable support from multilateral institutions. At end-2022, multilateral creditors accounted for close to 47 percent of external debt, while debt from bilateral creditors represented about 28 percent (Text Table 2). Of Kenya's bilateral debt, close to 64 percent is owed to non-Paris Club members, mainly loans from China.
- The share of commercial debt in total external debt decreased in 2021-22, as the authorities prioritized concessional borrowing during the pandemic after several years of reliable access to global financial markets. Commercial debt (mainly Eurobonds, loans, and export credits) accounted for about 25 percent of external public debt. Eurobonds accounted for 75.5 percent of commercial debt (US$7.1 billion).[8]

[8] Syndicated loans amounting to Euro 305.4 million claimed by a syndicate of Italian commercial banks in relation to Arror, Kimwarer, and Itare dams' projects are disputed and subject to on-going arbitration/court proceeding. The debt service schedule associated with these loans is not included in the DSA baseline, as budget provisions for their servicing are suspended until the matter is determined, but the outstanding amount on these loans is kept in the stock of public debt, following authorities' approach for reporting PPG debt in national publications (more conservative than prescribed in the LIC DSA Guidance Note).

- Kenya has not contracted any collateralized external debt. Guarantees by the central government on debt contracted by other entities amount to around US$1.4 billion and are included in the stock of PPG debt.

6. Kenya's domestic public debt reached 33.9 percent of GDP at end-2022 (Text Table 2 and Table 2). Since end-2021, the yield curve has shifted up and flattened, reflecting the increase in near-term inflationary pressures and related policy adjustments by the Central Bank of Kenya (CBK), and low transmission of the policy rate to higher-end of the yield curve (Text Figure 1). The successful implementation of authorities' strategy to lengthen the maturity profile of domestic debt has resulted in a significant decline in the share of Treasury bills in the domestic debt stock (from 35 percent at the end of FY2018/19 to 18.7 percent at the end of FY2021/22) and a notable increase in the average time to maturity of government domestic bonds, excluding T-bills (from 6.3 years at the end of FY2018/19 to 9.1 years at end-December 2022). This has helped alleviate short-term rollover risks, enabling the local market to absorb pressures in 2022. About half of government domestic debt securities are held by pension funds, followed by commercial banks with 47 percent share. Starting in the last quarter of the FY2021/22, domestic debt issuance has taken place mainly at the short end of the maturity spectrum in an environment of elevated inflation and flatter yield curve, increasing the intra-year rollover needs.

Text Figure 1. Kenya: Securities Yield Curve
(Percent)



Source: Bloomberg, L.P.

7. Published data on private external debt is available through 2021 and is extrapolated going forward with the net private external debt BOP flows. The source of pre-2022 data on private external debt is the International Investment Position (IIP) data on "Other sectors", which includes both the private sector and market profit institutions that are controlled or financed by government (financial and nonfinancial public corporations), published in the IMF's IIP database. BOP data on net private external debt flows through end-2022 point to a steady upward trend in the stock of private debt as a share of GDP, which is also maintained in projections.

Text Table 2. Kenya: Decomposition of Public Debt and Debt Service by Creditor, 2021–23[1]

	Debt Stock (end of period)			Debt Service					
	2022			2023	2024	2025	2023	2024	2025
	(In US$ mln)	*(Percent total debt)*	*(Percent GDP)* [2]	*(In US$ mln)*			*(Percent GDP)*		
Total	**74,120**	**100.0**	**66.8**	**11,228**	**11,393**	**8,913**	**10.0**	**9.9**	**7.3**
External	**37,370**	**50.4**	**34.5**	**3,356**	**5,057**	**3,531**	**3.0**	**4.4**	**2.9**
Multilateral creditors	17,474	23.6	15.4	642	638	786	0.6	0.6	0.6
IMF	2,399	3.2	2.1	-	-	-	-	-	-
World Bank	11,086	15.0	9.7	-	-	-	-	-	-
African Development Bank	3,492	4.7	3.1	-	-	-	-	-	-
European Economic Community (incl. EIB)	177	0.2	0.2	-	-	-	-	-	-
International Fund For Agricultural Development	225	0.3	0.2	-	-	-	-	-	-
Other Multilaterals	96	0.1	0.1	-	-	-	-	-	-
o/w: Arab Bank For Economic Development In Africa	45	0.1	0.0	-	-	-	-	-	-
Nordic Development Fund	23	0.0	0.0	-	-	-	-	-	-
Bilateral Creditors	10,497	14.2	9.2	1,447	1,376	1,330	1.3	1.2	1.1
Paris Club	3,793	5.1	3.3	430	398	383	0.4	0.3	0.3
o/w: Japan	1,403	1.9	1.2	-	-	-	-	-	-
France (incl. AFD)	774	1.0	0.7	-	-	-	-	-	-
Non-Paris Club	6,705	9.0	5.9	1,017	978	946	0.9	0.8	0.8
o/w: EXIM China	6,557	8.8	5.8	-	-	-	-	-	-
EXIM India	61	0.1	0.1	-	-	-	-	-	-
Bonds	7,100	9.6	6.2	515	2,444	667	0.5	2.1	0.5
Commercial creditors	1,881	2.5	1.7	680	537	698	0.6	0.5	0.6
o/w: Trade and Development Bank	1,728	2.3	1.5	-	-	-	-	-	-
China Development Bank	88	0.1	0.1	-	-	-	-	-	-
Other international creditors	418	0.6	0.4	73	61	50	0.1	0.1	0.0
o/w: Intesa SanPaolo	235	0.3	0.2	-	-	-	-	-	-
ING Bank Germany	23	0.0	0.0	-	-	-	-	-	-
Domestic[3]	**36,750**	**49.6**	**32.3**	**7,872**	**6,336**	**5,382**	**7.0**	**5.5**	**4.4**
Held by residents, total	36,493	49.2	32.1						
Held by non-residents, total	257	0.3	0.2	-	-	-	-	-	-
T-Bills	5,587	7.5	4.9	-	-	-	-	-	-
Bonds	30,076	40.6	26.5	-	-	-	-	-	-
Loans	1,087	1.5	1.0	-	-	-	-	-	-
Memo items:									
Collateralized debt	0	0.0	0.0	-	-	-	-	-	-
o/w: Related	0	0.0	0.0	-	-	-	-	-	-
o/w: Unrelated	0	0.0	0.0	-	-	-	-	-	-
Contingent liabilities	1,417	1.9	1.2	-	-	-	-	-	-
o/w: Public guarantees [4]	1,417	1.9	1.2	-	-	-	-	-	-
o/w: Other explicit contingent liabilities [5, 6]	n.a.	n.a.	n.a.	-	-	-	-	-	-

Sources: Kenyan authorities; and IMF staff calculations.

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

[2] Debt ratios are constructed by converting external debt to Ksh using end-period exchange rate and dividing by Ksh GDP.

[3] Includes CBK on-lending to the government of the Ksh-equivalent of three-quarters of the 2021 general allocation of SDRs.

[4] Loan guarantees are included in the perimeter of debt covered by the DSA and include undrawn amount of government-guaranteed loan facilities and letters of credit at high risk of being fully utilized

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

[6] Capacity constraints limit data availability on other explicit liabilities not elsewhere classified. Data is expected to become available at the time of the next review of the IMF EFF/ECF arrangements.

UNDERLYING ASSUMPTIONS

8. Following lower than expected 2022 outturn, real GDP growth is expected to pick up modestly in 2023 on the way of converging to 5.4 percent over the medium term (Text Table 4):

- 2022 real GDP growth decelerated faster than anticipated to 4.8 percent, on the back of the intensification of the multi-decade-worst drought, which led to a second consecutive year of decline in agricultural output and slowed activity in the downstream sectors (e.g., manufacturing and wholesale and retail trade), and tighter policies.

- Real GDP growth is projected to reach 5 percent in 2023, below the forecast in the last DSA, as the need to maintain mutually consistent tighter domestic policy environment weighs on the demand and partly dampens the positive effect from a return to growth in the agricultural sector following near-normal rains.
- Medium-to long-term real GDP growth projections are slightly lower than in the last DSA at around 5.3 percent. They are supported by the steady tourism recovery, increasing regional integration, projected productivity growth, policies to reinforce credit to the private sector, favorable demographic trends, and an ambitious structural reform agenda.[9] The reform agenda of President Ruto's administration aims at boosting agricultural transformation and inclusive growth; enabling the micro- small- and medium-sized enterprise (MSME) economy as a private sector growth driver; improving housing and healthcare; promoting the digital superhighway; and supporting the creative economy. Over the medium term, growth is backstopped by the crowding-in effect of fiscal consolidation (i.e., lowering public financing needs would reduce demand-side pressures on domestic interest rates and free up financing for private investment, while privatization of SOEs would raise productivity),[10] which is based on growth-friendly domestic revenue mobilization and spending rationalization measures to anchor debt sustainability.
- Nominal GDP in US dollars is projected to be lower than in the last DSA over the medium term, reflecting the base effect of the lower 2022 outturn and faster REER depreciation in 2023, as well as the slight markdown of growth prospects in 2023 and over the medium-term.

9. The adjustment in the primary fiscal balance is expected to remain on track with commitments under the IMF-supported program (Text Table 4):

- Challenges in mobilizing budgeted resources have impeded the implementation of the FY2022/23 supplementary budget, approved in February 2023. This necessitated the passage of a second supplementary budget to offset the projected revenue shortfall and introduce expenditure savings—mostly related to undisbursed budgeted resources for projects—so as to contain the primary fiscal deficit to 1.1 percent of GDP. Should FY2022/23 net domestic financing or tax collection fall short of the baseline, reflecting limited investor appetite amid expectations of further rate increases especially at the longer spectrum of the yield curve, which has flattened considerably, the fiscal year could end with a significant amount of unpaid bills carried over to FY2023/24. To avoid accumulation of arrears (i.e., unpaid bills for more than 90 days), the authorities have plans in place to prioritize execution of spending and clear the unpaid bills by end-September 2023.
- The FY2023/24 budget currently tabled at parliament targets a primary surplus of 0.7 percent of GDP—a level higher than the 0.3 percent of GDP program target set at the 4th EFF/ECF reviews (Text Table 3). This is predicated on a comprehensive revenue package

[9] Climate-related risks are not explicitly modeled in the baseline. Their effect is, instead, captured in the natural disaster stress test scenario.

[10] The Kenya Kwanza administration has prioritized the privatization of SOEs that can operate as market producers.

for 1.6 percent of GDP to mitigate the likely underperformance of tax by end-June 2023. The draft Budget also envisage a further rationalization of primary expenditures—particularly for slow-moving projects, while supporting new initiatives (e.g., Hustler Fund) and protecting social spending. The impact of the clearance of any unpaid bills from FY2022/23 will be offset by a Supplementary FY2023/24 budget, which is expected to be submitted to Parliament by end-October 2023. Offsets will be geared to increase tax revenues and control expenditures to anchor debt sustainability, while protecting social spending (Text Table 3).[11]

- Going forward, the overall deficit is expected to durably decline to below 4 percent of GDP (Text Table 5), reflecting continued efforts to strengthen tax compliance in line with the priority areas identified under Kenya's Medium Term Revenue Strategy (MTRS)[12] and streamline primary expenditures—particularly for wages, stalled investment projects, and transfers to public sector entities, a number of which are slated for privatization or merger—while improving public investment management and budgetary controls. Compared to the last DSA, once debt burden metrics fall below their sustainability thresholds, the long-term target of the primary surplus is roughly halved to 0.5 percent of GDP, which does not lead to future threshold breaches. This is consistent with safeguarding debt sustainability, while relaxing somewhat the budget constraint on social and developmental spending over the long run.

10. Macro-fiscal assumptions underlying the DSA baseline scenario include an estimate of the authorities' climate-related public investment. The forecast is benchmarked by the latest available data of 2.6 percent of GDP in 2018. It includes an additional climate investment of around 0.25 percent of GDP per year, supported by the IMF's Resilience and Sustainability Facility (RSF) and WB climate-oriented financing (see paragraph 27 below), as well as from other financing from development partners. [13,14] Fiscal constraints in the short run limit the government's capacity for increasing public spending to accommodate additional climate-related needs. Against this backdrop, scaling up climate related investments will require additional focus on improving the efficiency of public spending, attracting highly concessional external climate financing, and encouraging private sector participation in reaching Kenya's ambitious climate objectives (see paragraph 27).

[11] Additional revenue measures may include the adoption of a motor vehicle circulation tax, a reduction in the VAT exemptions (including through a review of the VAT apportionment ratio of allowable inputs VAT on exempt supplies), and a reduction of exemptions on interest income.

[12] The MTRS will provide the blueprints for achieving the authorities' objective of increasing revenue mobilization by 8 percentage points of GDP by 2030, while supporting global competitiveness and prosperity consistent with Kenya's Vision 2030.

[13] The RSF disbursements would substitute more expensive domestic debt, thus improving debt dynamics by helping reduce the present value of debt and debt servicing burdens.

[14] Economic benefits of successful mitigation and adaptation strategies will be incorporated at a later stage.

Text Table 3. Kenya: Social Spending Outlays, 2016–23

	FY16/17	FY17/18	FY18/19	FY19/20	FY20/21	FY21/22	FY22/23
				(Ksh. Millions)			
Social spending	256,253	305,275	345,956	380,051	407,905	434,585	427,750
Social protection	15,489	18,329	26,669	25,554	26,031	26,194	26,194
Education	219,010	269,534	295,555	314,027	337,524	359,130	356,241
Health	21,754	17,412	23,732	40,470	44,350	49,260	45,315
Memo item				*(Percent of GDP)*			
Social spending	2.9	3.1	3.3	3.3	3.2	3.0	3.0

Source: Authorities data and estimates.
Note: Fiscal year GDP is estimated as average of its values in the calendar years it spans.

Text Table 4. Kenya: Selected Macroeconomic Assumptions, 2022–42

	2022	2023	2024	2025	2026	2027	2028	Long-term 1/
Nominal GDP (Ksh billion)								
Current DSA	13,368	15,179	17,041	18,920	21,019	23,273	25,754	63,199
Previous DSA (December 2022)	13,650	15,453	17,237	19,087	21,137	23,387	25,880	57,822
Real GDP (growth)								
Current DSA	4.8	5.0	5.3	5.3	5.4	5.4	5.4	5.4
Previous DSA (December 2022)	5.3	5.1	5.5	5.5	5.5	5.5	5.5	5.5
Inflation								
Current DSA	7.6	7.8	6.6	5.4	5.4	5.0	5.0	5.0
Previous DSA (December 2022)	7.7	7.8	5.7	5.0	5.0	4.9	5.0	5.0
Revenue and grants (percent of GDP)								
Current DSA	17.8	18.0	18.3	18.1	17.9	18.1	18.2	18.8
Previous DSA (December 2022)	17.5	17.6	17.9	18.0	17.9	18.1	18.4	19.2
Overall fiscal balance (percent of GDP)								
Current DSA	-6.2	-5.1	-4.1	-3.7	-3.6	-3.7	-3.7	-3.7
Previous DSA (December 2022)	-6.0	-5.0	-4.1	-3.9	-3.8	-3.8	-3.7	-2.4
Primary fiscal balance (percent of GDP)								
Current DSA	-1.4	-0.2	0.8	1.0	1.1	1.0	1.0	0.5
Previous DSA (December 2022)	-1.4	-0.3	0.5	0.8	0.8	0.9	1.0	1.0
Public debt (percent of GDP)								
Current DSA	68.4	70.6	68.5	66.9	65.1	63.5	61.6	48.3
Previous DSA (December 2022)	68.6	67.0	64.9	63.0	61.1	59.6	58.0	44.8
Current account (percent of GDP)								
Current DSA	-5.1	-4.8	-5.0	-5.0	-5.0	-5.0	-4.8	-4.5
Previous DSA (December 2022)	-5.7	-5.4	-5.3	-5.1	-5.0	-5.0	-5.0	-4.6
Non-interest current account (percent of GDP)								
Current DSA	-3.9	-3.2	-3.4	-3.4	-3.4	-3.5	-3.4	-3.3
Previous DSA (December 2022)	-3.5	-3.0	-3.2	-3.1	-3.1	-3.1	-3.0	-3.0
Exports of goods and services (growth)								
Current DSA	17.2	9.1	10.0	10.2	9.2	9.2	8.9	9.6
Previous DSA (December 2022)	18.9	9.9	10.1	10.2	8.9	8.3	8.7	9.6

Sources: Kenyan authorities and IMF staff estimates.
1/ Average 2029-43 for current DSA and 2028-42 for the previous one.

11. **The path of nominal public debt-to-GDP ratio is revised up from the last DSA, reflecting lower 2022 GDP in US dollars, the REER depreciation in 2023:H1, and additional commitments by development partners over the next three years (Text Table 4).** 2022 real GDP growth was slower than projected (4.8 percent) and the REER depreciation in 2023:H1 has lowered the forecasted US$-value of nominal GDP. In addition, the authorities have requested additional access to IMF resources via augmentation (and extension through 2025Q1) of the existing EFF/ECF arrangements by around US$548 million (75 percent of quota or SDR407.1 million) and a new 20-month RSF arrangement of around US$548 million (75 percent of quota or SDR407.1 million). The

WB financing envelope was increased in FY2022/23 and is expected to be higher than projected in the last DSA in 2024 as well. This is partly offset by the projected under-execution of external, syndicated bank loans by US$50 million in FY2022/23 and further rationalization of external project financing in the FY2023/24 budget. As in the case of the unrealized EUR1 billion (around US$1.1 billion) Eurobond issuance in FY2021/22 and lower than initially budgeted external project financing in FY2021/22 and FY2022/23, these shortfalls in external financing are also not expected to be compensated going forward (though the external borrowing plan continues to provide space for it should market conditions normalize (Text Table 6)). In the case of project financing, limits to investment absorption capacity are expected to be binding.

12. To support economic recovery, the CBK has lent the equivalent of the full amount of the 2021 US$740 million general allocation of SDRs to the government in local currency to meet financing needs in FY2021/22 and FY2022/23. In the DSA, the amounts lent are recorded as domestic debt at face value.[15]

Text Table 5. Kenya: Selected Macroeconomic Indicators, 2021–28

	2021	2022	2023	2024	2025	2026	2027	2028
		Projections						
Real GDP growth (percent)	7.6	4.8	5.0	5.3	5.3	5.4	5.4	5.4
CPI inflation, average (percent)	6.1	7.6	7.8	6.6	5.4	5.4	5.0	5.0
Overall fiscal balance (percent of GDP) [1]	-7.7	-6.5	-5.4	-4.4	-3.9	-3.8	-3.9	-3.9
Primary balance (percent of GDP)[1]	-4.0	-1.3	-1.1	0.7	0.9	1.1	1.0	1.0
Current account balance (percent of GDP)	-5.2	-5.1	-4.8	-5.0	-5.0	-5.0	-5.0	-4.8
Exports of goods and services (US$ billion)	11.8	13.9	15.1	16.6	18.3	20.0	21.8	23.8
Exports of goods and services (growth; percent)	21.8	17.2	9.1	10.0	10.2	9.2	9.2	8.9
Gross international reserves (US$ billion)	9.5	8.0	7.3	8.5	9.7	10.5	11.6	12.2

Sources: Kenyan authorities and IMF staff estimates and projections.
[1] Fiscal years (e.g., 2021 refers to FY 2020/21).

13. As part of the restructuring of Kenya Airways (KQ), the Government of Kenya has begun servicing the guaranteed portion of KQ external debts, which the company can no longer service, while discussions on novation of a part of this guaranteed stock are ongoing. As a result, the 2022 stock of public and publicly guaranteed debt includes the sum of the principal of these obligations and the remaining government guarantee on other KQ external loans (US$638 million as of December 2022)[16] in place of the US$750 million government guarantee of KQ debts recorded previously.

14. The current account deficit was 5.1 percent of GDP in 2022 and is expected to stabilize around 5 percent over the medium term:

- Despite the upward pressure on the import bill from the elevated global prices of commodities with relatively inelastic demand, such as oil derivatives, cereals, and fertilizers,

[15] In the last DSA, these loans entered the calculation in present-value terms with a grant element of 39.4 percent. A review of the loan agreements has since determined that the principal repayments are effectively indexed to the Ksh/SDR rate, making them non-concessional.

[16] The total includes the undrawn amount of government-guaranteed loan facilities and letters of credit by local banks, due to the high likelihood that they would be fully utilized.

the merchandize trade balance remained broadly unchanged at 10 percent of GDP in 2022, due to a slowdown in capital goods imports and higher prices for Kenya's main agricultural exports (tea, horticulture, and coffee) and consumer and intermediate goods exports in 2022, reflecting global developments. The weakness of capital goods imports reflects the completion of large, import-intensive infrastructure projects and the rationalization of the pipeline of public investments. This has a level impact on the path of imports over the medium term, as the lower than initially budgeted external project financing in FY2021/22 and FY2022/23 is not compensated going forward, as limits to investment absorption capacity are expected to be binding.

- Over the medium term, the expected stabilization of the current account deficit will be supported by the further fiscal consolidation and robust goods exports and tourism receipts, a continued flexible exchange rate, and by the gradual normalization of global commodity and financial market conditions. Export growth stands to benefit from Kenya's improving business environment, leveraging on existing trade and investment agreements,[17] and the new administration's policy priorities to increase the share of manufacturing (including agro-processing) and services (including tourism and financial sector) in the economy. In addition, export growth will be supported by policies to enhance agricultural productivity, including focus on farmer-led irrigation, efforts to modernize Kenya's food systems, and greater value chain integration. Services are projected to gradually increase over the medium term, as the tourism sector realizes its full potential. Remittances are also projected to remain robust over the medium term. The private sector current account deficit is expected to be financed by a diversified set of sources, including foreign direct investment (FDI) and financial and non-financial corporate borrowing.

15. As part of a continuing commitment to reduce external debt-related vulnerabilities, the public sector gross financing needs will be met with a balanced mix of external and domestic financing. For external financing, Kenya is expected to continue to primarily rely on concessional development loans. The authorities' external borrowing program, set out in Text Table 6, is in line with the authorities' commitments under the IMF-supported EFF/ECF arrangements. These include an overall ceiling on the present value of newly contracted or guaranteed external public debt, which is also a performance and policy action (PPA) under the World Bank's Sustainable Development Finance Policy (SDFP).[18] The cumulative external borrowing program through end-June 2024 is consistent with planned drawings of concessional and non-concessional loans in FY2022/23 and FY2023/24. The borrowing program continues to provide space for the US$1.1 billion external commercial financing, which did not take place in FY2021/22, and US$5 billion for debt

[17] Kenya is a member of the East African Community Customs Union and the African Continental Free Trade Area. It has signed an Economic Partnership Agreement (EPA) with the UK and has started bilateral implementation of European Union-East African Community EPA. In 2022, Kenya and the United States launched Strategic Trade and Investment Partnership that aims, *inter alia*, to increase investment, promote sustainable and inclusive economic growth, and support African regional economic integration.

[18] One FY2022 PPA sought to improve debt management by ensuring that the government limits the present value of new external borrowing to US$5.6 billion in FY2021/22, except if this limit is adjusted by the World Bank to a) reflect any material change of circumstances or b) in coordination with the IMF, in particular in line with adjustments in the IMF Debt Limit Policy. The PPA was observed by a wide margin.

management operations, both of which have been put on hold in light of the current challenging market conditions for frontier markets and are not reflected in the DSA baseline. A successful execution of the debt management operations would significantly lower liquidity risks related to the debt service profile. Looking ahead, Kenya is expected to continue to tap global capital markets to roll over maturing external commercial financing. The authorities are proactively preparing for the June 2024 Eurobond rollover, by launching the process for hiring international lead managers and considering alternative sources of financing from multilateral and bilateral lenders and the syndicated loans market. Kenya's external position is backstopped by its gross international reserves, which remain at adequate levels. Import coverage of reserves is expected to remain above the 3-month threshold, which is also close to the value of the IMF's reserve adequacy metric for credit-constrained economies, and gradually strengthen over time from 3.3 months of imports of goods and services in 2023 to 3.9 months of imports in 2027.[19]

16. The realism tools flag some optimism compared to historical performance, reflecting a structural break with past trends based on the policies underpinning the authorities' ambitious reform program (Figure 4). While protecting social spending, the baseline scenario assumes an improvement of the fiscal primary balance of 2.4 percentage points of GDP over three years in 2023–25, which falls in the lower range of the top quartile of the distribution for LICs. Staff is of the view that this is realistic and in line with the authorities' plan for fiscal consolidation under the program, as reflected in the execution of the FY2021/22 budget, their careful management of expenditures to achieve fiscal targets in the face of unanticipated pressures in FY2022/23, and their medium-term plans to strengthen tax revenues and streamline recurrent expenditures—particularly for wages and transfers to public sector entities—while improving public investment management and budgetary controls. The authorities' commitment to fiscal consolidation— including actions taken during the pandemic to broaden the tax revenue base, which have delivered resilience by creating fiscal space to cover unanticipated needs resulting from the war in Ukraine (e.g., gradual approach to adjusting domestic fuel prices during 2022), and actions taken to compensate for expenditure pressures in FY2022/23, while reducing the primary balance below the initially budgeted levels— provide assurances that the fiscal adjustment under the program is achievable. The return of real GDP growth to its long-term potential, following the strong recovery from the COVID–19 shock in 2021, explains the near-term growth trajectory during planned fiscal consolidation. Export growth is projected to be higher than in the recent past, as exports of goods and services recover from the 2020 global shock and by 2029 return to a similar share of GDP as observed in 2015. The revised projection for private investment incorporates the weaker outturn in 2022, revised view of the impact in 2023 from the needed tightening in monetary policy and projected external adjustments in 2023 and over the medium term.

[19] In the near term, reserves are bolstered by increased support from multilateral institutions for the ambitious government reform agenda (see paragraph 11), while over the medium-term they are expected to benefit from the crowding-in effect of fiscal consolidation on private sector external borrowing (see paragraph 8).

Text Table 6. Kenya: Summary Table of Projected External Borrowing Program from July 1, 2021, to June 30, 2024

Public and Publicly Guaranteed (PPG) External Debt [1]	Volume of New Debt from Jul 1, 2021 to Jun 30, 2024		PV of New Debt from Jul 1, 2021 to Jun 30, 2024 (Program Purposes)	
	US$ million	Percent	US$ million	Percent
By sources of debt financing	**19,455**	**100**	**14,471**	**100**
Concessional debt, of which	**11,898**	**61**	**7,042**	**49**
Multilateral debt	5,108	26	2,969	21
Bilateral debt	3,113	16	1,769	12
Other	3,647	19	2,286	16
Non-concessional debt, of which	**7,557**	**39**	**7,429**	**51**
Semi-concessional	437	2	310	2
Commercial terms	7,120	37	7,120	49
By Creditor Type	**19,455**	**100**	**14,471**	**100**
Multilateral, *of which*	5,452	28	3,198	22
World Bank	4,494	23	2,607	18
Bilateral - Paris Club	1,152	6	683	5
Bilateral - Non-Paris Club	1,962	10	1,086	8
Other, *of which*	10,890	56	9,504	66
For debt management operations [2]	5,000	26	5,000	35
Uses of debt financing	**19,455**	**100**	**14,471**	**100**
Infrastructure	4,693	24	3,591	25
Social Spending	6,703	34	4,005	28
Budget Financing	2,127	11	1,338	9
Other, *of which*	5,932	30.5	5,536	38
For debt management operations [2]	5,000	26	5,000	35

Source: IMF calculations using authorities' data.

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

2/ Planned potential borrowing for debt management operations to improve the debt profile (in terms of PV and debt service profile). Debt management operations are not reflected in the DSA baseline.

17. **The realism tools flag some optimism compared to historical performance, reflecting a structural break with past trends based on the policies underpinning the authorities' ambitious reform program (Figure 4).** While protecting social spending, the baseline scenario assumes an improvement of the fiscal primary balance of 2.4 percentage points of GDP over three years in 2023–25, which falls in the lower range of the top quartile of the distribution for LICs. Staff is of the view that this is realistic and in line with the authorities' plan for fiscal consolidation under the program, as reflected in the execution of the FY2021/22 budget, their careful management of expenditures to achieve fiscal targets in the face of unanticipated pressures in FY2022/23, and their medium-term plans to strengthen tax revenues and streamline recurrent expenditures—particularly for wages and transfers to public sector entities—while improving public investment management and budgetary controls. The authorities' commitment to fiscal consolidation— including actions taken during the pandemic to broaden the tax revenue base, which have delivered resilience by creating fiscal space to cover unanticipated needs resulting from the war in Ukraine (e.g., gradual approach to adjusting domestic fuel prices during 2022), and actions taken to compensate for

expenditure pressures in FY2022/23, while reducing the primary balance below the initially budgeted levels— provide assurances that the fiscal adjustment under the program is achievable. The return of real GDP growth to its long-term potential, following the strong recovery from the COVID–19 shock in 2021, explains the near-term growth trajectory during planned fiscal consolidation. Export growth is projected to be higher than in the recent past, as exports of goods and services recover from the 2020 global shock and by 2029 return to a similar share of GDP as observed in 2015. The revised projection for private investment incorporates the weaker outturn in 2022, revised view of the impact in 2023 from the needed tightening in monetary policy and projected external adjustments in 2023 and over the medium term.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

18. Kenya's debt carrying capacity is assessed as Medium (Text Table 7). The debt carrying capacity determines the applicable thresholds for the PPG external and total public debt sustainability indicators used in the assessment. It is informed by the value for Kenya of the Composite Indicator (CI) Index of 2.98,[20] which incorporates data from the IMF's April 2023 *World Economic Outlook* (WEO) macroeconomic projections and the 2021 World Bank's Country Policy and Institutional Assessment (CPIA), published in July 2022. The marginally lower CI score relative to the last published DSA is on account of the weaker outlook for global growth and lower projected path of import coverage of reserves, which are partly offset by upward revisions in real growth and the ratio of remittances to GDP.

19. Besides the six standardized stress tests, the analysis includes three tailored stress tests. The combined contingent liabilities stress test is described in paragraph 2 above and the natural disaster stress test is outlined in the Climate Change Risks section below. The market financing shock is applied to countries with market access, such as Kenya. It assesses rollover risks resulting from a deterioration in global risk sentiment, temporary nominal depreciation, and shortening of maturities of new external commercial borrowing.

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

Text Table 7. Kenya: Debt Carrying Capacity, Composite Indicator, and Thresholds

Country	Kenya
Debt Carrying Capacity	Medium

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Medium	Medium 2.98	Medium 3.02	Medium 3.03

Note: The current-vintage Composite Indicator Index is based on the IMF's 2023 April World Economic Outlook and the 2021 World Bank Country Policy and Institutional Assessment (CPIA), published in July 2022.

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.74	1.44	48%
Real growth rate (in percent)	2.719	5.06	0.14	5%
Import coverage of reserves (in percent)	4.052	36.02	1.46	49%
Import coverage of reserves^2 (in percent)	-3.990	12.98	-0.52	-17%
Remittances (in percent)	2.022	3.53	0.07	2%
World economic growth (in percent)	13.520	2.86	0.39	13%
CI Score			2.98	100%
CI rating			Medium	

Applicable thresholds

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

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

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

20. **External debt burden indicators in terms of exports and revenues breach sustainability thresholds under the baseline, giving rise to a mechanical high-risk signal (Table 1, Table 3, and Figure 1).** The PV of PPG external debt-to-exports solvency indicator remains above the threshold (180 percent) through 2026, while the debt service-to-exports liquidity indicator exceeds its threshold (15 percent) through 2030. The solvency indicator gradually declines as exports recover; the long-term trend decline in the liquidity indicator is interrupted by Eurobond repayments in 2024 and 2028 and the rollover of external bank loans coming due in 2025–26 and 2028. The projected rollovers of maturing commercial financing also push the external debt service-to-revenue ratio above its sustainability threshold (18 percent) in the same years. The PV of PPG external debt as a share of GDP remains well below the 40 percent indicative threshold throughout the projection period (Table 1 and Figure 1). Reflecting fiscal consolidation efforts and a borrowing mix that favors concessional borrowing, this solvency indicator is expected to decline from 27.8 percent in 2022 to 16 percent in 2043. The external debt burden indicators are higher than

projected in the last DSA, reflecting the level effect of lower GDP in US dollars in 2022, the REER depreciation in 2023:H1, further increase in interest expenses of external loans with floating interest rates, recording of the SDR on-lending to the government at face value (¶11) and increased support by development partners (¶10).

21. Standard stress test results highlight the sensitivity of debt burden indicators in terms of exports (Figure 1 and Table 1). Specifically, under the most extreme shock scenario (shock to export growth), the PV of debt-to-exports and the debt service-to-exports ratios breach the threshold over the entire medium-term projection period. Under the most extreme scenario involving one-time depreciation, the debt service-to-revenue ratio can potentially breach the threshold through 2029.

22. The market financing pressures module ranks market liquidity risks as moderate (Figure 5). Kenya's EMBI spread has widened above the threshold of 570 basis points (677 basis points as of June 22, 2023, having come down from the highs reached in the runup to the 2022 elections). On the plus side, gross financing needs are below the threshold (14 percent of GDP) that indicates high risk. Fiscal consolidation efforts under the IMF-supported EFF/ECF arrangements would help keep gross financing needs below the threshold. As is the case for other emerging and frontier economies, financing risks are affected by global liquidity conditions. Persistent deterioration in global market conditions would exacerbate financing risks for Kenya. The shift in the deficit financing mix toward domestic resources calls for monitoring, given the elevated levels of domestic interest rates.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

23. The PV of total public debt-to-GDP ratio remains above the 55 percent benchmark—for a country rated at medium debt-carrying capacity—through 2027 (Figure 2 and Table 2), giving rise to a mechanical high-risk signal. Public sector debt is projected to peak in 2023 at 64.4 percent of GDP (PV terms), followed by a steady decline. Supported by fiscal consolidation under the program, including revenue mobilization measures, the PV of public debt-to-revenue ratio (355 percent in 2022) is projected to more than halve by 2043.

24. Standard stress tests indicate that the PV of debt-to-GDP ratio is likely to remain above its indicative benchmark for most of the projection period under these scenarios (Figure 2 and Table 4). This is also the case in the historical scenario, in which key variables are kept at their historical averages, underscoring the importance of the authorities' ambitious reform agenda to reorient the economy to private-sector and export-oriented growth drivers to durably reduce debt-related vulnerabilities. Under the most extreme *standard* shock scenario (primary balance shock),[21] the PV of the public debt-to-GDP ratio would breach the 55 percent benchmark for a country with medium debt-carrying capacity through 2033.

[21] See next section for a discussion of the natural disaster *custom* stress scenario, which has an even bigger impact on debt burden metrics.

CLIMATE CHANGE RISKS

25. Kenya is highly vulnerable to climate change shocks, especially floods and droughts, which might affect debt dynamics. The total cost of climate change is estimated at 2–2.4 percent of GDP per year in Kenya.[22] This is largely due to the climate-sensitive nature of Kenya's economy, with agriculture, water, energy, tourism, and wildlife sectors playing an important role in it. Climate change can affect debt sustainability indicators through the negative impact on the fiscal deficit and balance of payments, short-term output losses from destruction of capital and the possibility of long-term scarring from productivity losses in climate-sensitive economic activities, as well as inflationary pressures that can further erode purchasing power. Specifically:

- The expected increase in the frequency of natural disasters would destroy capital and reduce output in the short run and can have a long-term impact on the level of GDP (see results from the natural disaster stress test below). Climate change can disrupt agricultural activities, leading to reduced crop yields, livestock losses, and decreased agricultural productivity over the long run. This can hinder overall economic growth, contribute to food insecurity and rural poverty and increase inflationary pressures from food prices.
- Government spending needs would rise with reconstruction costs and fiscal transfers to support those affected, while the disruptions of economic activities would simultaneously reduce government revenues. This would worsen fiscal deficits, which in the absence of corrective measures would translate into higher levels of public debt.
- The balance of payments will also be under pressure from the import component of reconstruction spending and terms-of-trade shocks stemming from price pressures in climate-sensitive economic activities (e.g., agriculture and tourism).

However, private and public spending on reconstruction also holds the promise of replacing obsolete production capacity with state-of-art technologies that can spur long-term growth. The current macro baseline does not explicitly model the effect of climate change, beyond the broad view on growth prospects of the economy, which embed the average effect of climate change in historical series.[23] The impact of climate change is, instead, accounted by a customized natural disaster stress test.

26. A natural disaster stress test for Kenya illustrates the risks to debt sustainability of an extreme climate event. The standard natural disaster stress test is informed by the 2008–11 drought, which caused widespread losses and damages creating a need for recovery and reconstruction public spending estimated at US$1.8 billion, slowed real GDP growth by an average of 2.8 percent a year, and negatively affected tourism and agricultural exports (see Kenya: Post Disaster Needs Assessment). The calibration assumes US$1.8 billion increase in public debt, one-off

[22] National Policy for Disaster Management in Kenya, Government of Kenya, 2017.

[23] This reflect the fact that (i) quantifying the exact impact of climate change on economic variables is challenging due to the inherent uncertainty associated with climate models and the complex interactions between climate and economic systems; (ii) projecting the future economic impacts of climate change requires concerted effort to compile comprehensive data that will take time to put in practice.

9 percentage points decline in real GDP growth, pro-rated from the 2008–11 precedent to account for the more diversified nature of the economy, and the standard 3.5 percentage points shock on exports growth (overall exports of goods and services grew over the 2008–11 episode). Results illustrate the very limited scope for meeting additional financing needs in the stress scenario with semi-concessional or commercial external financing without jeopardizing debt sustainability (see Tables 3 and 4). This highlights the need to expedite institutional reforms and capacity building to improve public investment efficiency, reduce leakages, and promote private climate investments.

27. Kenya's Nationally Determined Contribution (NDC) envisions 32 percent reduction in country's greenhouse gas emissions by 2030. At end-2022, more than 90 percent of electricity was generated from renewable sources. Kenya has also made significant strides in leveraging private climate finance through various channels—including public private partnerships (PPPs) in renewable energy projects, corporate green bond issuance, several blended finance mechanisms to de-risk private sector investments, and active engagement in global climate funds.

28. Achieving Kenya's ambitious climate objectives would require private sector participation and mobilization of additional tax revenues and concessional resources. Achieving Kenya's NDC pledge is estimated to entail climate-related investment needs of around 6 percent of GDP per year over 2023–30.[24] Some of these needs are addressed by existing investment projects,[25] with the balance expected to be met through a mix of private sector participation and highly concessional external financing.

29. Debt sustainability risks from reaching the climate goals are assumed to be limited, as authorities' efforts, beyond making the existing investment pipeline more climate responsive, will be contingent on mobilizing additional, highly concessional, climate financing and private sector solutions supported by market incentives. The implementation of reforms supported by the requested IMF Resilience and Sustainability Facility (RSF) would help achieve NDC pledges while safeguarding debt sustainability by: (i); incorporating climate risks into fiscal planning and investment framework; (ii) mobilizing climate revenue and strengthening the efficiency of climate spending; (iii) enhancing effectiveness of Kenya's existing frameworks to mobilize climate finance; (iv) strengthening disaster risk reduction and management. By supporting enhancements in Kenya's public financial management framework and improvements in public investment efficiency, RSF-related reform measures will help Kenya make public investment more climate responsive. They would also provide strong signal to investors, support establishing a pipeline of bankable projects, and accelerate mobilization of private financing.[26]

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[24] See Kenya's Updated Nationally Determined Contribution 2020–30.

[25] For example, active WB lending operations with more than 20 percent climate co-benefits include "Off-grid Solar Access Project for Underserved Counties", "Climate Smart Agriculture Project", "Financing Locally Led Climate Action Program", "Additional Financing for Coastal Region Water Security and Climate Resilience Project", "Kenya Urban Support Program ", etc.

[26] For example, the National Green Fiscal Incentives Policy Framework, to be adopted by end-2023, is expected to include fiscal and economic mechanisms, that could be used to promote climate-friendly investments, including carbon pricing and electric and hybrid modes of transportation.

RISK RATING AND VULNERABILITIES

30. Kenya's overall and external public debts are sustainable but remain at high risk of debt distress. The mechanical risk signals indicate sustained breaches of sustainability thresholds by solvency and liquidity indicators under the baseline scenario—the PV of external debt-to-exports and external debt service-to-exports ratios, as well as the PV of overall public debt-to-GDP ratio. A number of additional considerations support the assessment that debt is sustainable:

- The decisive actions already undertaken in 2020-23 to limit the increase in the deficit from global shocks (pandemic, war in Ukraine) and to broaden the tax base;
- The multi-year fiscal consolidation under the IMF supported EFF/ECF arrangements which aims to decisively reduce deficits and increase tax revenue;
- The consistently strong performance of remittances, which supports external sustainability, paired with a more favorable outlook for exports;
- A generally smooth external debt service profile on a clear declining trajectory as share of exports and public revenues, which authorities plan to further optimize if market conditions are favorable;
- Close attention to evaluating risks at SOEs and the commitment under the IMF-supported EFF/ECF arrangements to limit the impact on the deficit of any fiscal support (e.g., via offsets);
- Ongoing efforts to strengthen fiscal sustainability under the SDFP by rationalizing public investments on the basis of rigorous criteria.
- Climate adaptation and mitigation strategies, with focus on water management, agriculture and food security, ecosystem conservation, disaster risk reduction, sustainable energy transition, climate information and research, health and human security, education and awareness, can help curb and cushion climate risks, limiting the impact on debt ratios.
- The authorities' proactive preparation for the June 2024 Eurobond rollover, by launching the process for hiring international lead managers and considering alternative sources of financing from multilateral and bilateral lenders and the syndicated loans market.
- Looking ahead, efficient investment in infrastructure will raise growth and export potential, both of which will support Kenya's external debt sustainability.

31. Fiscal consolidation under Kenya's IMF-supported program would achieve and surpass the debt-stabilizing primary balance. Debt would begin declining as a share of GDP starting in 2024. Indicators measured against exports will also gradually improve as the recovery of exports takes hold and reforms under the IMF-supported EFF/ECF arrangements enhance competitiveness. Given the magnitude of mechanical threshold breaches under the baseline, consolidation efforts would need to be sustained over the medium term to restore fiscal space and reduce debt-related risks. Of note:

- While the PV of total public debt-to-GDP ratio remains above the indicative threshold (55 percent), the authorities' commitment to fiscal consolidation under the program safeguards debt sustainability. Important actions have already been taken to permanently broaden the tax revenue base, alongside expenditure savings to limit expansion of the deficit from the COVID-19 shock and the war in Ukraine. The multiyear fiscal consolidation plan highlighted in the 2023 Budget Policy Statement (BPS) and substantiated by the FY2023/24 Budget is premised on a more conservative approach to revenue projections and a commitment to additional policy steps to increase tax revenues and control expenditures under the EFF/ECF arrangements with the specific objective of anchoring debt sustainability.
- Kenya's PV of external debt as a share of GDP is well below the 40 percent indicative threshold and will gradually decline over time. Kenya's external debt indicators are expected to gradually improve as fiscal consolidation progresses, exports recover after the global shocks dissipate, and Kenya makes progress to unlock its substantial export potential.
- Kenya's borrowing plan relies on a balanced mix of commercial and concessional financing that contributes to reducing debt risks, supported by limits on the government's external borrowing under the EFF/ECF arrangement and PPAs under the SDFP, which also support steps to improve debt transparency.

32. Debt sustainability is also supported by stable and strong remittances, Kenya's generally smooth debt service profile and the authorities' commitment to insulate the public sector balance sheet from SOE-related contingent liabilities. While the protracted breaches of most debt burden indicators are a source of concern, there are mitigating factors that help support the debt sustainability assessment. The relatively smooth debt service profile—except for maturing Eurobonds and external bank loans in 2024-26 and 2028—is on a clear declining trajectory over the projection period, signaling a strengthening in debt servicing capacity. The authorities' commitment to absorb the fiscal costs associated with materialization of SOE-related contingent liabilities with a limited impact on the programmed fiscal envelope will help avoid further deterioration in the public sector balance sheet. Stable and strong remittances, amounting to 29 percent of exports of goods and services in 2022, would also continue to be an important source for foreign currency receipts going forward.

33. The assessment is subject to heightened uncertainty in the global environment and a narrow scope for deviations from the domestic reform agenda underpinning the baseline. Kenya is exposed to heightened risks to the global outlook through international trade and financing channels. Intensification of global spillovers from the war in Ukraine could drive persistent investor concerns about the prospects of frontier economies and increase the cost of financing. Exports could underperform the baseline on account of a) lower demand from major economies due to shocks or policy measures (e.g., faster tightening of monetary policy to address concerns on inflation); and b) delays in domestic structural reforms needed to support medium-term export growth. Domestic government bond holdings by pension funds and commercial banks expose the economy to feedback between sovereign and financial sector risks, while the need to rollover maturing external commercial debt exposes the country to risks from a liquidity squeeze. Domestic political risks (e.g., any unrest or disruptions due to concerns on cost of living, rising tax burden, etc.) or any deterioration in the security situation could disrupt trade and tourism. Even with the strong commitment by authorities to fiscal consolidation, there is a risk for slippages especially in the long run. Finally, crowding-in effect of the fiscal consolidation into private sector growth might take longer to materialize.

AUTHORITIES' VIEWS

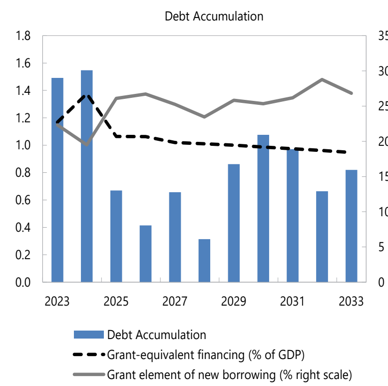
34. The authorities broadly shared IMF staff's assessment, emphasizing that reducing debt vulnerabilities is a key priority to support Kenya's developmental agenda. At the same time, they stressed the indispensable role of sustainable debt financing in meeting the infrastructure needs of Kenya's vibrant economy. The authorities highlighted their determination to continue to extend the maturity of domestic debt and pursue a financing strategy that balances domestic and external financing, relies primarily on concessional financing, and accesses international capital markets judiciously. They emphasized the active preparation for the June 2024 Eurobond rollover, including launching the process for hiring international lead managers and considering alternative sources of financing from multilateral and bilateral lenders and the syndicated loans market. The authorities reiterated their strong commitment to debt transparency. They expressed confidence that legislative amendments, currently tabled in Parliament, to replace the existing nominal debt ceiling with a ceiling expressed in present value terms and in percent of GDP will better anchor their medium-term fiscal policies.

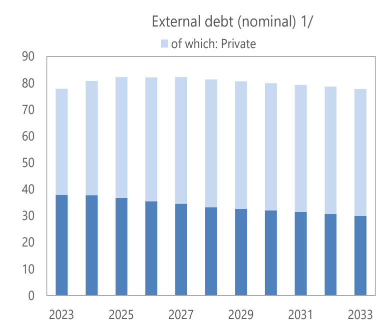
Table 1. Kenya: External Debt Sustainability Framework, Baseline Scenario, 2020–43

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2033	2043	Historical	Projections
External debt (nominal) 1/	72.2	71.1	72.6	77.8	80.8	82.2	82.1	82.2	81.3	77.8	73.1	57.5	80.2
of which: public and publicly guaranteed (PPG)	35.4	34.7	34.5	37.9	37.8	36.7	35.5	34.6	33.3	30.0	22.4	27.7	33.9
Change in external debt	6.3	-1.1	1.5	5.2	2.9	1.4	-0.1	0.1	-0.9	-0.8	-1.0		
Identified net debt-creating flows	3.8	-0.7	2.4	0.5	0.0	-0.2	-0.5	-0.6	-0.9	-1.4	-1.4	2.0	-0.7
Non-interest current account deficit	3.6	4.1	3.9	3.2	3.3	3.2	3.3	3.4	3.2	3.1	3.4	5.2	3.2
Deficit in balance of goods and services	7.9	9.1	9.3	8.5	8.6	8.6	8.6	8.7	8.4	7.6	7.3	9.9	8.2
Exports	9.6	10.8	12.2	13.4	14.5	15.0	15.4	15.9	16.3	19.0	26.5		
Imports	17.6	19.9	21.5	21.9	23.1	23.6	24.0	24.6	24.7	26.6	33.8		
Net current transfers (negative = inflow)	-4.9	-5.6	-5.7	-6.1	-6.3	-6.4	-6.4	-6.5	-6.5	-6.3	-6.1	-5.2	-6.4
of which: official	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0		
Other current account flows (negative = net inflow)	0.6	0.5	0.3	0.9	1.0	1.0	1.1	1.2	1.4	1.8	2.2	0.5	1.3
Net FDI (negative = inflow)	-0.6	0.0	-0.3	-0.7	-0.9	-1.1	-1.3	-1.4	-1.5	-1.8	-2.2	-0.7	-1.4
Endogenous debt dynamics 2/	0.8	-4.7	-1.1	-2.0	-2.4	-2.4	-2.5	-2.5	-2.6	-2.6	-2.6		
Contribution from nominal interest rate	1.2	1.2	1.3	1.6	1.6	1.7	1.7	1.6	1.6	1.4	1.1		
Contribution from real GDP growth	0.2	-5.0	-3.3	-3.6	-4.0	-4.1	-4.1	-4.2	-4.2	-4.0	-3.7		
Contribution from price and exchange rate changes	-0.6	-0.9	0.9	...	...	...	...	...	...	...	...		
Residual 3/	2.5	-0.4	-1.0	4.7	2.9	1.6	0.4	0.7	0.0	0.5	0.4	2.3	1.2
of which: exceptional financing	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	27.8	29.5	30.5	29.4	28.0	27.1	25.9	22.9	16.3		
PV of PPG external debt-to-exports ratio	...	...	228.3	220.4	210.8	195.6	181.7	170.3	158.2	120.4	61.5		
PPG debt service-to-exports ratio	25.7	22.5	21.2	22.0	31.1	21.7	22.0	19.7	22.2	12.7	6.5		
PPG debt service-to-revenue ratio	15.1	14.6	14.8	16.6	24.9	18.2	19.2	17.6	20.2	13.2	8.5		
Gross external financing need (Million of U.S. dollars)	27,431	28,168	29,066	29,542	32,122	31,887	33,699	34,739	36,625	41,307	62,052		
Key macroeconomic assumptions													
Real GDP growth (in percent)	-0.3	7.6	4.8	5.0	5.3	5.3	5.4	5.4	5.4	5.4	5.4	4.5	5.3
GDP deflator in US dollar terms (change in percent)	0.9	1.2	-1.3	-5.5	-3.1	0.7	0.8	0.4	0.6	0.6	1.9	2.7	-0.2
Effective interest rate (percent) 4/	1.8	1.8	1.8	2.2	2.1	2.2	2.2	2.1	2.0	1.9	1.6	2.1	2.0
Growth of exports of G&S (US dollar terms, in percent)	-15.4	21.8	17.2	9.1	10.0	10.2	9.2	9.2	8.9	9.6	9.9	2.7	9.4
Growth of imports of G&S (US dollar terms, in percent)	-13.2	23.3	11.7	1.0	7.8	8.3	8.3	8.2	6.5	8.2	9.2	3.8	7.2
Grant element of new public sector borrowing (in percent)	...	...	...	22.3	19.5	26.1	26.7	25.2	23.5	26.8	32.2	...	25.1
Government revenues (excluding grants, in percent of GDP)	16.4	16.6	17.5	17.7	18.0	17.9	17.7	17.8	18.0	18.2	20.5	17.1	18.0
Aid flows (in Million of US dollars) 5/	1,841	1,785	1,791	2,293	2,793	2,435	2,802	2,866	3,005	3,762	5,927		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.2	1.4	1.1	1.1	1.0	1.0	0.9	0.9	...	1.1
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	27.7	23.2	31.2	31.9	30.5	28.6	32.9	42.0	...	30.5
Nominal GDP (Million of US dollars)	100,912	109,875	113,701	112,818	115,115	122,115	129,728	137,287	145,524	195,793	356,303		
Nominal dollar GDP growth	0.6	8.9	3.5	-0.8	2.0	6.1	6.2	5.8	6.0	6.1	7.4	7.3	5.1
Memorandum items:													
PV of external debt 7/	...	...	65.9	69.4	73.4	74.8	74.6	74.8	73.9	70.7	66.9		
In percent of exports	...	...	541.0	518.0	508.1	498.6	483.9	469.9	452.3	371.9	252.6		
Total external debt service-to-exports ratio	239.4	200.0	175.7	166.2	164.0	145.1	138.5	129.0	124.9	85.3	44.7		
PV of PPG external debt (in Million of US dollars)			31,629	33,325	35,072	35,843	36,349	37,202	37,633	44,808	58,110		
(PVt-PVt-1)/GDPt-1 (in percent)				1.5	1.5	0.7	0.4	0.7	0.3	0.8	0.4		
Non-interest current account deficit that stabilizes debt ratio	-2.7	5.2	2.4	-2.0	0.4	1.8	3.4	3.2	4.1	3.9	4.4		

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





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

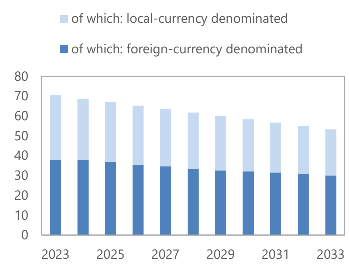
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 2. Kenya: Public Sector Debt Sustainability Framework, Baseline Scenario, 2020–43
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2033	2043	Historical	Projections
Public sector debt 1/	68.0	68.2	68.4	70.6	68.5	66.9	65.2	63.5	61.7	53.2	37.2	55.1	61.8
of which: external debt	35.4	34.7	34.5	37.9	37.8	36.7	35.5	34.6	33.3	30.0	22.4	27.7	33.9
Change in public sector debt	8.9	0.3	0.2	2.2	-2.1	-1.6	-1.7	-1.7	-1.8	-1.8	-1.5		
Identified debt-creating flows	7.8	1.0	2.1	-1.9	-2.3	-2.0	-2.1	-2.1	-2.2	-2.1	-1.8	2.7	-2.1
Primary deficit	3.8	2.7	1.4	0.2	-0.8	-1.0	-1.1	-1.0	-1.0	-0.6	-0.2	3.3	-0.8
Revenue and grants	16.7	16.8	17.8	18.0	18.3	18.1	17.9	18.1	18.2	18.4	20.8	17.4	18.2
of which: grants	0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.3		
Primary (noninterest) expenditure	20.5	19.5	19.2	18.2	17.5	17.1	16.8	17.0	17.2	17.8	20.7	20.7	17.4
Automatic debt dynamics	4.0	-1.8	0.8	-2.1	-1.5	-1.0	-1.1	-1.1	-1.2	-1.5	-1.6		
Contribution from interest rate/growth differential	2.7	-3.0	-2.5	-2.1	-1.5	-1.0	-1.1	-1.1	-1.2	-1.5	-1.6		
of which: contribution from average real interest rate	2.6	1.8	0.7	1.2	2.0	2.5	2.3	2.2	2.1	1.3	0.4		
of which: contribution from real GDP growth	0.2	-4.8	-3.2	-3.2	-3.5	-3.5	-3.4	-3.3	-3.2	-2.8	-2.0		
Contribution from real exchange rate depreciation	1.2	1.2	3.2	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	1.1	-0.7	-2.0	4.1	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.4	0.7
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	63.1	64.4	61.9	60.2	58.3	56.6	54.8	46.6	31.6		
PV of public debt-to-revenue and grants ratio	...	...	355.2	357.8	338.1	331.7	325.8	313.3	301.0	252.6	151.7		
Debt service-to-revenue and grants ratio 3/	54.1	55.2	54.5	55.1	65.9	56.7	56.9	52.8	52.5	43.0	22.9		
Gross financing need 4/	12.8	12.0	11.1	10.1	11.3	9.3	9.1	8.5	8.5	7.3	4.6		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	-0.3	7.6	4.8	5.0	5.3	5.3	5.4	5.4	5.4	5.4	5.4	4.5	5.3
Average nominal interest rate on external debt (in percent)	3.5	3.1	3.0	3.7	3.4	3.5	3.4	3.3	3.2	3.0	2.4	2.9	3.2
Average real interest rate on domestic debt (in percent)	6.7	7.5	6.1	3.8	5.3	6.6	6.3	6.3	6.0	4.3	1.6	5.3	5.4
Real exchange rate depreciation (in percent, + indicates depreciation)	4.0	3.8	10.1	...	...	...	...	...	...	...	...	0.2	...
Inflation rate (GDP deflator, in percent)	4.9	4.3	6.0	8.2	6.7	5.4	5.4	5.1	5.0	4.9	4.9	6.1	5.5
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.2	2.8	2.8	-0.6	1.5	3.0	3.6	6.6	6.3	6.0	7.4	4.0	4.7
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-5.1	2.5	1.2	-2.1	1.3	0.6	0.7	0.6	0.8	1.2	1.3	-0.5	0.6
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

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

Public sector debt 1/



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

Table 3. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2023–33

(In percent)

	Projections 1/										
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
PV of debt-to GDP ratio											
Baseline	30	30	29	28	27	26	25	25	24	23	23
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	30	31	32	32	33	34	36	38	39	**41**	**42**
B. Bound Tests											
B1. Real GDP growth	30	32	32	31	30	28	28	27	26	26	25
B2. Primary balance	30	32	35	33	33	31	31	30	30	29	29
B3. Exports	30	33	36	35	34	32	32	31	30	29	28
B4. Other flows 3/	30	32	33	32	31	30	29	28	28	27	26
B5. Depreciation	30	39	33	32	31	29	28	28	27	27	26
B6. Combination of B1-B5	30	35	36	35	34	32	31	31	30	29	28
C. Tailored Tests											
C1. Combined contingent liabilities	30	33	33	32	31	29	29	29	29	28	27
C2. Natural disaster	30	35	35	34	34	33	33	34	34	34	35
C3. Commodity price	30	30	29	28	27	26	25	25	24	23	23
C4. Market Financing	30	34	33	32	31	29	28	27	27	26	25
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	**220**	**211**	**196**	**182**	170	158	150	144	136	128	120
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**220**	**214**	**211**	**210**	**210**	**210**	**214**	**219**	**221**	**222**	**222**
B. Bound Tests											
B1. Real GDP growth	**220**	**211**	**196**	**182**	170	158	150	144	136	128	120
B2. Primary balance	**220**	**222**	**230**	**217**	**205**	**191**	**183**	176	168	159	151
B3. Exports	**220**	**272**	**344**	**321**	**302**	**282**	**268**	**256**	**240**	**224**	**209**
B4. Other flows 3/	**220**	**224**	**222**	**207**	**195**	**182**	173	165	155	145	136
B5. Depreciation	**220**	**211**	175	162	151	140	132	127	121	114	108
B6. Combination of B1-B5	**220**	**264**	**222**	**267**	**252**	**235**	**224**	**214**	**202**	**188**	177
C. Tailored Tests											
C1. Combined contingent liabilities	**220**	**232**	**219**	**205**	**193**	**180**	173	167	160	152	145
C2. Natural disaster	**220**	**231**	**220**	**210**	**201**	**192**	**188**	**185**	**181**	176	171
C3. Commodity price	**220**	**211**	**196**	**182**	170	158	150	144	136	128	120
C4. Market Financing	**220**	**211**	**196**	**183**	171	158	149	142	134	125	118
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	**22**	**31**	**22**	**22**	**20**	**22**	**16**	14	14	13	13
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**22**	**30**	**21**	**21**	**20**	**22**	**17**	**16**	**17**	**17**	**17**
B. Bound Tests											
B1. Real GDP growth	**22**	**31**	**22**	**22**	**20**	**22**	**16**	14	14	13	13
B2. Primary balance	**22**	**31**	**23**	**24**	**22**	**24**	**18**	**17**	**16**	**16**	**15**
B3. Exports	**22**	**38**	**32**	**34**	**31**	**34**	**25**	**24**	**24**	**23**	**22**
B4. Other flows 3/	**22**	**31**	**22**	**23**	**21**	**23**	**17**	**16**	**16**	**15**	14
B5. Depreciation	**22**	**31**	**22**	**21**	**19**	**21**	**16**	14	12	12	11
B6. Combination of B1-B5	**22**	**35**	**30**	**30**	**27**	**30**	**23**	**22**	**21**	**20**	**19**
C. Tailored Tests											
C1. Combined contingent liabilities	**22**	**31**	**23**	**23**	**21**	**23**	**17**	**15**	15	14	14
C2. Natural disaster	**22**	**32**	**23**	**23**	**21**	**24**	**18**	**16**	**16**	**15**	15
C3. Commodity price	**22**	**31**	**22**	**22**	**20**	**22**	**16**	14	14	13	13
C4. Market Financing	**22**	**31**	**22**	**25**	**23**	**22**	**16**	**19**	15	13	12
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	17	**25**	**18**	**19**	18	**20**	15	14	14	13	13
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	17	**24**	18	**19**	18	**20**	16	16	16	17	18
B. Bound Tests											
B1. Real GDP growth	17	**26**	**20**	**21**	**19**	**22**	17	15	15	15	14
B2. Primary balance	17	**25**	**19**	**21**	**19**	**22**	17	16	16	16	16
B3. Exports	17	**25**	**19**	**21**	**19**	**22**	17	16	17	17	16
B4. Other flows 3/	17	**25**	**19**	**20**	**18**	**21**	16	15	15	15	15
B5. Depreciation	17	**32**	**23**	**24**	**22**	**25**	**18**	17	15	15	15
B6. Combination of B1-B5	17	**26**	**21**	**22**	**20**	**23**	18	17	17	17	17
C. Tailored Tests											
C1. Combined contingent liabilities	17	**25**	**19**	**20**	**18**	**21**	16	15	14	14	14
C2. Natural disaster	17	**25**	**19**	**20**	**18**	**21**	16	15	15	15	15
C3. Commodity price	17	**25**	**18**	**19**	18	**20**	15	14	14	13	13
C4. Market Financing	17	**25**	**19**	**22**	**20**	**20**	15	18	15	13	13
Threshold	18	18	18	18	18	18	18	18	18	18	18

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

Table 4. Kenya: Sensitivity Analysis for Key Indicators of Public Debt, 2023–33

(In percent)

	Projections 1/										
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
PV of Debt-to-GDP Ratio											
Baseline	**64**	**62**	**60**	**58**	**57**	55	53	51	50	48	47
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	**64**	**67**	**69**	**71**	**73**	**75**	**76**	**78**	**79**	**80**	**81**
B. Bound Tests											
B1. Real GDP growth	**64**	**65**	**68**	**67**	**67**	**66**	**66**	**66**	**65**	**65**	**64**
B2. Primary balance	**64**	**67**	**71**	**69**	**68**	**66**	**64**	**62**	**60**	**58**	**56**
B3. Exports	**64**	**64**	**66**	**65**	**63**	**61**	**59**	**57**	**55**	53	51
B4. Other flows 3/	**64**	**64**	**64**	**62**	**61**	**59**	**57**	**55**	53	51	50
B5. Depreciation	**64**	**66**	**63**	**60**	**57**	54	51	48	46	43	40
B6. Combination of B1-B5	**64**	**64**	**68**	**67**	**65**	**63**	**61**	**59**	**58**	**56**	54
C. Tailored Tests											
C1. Combined contingent liabilities	**64**	**70**	**68**	**66**	**65**	**63**	**61**	**59**	**57**	**56**	54
C2. Natural disaster	**64**	**73**	**73**	**72**	**72**	**71**	**71**	**71**	**70**	**70**	**69**
C3. Commodity price	**64**	**63**	**62**	**61**	**60**	**60**	**59**	**59**	**59**	**58**	**58**
C4. Market Financing	**64**	**62**	**60**	**58**	**57**	55	53	51	49	48	46
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	358	338	332	326	313	301	291	282	272	263	253
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	358	363	379	396	403	410	418	425	431	436	440
B. Bound Tests											
B1. Real GDP growth	358	357	374	376	370	364	362	359	355	352	348
B2. Primary balance	358	364	393	387	374	360	350	339	328	317	306
B3. Exports	358	350	367	361	347	334	324	313	301	290	277
B4. Other flows 3/	358	349	354	349	335	323	313	302	291	280	269
B5. Depreciation	358	361	347	334	314	295	279	264	249	234	220
B6. Combination of B1-B5	358	352	378	372	359	346	336	326	315	305	294
C. Tailored Tests											
C1. Combined contingent liabilities	358	385	377	371	358	344	334	323	313	302	292
C2. Natural disaster	358	400	402	404	398	392	389	386	382	379	375
C3. Commodity price	358	342	340	340	333	327	325	322	320	318	315
C4. Market Financing	358	338	332	327	314	301	291	280	270	261	250
Debt Service-to-Revenue Ratio											
Baseline	55	66	57	57	53	53	46	44	43	43	43
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	55	67	61	63	60	61	56	56	57	60	61
B. Bound Tests											
B1. Real GDP growth	55	69	63	64	60	61	54	53	54	55	57
B2. Primary balance	55	66	63	67	59	58	53	54	54	53	52
B3. Exports	55	66	57	58	54	54	47	46	46	46	46
B4. Other flows 3/	55	66	57	58	54	53	47	45	45	45	45
B5. Depreciation	55	65	58	58	54	55	47	44	43	43	42
B6. Combination of B1-B5	55	64	59	65	57	56	50	50	50	49	49
C. Tailored Tests											
C1. Combined contingent liabilities	55	66	67	61	56	56	52	51	50	50	47
C2. Natural disaster	55	72	69	67	63	63	58	58	58	59	59
C3. Commodity price	55	66	57	58	54	54	48	48	48	50	51
C4. Market Financing	55	66	57	60	56	52	45	48	44	42	43

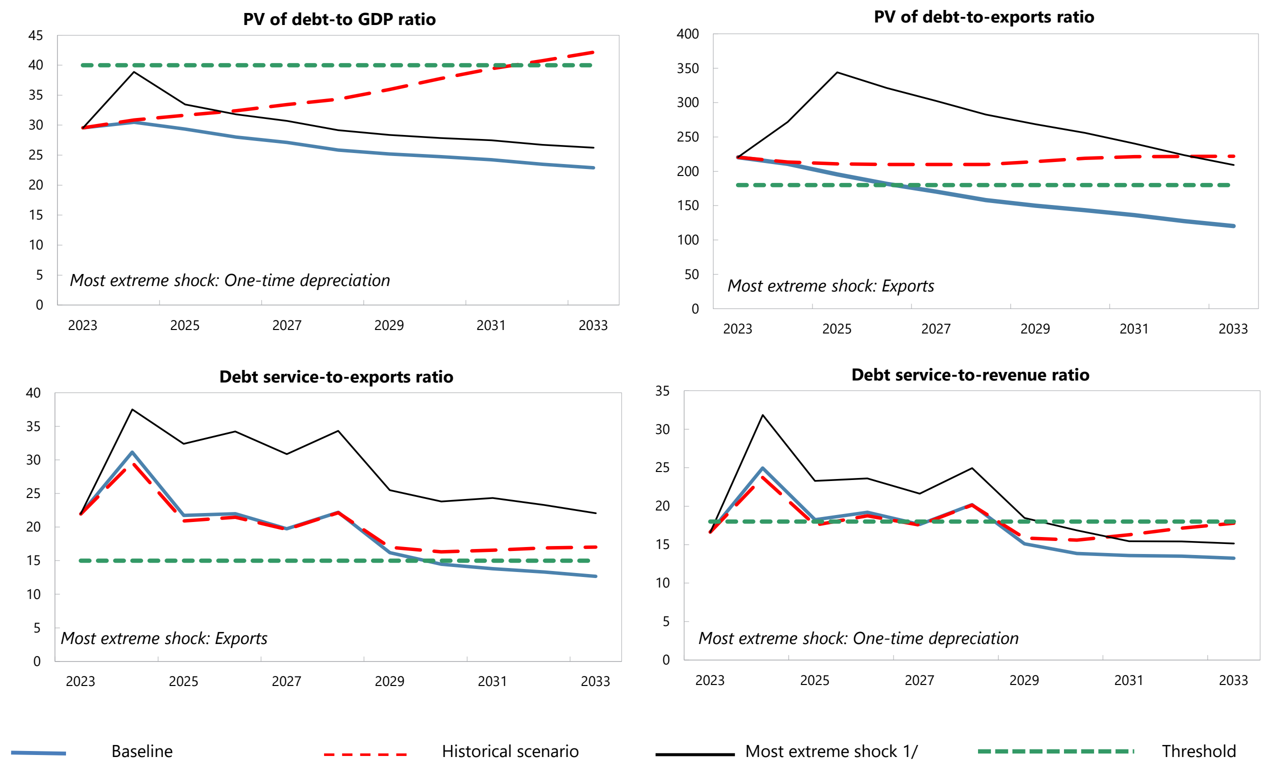
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Figure 1. Kenya: Indicators of Public and Publicity Guaranteed External Debt Under Alternatives Scenarios, 2023–33



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

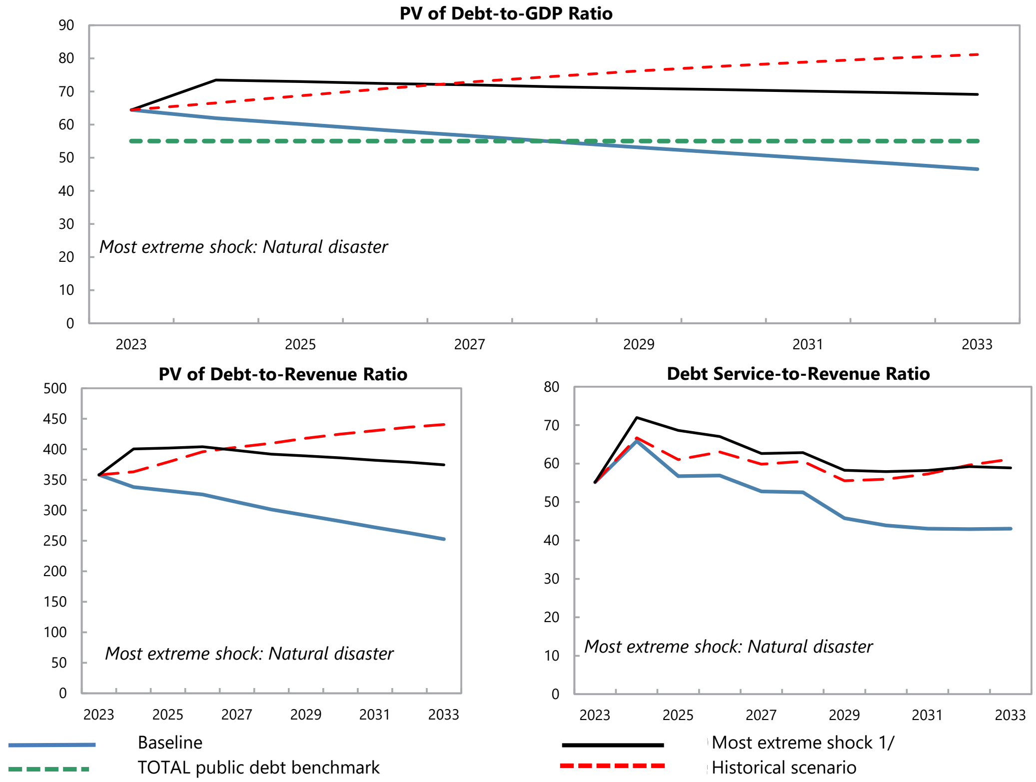
Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	3.6%	3.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	21	21
Avg. grace period	5	5

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

Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Kenya: Indicators of Public Debt Under Alternative Scenarios, 2023–33



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	38%	38%
Domestic medium and long-term	46%	46%
Domestic short-term	15%	15%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	3.6%	3.6%
Avg. maturity (incl. grace period)	21	21
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.2%	4.2%
Avg. maturity (incl. grace period)	8	8
Avg. grace period	4	4
Domestic short-term debt		
Avg. real interest rate	1.1%	1.1%

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

Sources: Country authorities; and staff estimates and projections.

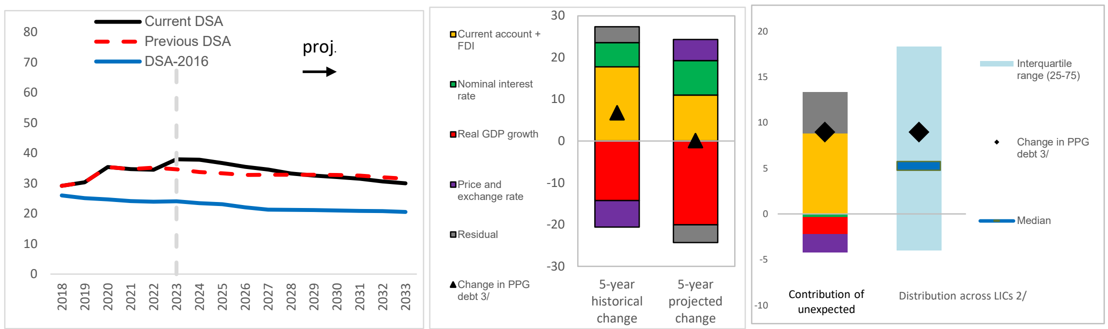
1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

Gross Nominal PPG External Debt
(in percent of GDP; DSA vintages)

Debt-creating flows
(percent of GDP)

Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

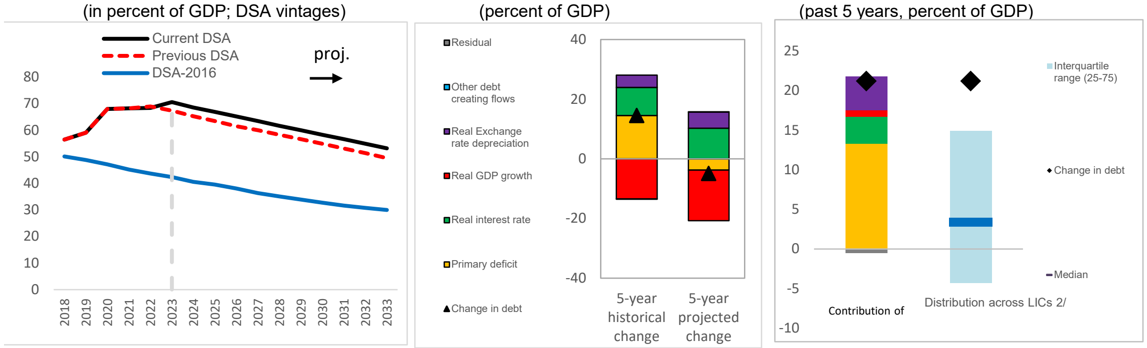


Public Debt

Gross Nominal Public Debt
(in percent of GDP; DSA vintages)

Debt-creating flows
(percent of GDP)

Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)



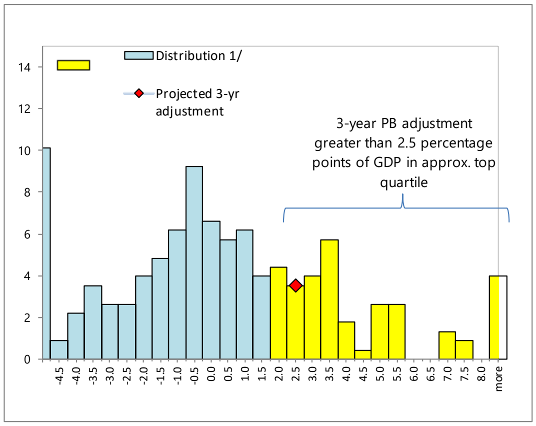
1/ Difference between anticipated and actual contributions on debt ratios.

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

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

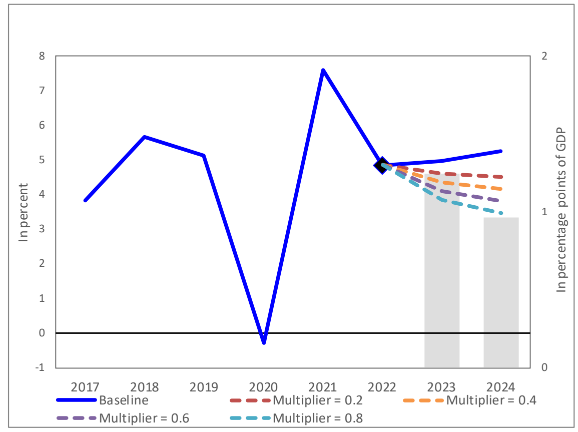
Figure 4. Kenya: Realism Tools

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



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

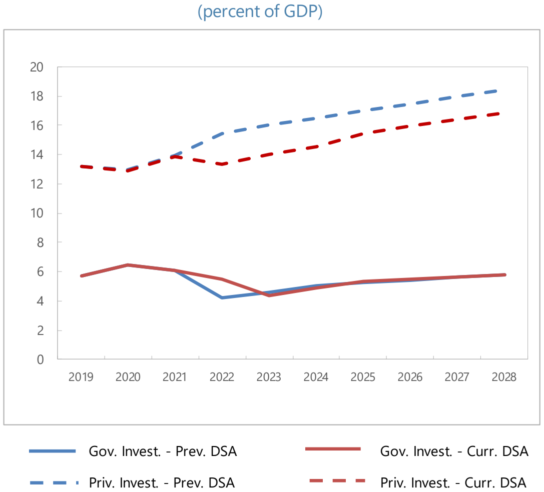
Fiscal Adjustment and Possible Growth Paths 1/



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

Public and Private Investment Rates

(percent of GDP)



Contribution to Real GDP growth

(percent, 5-year average)

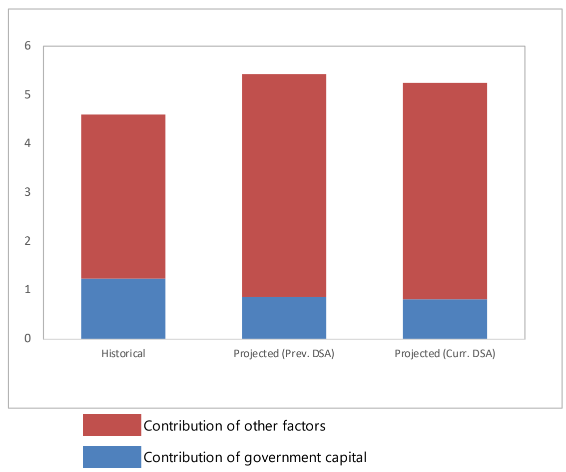
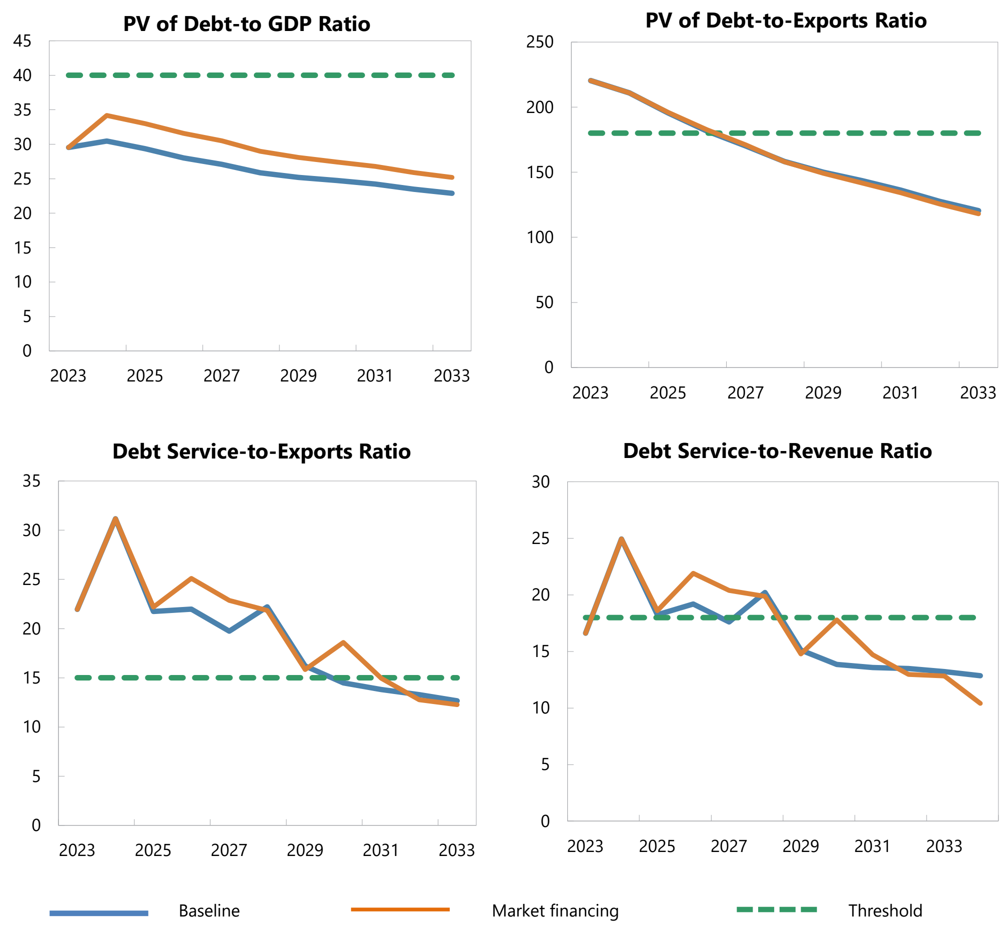


Figure 5. Kenya: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	11	779
Breach of benchmark	No	Yes
Potential heightened liquidity needs	Moderate	

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



Sources: Country authorities; and staff estimates and projections.

KENYA

June 30, 2023

FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS AND REQUEST FOR A 20-MONTH ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY; REQUESTS FOR EXTENSION, REPHASING, AND AUGMENTATION OF ACCESS, MODIFICATION OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA AND WAIVER OF NONOBSERVANCE FOR A PERFORMANCE CRITERION, AND MONETARY POLICY CONSULTATION CLAUSE

WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

A. Country Vulnerability to Climate Change Including Human, Social, and Economic Costs

1. **Kenya is vulnerable to climate-induced natural disasters. The Notre Dame Global Adaptation Initiative (ND-GAIN) ranks Kenya as the 39th most vulnerable country to climate change (2020).** A range of climate models forecast that Kenya's mean temperature will increase, with temperature increasing relatively more under a scenario in which there is no global decarbonization effort. Precipitation, in contrast, is forecast to fluctuate significantly, with the relative change in mean precipitation varying depending on the model. Climate change impacts vary spatially according to the biophysical conditions across the country and depend on where population and economic activities are concentrated.

2. **Climate change is already a source of significant risk for Kenya. Estimates suggest that more than 70 percent of natural disasters in Kenya are attributable to extreme climatic events.** These include major droughts that occur every ten years, and moderate droughts or floods every three to four years. The repeating patterns of floods and droughts in the country have had devastating socio-economic impacts. For example, the 2008–11 drought, is estimated to have cost Kenya US$12.1 billion, including US$0.8 billion from the destruction of physical and durable assets and US$11.3 billion from losses across all sectors of the economy (Kenya Post Disaster Needs Assessment 2008–11 Drought). Droughts have increased in frequency affecting more people with an estimated economic impact of 8 percent of GDP every five years. While droughts are often nationwide, the most severe impacts are felt in the

country's highly arid zones, which encompass many of the poorest counties. Floods and droughts have resulted in episodes of acute food insecurity and loos of assets. Although Kenya's economy has grown rapidly and the incidence of poverty trending downward, one third of Kenya's population still lives under the international poverty line. This highlights that the country's development path toward reducing poverty and achieving prosperity will have to mitigate significant climate risks.

3. Kenya contributes less than 0.1 percent of global greenhouse gas emissions annually. In 1995, GHG emissions were estimated 56.8MTCO2e and increased to 93.7MT CO2e in 2015 and is projected, in Kenya's draft Long-Term Strategy, to reach 300MTCO2e by 2050 in a scenario of no intervention. Agriculture is the leading source of emissions (40 percent) due largely to enteric fermentation, followed by land use and land use change and forests (38 percent), transport (12 percent), energy (excluding transport) (6 percent), industrial processes (3 percent), waste (3 percent) and electricity (1 percent).

B. Government Policies and Commitments for Climate Change Adaptation and Priority Areas to Strengthen Resilience

4. Kenya's National Determined Contribution (NDC) embodies ambitious adaptation goals. With respect to adaptation, the NDC identifies water, agriculture, land use, forestry, energy, health, and infrastructure as priority sectors to focus adaptation efforts. the NDC also aims to ensure a climate-resilient society through mainstreaming climate change adaptation in the Medium-Term Plans (MTPs) and County Integrated Development Plans (CIDPs).

5. Kenya has developed a strong climate-related policy framework to deliver on its NDC. The main elements of this framework are: (i) the National Climate Change Response Strategy (2010), (ii) the National Climate Change Action Plans, (iii) the National Drought Management Authority Act (2016), (iv) the Green Economy Strategy and Implementation Plan (2016-2030), (v) the National Adaptation Plan (2017), and (v) the National Climate Change Act (2016). The Climate Change Act provides a framework for promoting climate resilient and low carbon economic development and establishes the key institutions in charge of monitoring and implementing the climate change agenda. The act also describes the measures and mechanisms that shall be included in the National Climate Change Actions Plan, whose overarching objective is to pave the way for sustainable, low-carbon, climate-resilient development.

6. Kenya is well placed to further strengthen the institutional framework for resilience. Kenya ranks 154th out of 181 countries in terms of readiness to leverage investments and convert them to adaptation actions (ND-GAIN, 2020), which highlights the scope of challenges that Kenya needs to address. The main focus areas for further institutional strengthening include: i) improved fiscal financing for adaptation projects (including through operationalization of the Climate Change Council and the National Climate Change Fund) with a focus on sectors that are underfunded, such as agriculture, forestry and land use, transport, and water management; ii) improved alignment between the MTPs and CIDPs regarding the mainstreaming of the climate agenda to ensure integration between sectoral goals and county development priorities; iii) understanding better the risk exposure of local communities, engaging them in strengthening resilience, making adaptation a core component of CIDPs, and prioritizing the resilience of local communities in national and county-level development planning and implementation; iv) improving coordination arrangements to integrate the National Environmental Management Authority and the National Drought Management Authority into the consultation and coordination process, and eliminating overlaps in mandates across entities and levels of government (such as significant overlap in mandates and duplication of efforts between regulatory state-owned enterprises in key climate-related sectors, which hampers the effectiveness of the climate change strategies).

7. **Going forward, several actions that are feasible and can generate relatively more climate and development benefits in short- to medium-term warrant prioritization.** Actions related to agricultural productivity, expansion of irrigation, climate-proofing critical infrastructure links, health, waste management, forest resource management and restoration are expected to substantially support the country's resilient growth and development objectives.

C. Government Policies and Commitments in for Climate Change Mitigation and Priority Areas to Reduce Greenhouse Gas Emissions

8. **The updated NDC targets a 32 percent reduction in GHG emissions by 2030 relative to a business-as-usual scenario of 143MtCO2e, compared to 30 percent in the first NDC.** It identifies energy, industrial processes and product use, agriculture, forestry, waste, and land use as key sectors where mitigation efforts will be focused. Overall, estimates of Kenya's carbon intensity are lower than that of many other countries in sub-Saharan Africa and have been relatively constant between 2010 and 2019. Kenya is well on its way to achieving a fully green grid by 2030. It already has a diversified, low-carbon power generation mix, with about 93 percent of electricity being generated from clean sources, including geothermal, hydro, and wind. Installed power generation capacity currently stands at 3,121MW compared to peak demand of 2,128 MW. Fossil fuel-based generation (thermal capacity) has been declining from about a third of the installed capacity (contributing to about 20 percent of generation in 2015) to about a fifth of the installed capacity and contributing only to around 10 percent of generation. Development of geothermal, wind, and solar power generation has enhanced energy security and significantly reduced the weather-induced supply shortages typical in systems with a large share of hydro. Kenya is now also connected to regional hydropower resources with the commissioning of the Kenya-Ethiopia Interconnector, giving impetus to regional energy trading through the Eastern Africa Power Pool. At current costs Kenya has a unique opportunity to meet its electricity needs almost entirely from green energy sources and at affordable costs soon which significantly contributes to maintaining a low-carbon development path.

9. **Going forward, the bulk of Kenya's emissions reduction target under its NDC will be achieved by increasing forest cover.** The government has introduced a program to increase tree cover to 10.6 million hectares, up from the current level of 7.2 million hectares. Based on an analysis of restoration potential, this new target is achievable and could position Kenya to not only meet its NDC commitments, but also use landscape restoration to move closer to a net-zero target and potentially offer carbon credits on international markets. Notwithstanding these benefits, several key measures will need to be in place to ensure that forest restoration results in sustainable gains, including improving agriculture productivity, lowering demand for biomass-based energy for cooking, boosting security of tenure, and putting in place

incentives and mobilizing financing for these activities including via carbon markets. With respect to biomass-based energy, a more concerted and accelerated effort is needed to transition households to more sustainably produced and cleaner fuel options. Kenya's reforestation efforts also require improved agricultural practices as conversion of forests for agricultural expansion and livestock grazing significantly contribute to forest degradation. Integration of climate considerations into the implementation of the Agricultural Sector Transformation and Growth Strategy 2019–29 can augment the agriculture sector's resilience and productivity while contributing to Kenya's emissions reduction target.

10. Ensuring that emerging and expanding cities maintain a low-carbon footprint is another priority in Kenya's mitigation agenda. Kenya would benefit from developing a comprehensive enabling national urban transport policy framework that can define the government's role in public transport management, address a clear direction to manage urban mobility in the country, and guide the financing framework for urban mobility. Furthermore, a low-carbon development path should be well articulated in the updated National Integrated Transport Policy. Availability of green and reliable public transport system and safe and secured walking environment in urban areas will have a strong impact on GHG reductions. Low-carbon transport system in urban areas should prioritize developing an integrated multi-modal public transport system and network/ improving public transport and non-motorized transport (sidewalk and bicycle lane), shifting from a car-centric to people-centric approach. Adopting battery electric vehicles (BEV) in conjunction with the development of mass rapid transit will contribute significantly to Kenya's decarbonization agenda. In addition to the transport sector, efforts to apply low-carbon approaches in supplying affordable housing in urban areas is another priority. Importantly, more resilient, and greener cities will require high levels of human, technical and financial resources and should ensure they institutionalize knowledge and support participatory governance

D. Other Challenges and Opportunities

11. Strengthening Policy and Institutional Structures for Addressing Climate Change. Kenya has developed a strong climate policy framework, including a Climate Change Act. Institutionalizing this effort requires fully operationalizing the climate policy planning and implementation framework and making the existing institutional coordination mechanisms fully functional. Key actions for operationalizing a whole-of-government approach to implementing the climate policy framework are: (i) incorporate the NDC targets into the MTPs, sectoral plans, and urban plans; (ii) provide guidance in Budget Circulars for aligning proposed programs and projects with the NDC targets; and (iii) streamline and strengthen the monitoring and evaluation of climate targets. Advancing implementation of the established institutional coordination platforms to address implementation challenges related to limited horizontal (between government agencies) and vertical coordination mechanisms (particularly for sectors decentralized as part of the Constitution) would benefit from: (i) operationalizing the National Climate Change Council and Climate Change Units and (ii) elaborating the governance, resource mobilization, and investment arrangements for the National Climate Change Fund and the County Climate Change Fund.

12. Climate change as a cross-cutting public finance issue. There has been progress in aligning the budget with climate change strategies and providing information on climate-related objectives, but specific climate targets and indicators could be further incorporated into the performance contracts of public sector budget units and public entities in charge of implementing climate-related programs. More work is needed on systems of internal controls to ensure compliance with climate-related expenditure, particularly in the Integrated Financial Management Information System. Although the public investment management framework requires environmental and social impact assessments for public investment projects, it does not integrate provisions for climate disaster risk screening. And although the authorities are developing a Sustainable Procurement Framework, it has not yet been integrated into procurement regulations. The public procurement framework does not include climate-responsive procurement guidelines and principles, and there is no comprehensive data to inform understanding the extent to which public procurement advances or impacts climate and sustainability objectives.

13. Accessing carbon markets for expanded green finance. Several sectors of Kenya's economy could generate credits for carbon markets, including forestry, blue economy, agriculture, buildings, energy, and transport. Further, enabling carbon credits of high quality could favorably position Kenya in carbon markets. At COP27, Kenya announced its commitment to scaling voluntary carbon markets. Kenya is one of the African countries expected to benefit from the new Africa Carbon Markets Initiative, which aims to support the rapid growth of carbon credit generation and associated jobs. Bilateral carbon trades under the Paris Agreement could potentially provide substantial revenues for Kenya, particularly if prices reflect the opportunity cost of additional mitigation action. Through a recent amendment to the Climate Change Act, Kenya has outlined a framework for decision-making related to participation in carbon markets. Capitalizing on carbon markets, however, will require the Government of Kenya to finalize the formulation of a robust legal framework to provide the necessary legal basis for carbon markets and to operationalize the legislation. In parallel, to benefit from the potential in carbon markets, Kenya will need to ensure the environmental integrity of its carbon credits. This will require development of the necessary infrastructure for measurement, reporting, and verification systems and registry infrastructure.

E. World Bank Engagement

14. The World Bank has an active portfolio of financing and technical assistance to help Kenya in implementing its climate commitments. The climate elements in the World Bank's portfolio span a range of key sectors from agriculture to blue economy, energy, urbanization, water management, and social protection. The World Bank is providing financing through a mix of project finance and budget support. The World Bank is also supporting the strengthening of the government program that enables devolution of climate action via the Financing Locally Led Climate Action Program for Results.

15. There are several other projects under preparation that include significant climate elements. This includes projects in the transport sector, energy, landscape restoration, and health. The World Bank is providing analytical and technical assistance of a range of climate change related issues including on greening the PPP pipeline, carbon markets and climate finance, landscape restoration, irrigation expansion, green jobs, greening housing development, etc.

16. The World Bank is also finalizing the Country Climate and Development Report for Kenya. The report integrates climate change and development considerations to help to prioritize the most impactful actions for boosting adaptation and maintain low emissions, while delivering on broader development goals.

Table 1. Kenya: Active Operations Producing More Than 20 Percent Climate Co-Benefits

- Kenya Urban Support Program
- Kenya: Off-grid Solar Access Project for Underserved Counties
- KenGen Guarantee Program
- Marine Fisheries and Socio-Economic Development Project
- Kenya Social and Economic Inclusion Project
- E-National Ag. and Rural Inclusive Grow
- Kenya-Climate Smart Agriculture Project
- Second Kenya Informal Settlements Improvement Project
- Accelerating Reforms for an Inclusive and Resilient Recovery DPF
- Financing Locally Led Climate Action Program
- Additional Financing for Coastal Region Water Security and Climate Resilience Project
- Accelerating Reforms for an Inclusive and Resilient Recovery DPF 2
- National Agricultural Value Chain Development Project (NAVCDP)

KENYA

July 12, 2023

FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS AND REQUEST FOR A 20-MONTH ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY; REQUESTS FOR EXTENSION, REPHASING, AND AUGMENTATION OF ACCESS, MODIFICATION OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA AND WAIVER OF NONOBSERVANCE FOR A PERFORMANCE CRITERION, AND MONETARY POLICY CONSULTATION CLAUSE—SUPPLEMENTARY INFORMATION AND SUPPLEMENTARY LETTER OF INTENT

Approved By
Catherine Pattillo (AFR) and Eugenio Cerutti (SPR)

Prepared by the African Department

This supplement provides updates to the staff report (EBS/23/76) issued on June 30, 2023. It does not alter either the staff recommendations or the thrust of the staff appraisal.

Program Monitoring

1. **June inflation stood at 7.9 percent y/y, triggering the Monetary Policy Consultation Clause (MPCC) for end-June 2023.** The three-month average (7.93 percent) was above the target range of 2.5–7.5 percent under the program's MPCC. The Central Bank of Kenya's decision to tighten the policy rate by 100 basis points to 10.5 percent on June 26 was appropriate (see Annex I).

2. **The end-June 2023 structural benchmark (SB) on AML/CFT was not met but implemented with a delay in early July.** The Anti-Money laundering and Combating of Terrorism Financing Laws (Amendment) Bill, 2023 was approved by the Cabinet on July 5 and was forwarded to Parliament on July 6 for publication and for its further necessary action.

Recent Developments

3. Real GDP grew by 5.3 percent y/y in 2023Q1. The outturn was stronger than the program baseline following a sharper rebound in agricultural production (5.8 percent y/y). However, quarterly growth (seasonally adjusted) slowed to 1.1 percent from 2.1 percent in 2022Q4. The current account deficit (in U.S. dollars) nearly halved from a year ago, driven by a decline in imports.

4. Parliament has approved the medium-term debt anchor on June 22 (Staff Report¶14). The approved amendments to the Public Financial Management Act replace the nominal debt ceiling with a medium-term debt anchor in present-value terms of 55 percent of GDP.

5. Broadly consistent with staff's expectations, preliminary fiscal data for the end-June 2023 outturn confirm a resource shortfall relative to target (Staff Report¶11). At end-May 2023, the primary balance on cash basis posted a surplus of 1.4 percent of GDP (Text Table 1) as budgeted spending—particularly for domestically-financed projects—continued to be under-executed due to difficulties in mobilizing planned financing and taxes. The latter stood at Ksh.1,672 billion (11.7 percent of GDP) at end-May, compared to the end-June target of Ksh.2,035 billion[1] (14.3 percent of GDP), mainly on weaker income taxes. Preliminary data suggest that the tax shortfall at end-June could range between 1.0 and 1.2 percent of GDP. Against this backdrop and reflecting spending commitments under the approved Supplementary II FY2022/23 Budget (MEFP¶15-16), staff expects a resource

Text Table 1. Kenya: Recent Fiscal Developments

(In Ksh. billions)

	2021/22	2022/23		
	June	December	May	June
	Actual	*Actual*	*Prel.*	*4th Rev.*
Revenues and grants	**2,231**	**1,151**	**2,102**	**2,541**
Tax revenue	1,770	913	1,672	2,035
Nontax revenue	430	234	408	478
Grants	31	4	22	28
Expenditure and net lending	**3,024**	**1,469**	**2,540**	**3,386**
Interest payments	578	319	627	687
Other current spending	1,910	944	1,589	2,090
Development and net lending	537	206	325	609
Overall balance including measures (cash basis, incl. grants)	-793	-233	-438	-845
Primary balance incl. grants	**-170**	**99**	**189**	**-158**
Memorandum:				
PC on tax collection	1,667	862		2,035
PC on the primary balance	-428	-110		-158

Source: National Treasury.

Text Table 2. Kenya: Estimated Resource Shortfall in FY2022/23

	4th Review	Supp. I Budget	Supp. II Budget	Baseline	Revised Estimate
			(in percent of GDP)		
1. Resources INFLOWS (on cash basis)	**24.8**	**25.3**	**25.2**	**25.3**	**24.3**
Revenues	17.3	17.7	17.4	17.4	16.4
Taxes	14.0	14.3	14.0	13.9	13.1
Non-taxes	3.3	3.5	3.4	3.5	3.4
Grants	0.2	0.2	0.3	0.3	0.3
Borrowing	7.4	7.3	7.6	7.6	7.6
Foreign disbursements	3.4	4.0	3.9	3.9	3.9
Domestic (net of repayments)	3.9	3.3	3.7	3.8	3.7
2. Resource OUTFLOWS (on cash basis)	**24.8**	**25.3**	**25.2**	**25.3**	**25.3**
Primary expenditure	18.5	19.0	18.8	18.8	18.8
Current	14.4	14.6	14.9	14.6	14.9
Capital and net lending	4.2	4.3	3.9	4.2	3.9
Debt service	6.3	6.3	6.4	6.5	6.5
Foreign	2.5	2.5	2.7	2.7	2.7
Interest payments	1.0	1.0	1.1	1.1	1.1
Repayments	1.6	1.6	1.6	1.7	1.7
Domestic (interest payments)	3.8	3.8	3.7	3.8	3.8
3. Resource gap (3 = 1 - 2)	**0.0**	**0.0**	**0.0**	**0.0**	**-1.0**
4. Financing of resource gap	**0.0**	**0.0**	**0.0**	**0.0**	**1.0**
Unpaid bills					1.0
Memorandum:					
			(in Ksh. Billions)		
Tax collection	*2,035*	*2,035*	*1,999*	*1,985*	*1,865*
Overall balance	*-845*	*-824*	*-846*	*-855*	*-994*
Primary balance	*-158*	*-148*	*-163*	*-158*	*-152*

Source: National Treasury.

[1] The approved Supplementary I also targeted tax collection at Ksh.2,035 billion (memo item in Text Table 2).

shortfall of about 0.8–1.0 percent of GDP at end-June 2023 (compared to 0.9 percent of GDP under staff's downside scenario). While the size of the resource shortfall is consistent with staff's downside scenario (Staff Report¶11), its composition is different from earlier expectations, with the tax shortfall accounting for a larger share of the resource shortfall.[2] If not addressed, this larger tax shortfall will affect tax collection in FY2023/24, increasing the likelihood of the tax path deviating from the envisaged path under the program. As a result of the resource shortfall, FY2022/23 will likely close with a carryover of unpaid bills to FY2023/24 of 0.8-1.0 percent of GDP (Text Table 2), which will require careful spending prioritization to clear older unpaid bills and avoid accumulation of arrears (MEFP¶17), as well as the adoption of corrective measures to ensure achievement of FY2023/24 tax and primary balance targets under Kenya's program (see below, MEFP¶20).With regard to tax corrective measures, while staff's baseline already included measures with a yield of 0.6 percent of GDP as a buffer, additional corrective measures of 0.4–0.6 percent of GDP will be needed given the larger shortfall in tax collection (see ¶7).

6. On June 22, Parliament approved a FY2023/24 Budget and 2023 Finance Act broadly consistent with program objectives. The approved Budget targets a primary surplus of Ksh.57 billion (0.4 percent of GDP), a level slightly above the program target but below the Ksh.112 billion (0.7 percent of GDP) originally proposed by National Treasury (Text Table 3). The approved 2023 Finance Act reflected strong

Text Table 3. Kenya: Approved FY2023/24 Budget

(In Ksh. billions)

	2023/24		
	June		
	4th Rev.	Budget (submitted)	Budget (approved)
Revenues and grants	**2,906**	**2,936**	**3,031**
Tax revenue	2,428	2,428	2,428
Nontax revenue	428	466	561
Grants	50	42	42
Expenditure and net lending	**3,620**	**3,599**	**3,749**
Interest payments	769	775	775
Other current spending	2,085	2,135	2,191
Development and net lending	765	689	783
Overall balance including measures (cash basis, incl. grants)	-714	-663	-718
Primary balance incl. grants	**55**	**112**	**-57**
Memorandum:			
PC on tax collection	2,428		
PC on the primary balance	55		

Source: National Treasury.

Text Table 4. Kenya: FY2023/24 Revenue Package

(In percent of GDP)

Measures	Proposed Finance bill	Approved Finance bill
Total Revenue Package underpinninf the FY2023/24 Budget	**1.6**	**1.5**
2023 Finance Bill	**1.5**	**1.4**
Tax measures	0.8	0.8
Income	0.2	0.1
o/w new PAYE band	0.1	0.1
o/w new branch profit tax	0.1	0.1
VAT	0.4	0.2
o/w VAT on fuel products at 16 percent	0.3	0.3
o/w new exemptions	0.0	-0.1
Excise	0.2	0.1
Other tax measures	0.0	0.4
o/w new payroll tax	-	0.4
Other revenue measures	0.7	0.5
Non-tax	0.1	0.1
Administrative	0.6	0.4
o/w tax amnesty (interest and penalties)	0.3	0.3
Custom taxes	**0.1**	**0.1**
Memorandum:		
Total tax policy measures (Finance bill and custom measures)	*0.9*	*0.9*

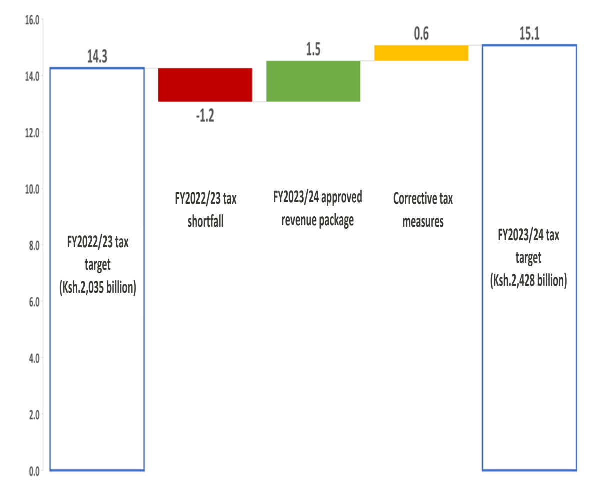
Source: National Treasury.

[2] The tax underperformance is larger than that assumed under staff's downside scenario (Staff Report¶11) as the rapid revenue measures (RRIs), recently adopted by the Kenya Revenue Authority (KRA), have not delivered the expected results due to legal and implementation delays.

concerns by members of Parliament on the impact of indirect taxes on cost of living. On the revenue side, the size of the tax package remained consistent with the program (0.9 percent of GDP). While the approved Bill preserved the proposed increase of the VAT rate on fuel products, it also introduced new payroll and trade taxes, compensating for parliament's decision to reintroduce several VAT exemptions and adopt less ambitious increases in excise and income taxes (Text Table 4). Several administrative measures also did not garner support during the parliamentary discussions, bringing the total size of the revenue package underpinning the FY2023/24 Budget to 1.5 percent of GDP (against the proposal by National Treasury of 1.6 percent of GDP). On the spending side, Parliament increased the proposed envelope of primary expenditures by about 0.9 percentage points of GDP to reflect the agreement reached on the use of the proceeds of the new payroll taxes (0.4 percent of GDP)[3] as well as additional spending needs (Text Table 3). The latter include transfers to line ministries (0.3 percent of GDP), domestic projects (0.1 percent of GDP), and defense spending (0.1 percent of GDP). Part of this additional spending was offset through spending reallocations, ensuring that the primary balance remained in line with program commitments.

Text Figure 1. Kenya: Tax Measures in FY2023/24

(In percent of GDP)



Source: National Treasury.

7. **Against this backdrop, the National Treasury is committed to activate its contingency plans to ensure achievement of FY2023/24 fiscal targets (MEFP¶20).** Specifically, the authorities plan to introduce, in addition to the already passed tax measures in the 2023 Finance Act (1.5 percent of GDP), new tax measures (policy and administrative changes) for about 0.4–0.6 percent of GDP, which have been identified to fully offset the carryover impact of the tax shortfall in FY2022/23 and ensure achievement of the FY2023/24 target (Text Figure 1, Supplement LOI).[4] Of these measures, the administrative ones that are already set in train are those on streamlining the VAT apportionment ratio of allowable inputs VAT on exempt supplies (MEFP¶20) and settling well-identified disputes on tax debt after some initial delays (MEFP¶13). These measures are expected to yield about 0.3–0.5 percentage points of GDP. In addition, the authorities will submit to Parliament, in conjunction with the Supplementary FY2023/24 Budget (end-October 2023 SB), tax measures such as a motor vehicle circulation tax, the reduction of tax exemption on interest income, and changes to the VAT exemption rules. These other set of measures is conservatively expected to yield 0.1–0.3 percent of GDP. On the spending side, the Supplementary FY2023/24 Budget will include spending offsets for 0.8–1.0 percent of GDP. These offsets could include a compression of primary current spending of about

[3] According to the agreement, the proceeds from the new payroll tax will be earmarked for providing affordable housing consistent with the "bottom-up" approach of the current administration (¶7 and ¶24 in CR/22/382).

[4] The size of the additional measures is estimated as the gap between the FY2023/24 and FY2022/23 tax targets after accounting for the impact of the expected FY2022/23 tax shortfall and the yield of the tax package underpinning the FY2023/24 Budget.

0.2–0.3 percent of GDP[5] and a reduction in domestic capital spending of 0.5–0.6 percent of GDP[6], supported by efforts to strengthen expenditure controls (0.1 percent of GDP). To ensure timely implementation of the needed measures, staff stressed the urgency of bringing forward, if feasible, to end-September the submission of the supplementary budget.

[5] Spending savings are expected to mainly come from a reduction in transfers to public sector institutions and administrative expenditures (e.g., official travels, expenditures for representation, official vehicles).

[6] These saving will reflect the continued rationalization of the portfolio of domestic projects, in line with the recommendation from a recent Public Expenditure Review (PER, 2020), and postponement of new domestic projects.

Supplementary Letter of Intent

Nairobi, Kenya, July 12, 2023

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

Dear Ms. Georgieva:

In light of the end-June 2023 fiscal performance with regard to significant underperformance in tax collections and unpaid bills that would be carried over to FY23/24, I wanted to inform you that we are activating our contingency plans described in ¶20 of the MEFP attached to the Letter of Intent dated June 29, 2023, to avoid the tax shortfall at end-June 2023 negatively affecting tax collection in FY2023/24. With regard to unpaid bill carryover, we are carefully prioritizing spending to clear older unpaid bills and avoid accumulation of arrears in FY2023/24 (MEFP¶17), and identifying spending offsets to ensure achievement of FY2023/24 primary balance.

While remaining committed to submitting to Parliament a Supplementary FY2023/24 Budget by end-October 2023 (MEFP¶20), we also recognize the need to promptly activate contingency measures earlier. To this end, we have instructed the Kenya Revenue Authority (KRA) to redouble its efforts to fully recover the resources targeted under the Rapid Revenue Initiatives (RRI) introduced last April (MEFP¶13). This will be achieved by securing settlement on the remaining well-identified disputes on tax and custom debt and prioritizing on-going compliance checks on 74 Large Tax Office cases related to VAT and withholding tax (expected yield about 0.1). In addition, KRA is streamlining procedures to compute the VAT apportionment ratio of allowable inputs on exempt supplies in line with international best practices, which is expected to generate about 0.2–0.4 percentage points of GDP on full-year basis.

In submitting the Supplementary FY2023/24 Budget, we will also seek parliamentary approval to adopt the remaining tax policy measures discussed in MEFP¶20 (expected to yield 0.1–0.3 percent of GDP). All these measures are in addition to those included in the recently-approved 2023 Finance Act and will help ensure tax collection in FY23/24 remains as envisaged under the program.

Sincerely yours,

/s/

Prof. Njuguna Ndung'u
Cabinet Secretary

Annex I. Supplemental Letter on Consultation with the IMF Executive Board on the Missed Inflation Target Under The MPCC

Nairobi, Kenya, July 10, 2023

Consultation on Breach of MPCC Target in June 2023

Central Bank of Kenya

The three-month average of inflation declined from 9.4 percent at end-December 2022 to 7.9 percent at the end of June 2023. Inflation, therefore, remained outside the inflation target band of 2.5–7.5 percent, agreed under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) Arrangements. This letter explains firstly the reasons why inflation has remained above the upper limit of the inflation consultation band, and then discusses the policy responses and the outlook of inflation.

I. INFLATION DEVIATION FROM THE CONSULTATION BAND

1. The 12-month overall inflation has remained outside the target band since June 2022, driven by food, fuel, and non-food non-fuel prices (Figures AI.1 and AI.2). Overall inflation stood at 7.9 percent in June 2023 compared to a peak of 9.6 percent in October 2022 and 9.1 percent in December 2022. The decline in inflation largely reflects lower food prices attributed to favorable weather conditions and easing global prices of key commodities particularly crude oil, wheat, and edible oils. Food inflation moderated to 10.3 percent in June 2023 compared to 13.8 percent in December 2022, with its contribution to overall inflation easing to 3.9 percentage points from 5.1 percentage points in the period. However, food inflation rose slightly in May and June 2023, due to a surge in sugar prices following reduced domestic production and lower global supply. Sugar accounts for 1.43 percent of the total CPI basket, and contributed 0.8 percentage points to overall inflation in June, up from 0.3 percentage points in April. Inflation of the four key non-vegetable items that had exerted upward pressure on inflation in 2022, continued to decline. These food items are edible oils, milk products, wheat products, and maize products, which collectively account for 12.4 percent of the total CPI basket and 37.7 percent of the food basket. They contributed 0.8 percentage points to overall inflation in June 2023, down from 2.5 percentage points in December 2022.

2. Fuel inflation remained elevated at 12.9 percent in June 2023 compared to 12.7 percent in December 2022, and contributed 2.7 percentage points to overall inflation in June 2023. The main fuel items driving fuel inflation were electricity, petrol, kerosene, and diesel, which collectively account for 3.1 percent of the total CPI basket. The fuel items contributed 1.2 percentage points to overall inflation in June 2023 compared to 0.8 percentage points in December 2022, reflecting the removal of the fuel subsidy and increases in electricity prices due to higher tariffs.

3. Non-food, non-fuel (NFNF) inflation has remained above 4 percent since November 2022, indicating persistent underlying inflationary pressures in the economy. The NFNF inflation increased from 4.1 percent in December 2022 to 4.4 percent in February 2023, before easing slightly to 4.1 percent in June 2023, reflecting the impact of monetary policy measures. The contribution of NFNF to overall inflation stood at 1.3 percentage points in June 2023.

II. POLICY RESPONSES

4. In May 2022, the CBK proactively tightened monetary policy by increasing the CBR by 50 basis points to 7.50 percent. Due to sustained inflationary pressures, elevated global risks, and their potential impact on the domestic economy, CBK tightened monetary policy further by increasing the CBR by additional 75 basis points in September 2022, 50 basis points in November 2022, 75 basis points in March 2023, and 100 basis points in June 2023. Since May 2022, CBK has cumulatively increased the CBR by 350 basis points to 10.50 percent, the most recent being the decisive action on June 26, 2023. Noting that the headline inflation is driven by supply side factors, the CBK remains committed to mitigating the second-round effects and ensuring inflation expectations are well anchored. Exchange rate depreciation has exerted some upward pressure on prices of imported goods.

5. The CBK's monetary policy measures have been complemented by fiscal measures implemented by the Government to moderate the prices of specific commodities and enhance food production, and subsidy on fertilizer prices.

6. The CBK continues to monitor the drivers of inflationary pressures and stands ready to implement additional measures when necessary.

III. INFLATION OUTLOOK

7. Overall inflation is expected to remain elevated in the near term due to the recent increase in electricity prices, the removal of the fuel subsidy, and associated second-round effects. Prices of some key food items particularly sugar and maize remain elevated. However, food inflation is expected to moderate in the coming months with the expected harvests particularly of maize following the recent long rains, and continued easing of global food prices. Additionally, the normalization of global supply chains, and lower crude oil prices are expected to ease pressure on fuel inflation.

8. The monetary policy measures adopted by CBK will moderate demand-driven inflationary pressures. The NFNF inflation is expected to fall below 4 percent in September 2023. On the fiscal side, the package of policy measures announced by the Government to increase food supply through imports particularly of sugar and maize, and production through fertilizer subsidy and irrigation are expected to provide relief in the short and medium term.

9. Considering these factors, CBK expects overall inflation to return to the target band by September 2023. The rate of decline will, however, depend on how food and fuel prices evolve in the period.

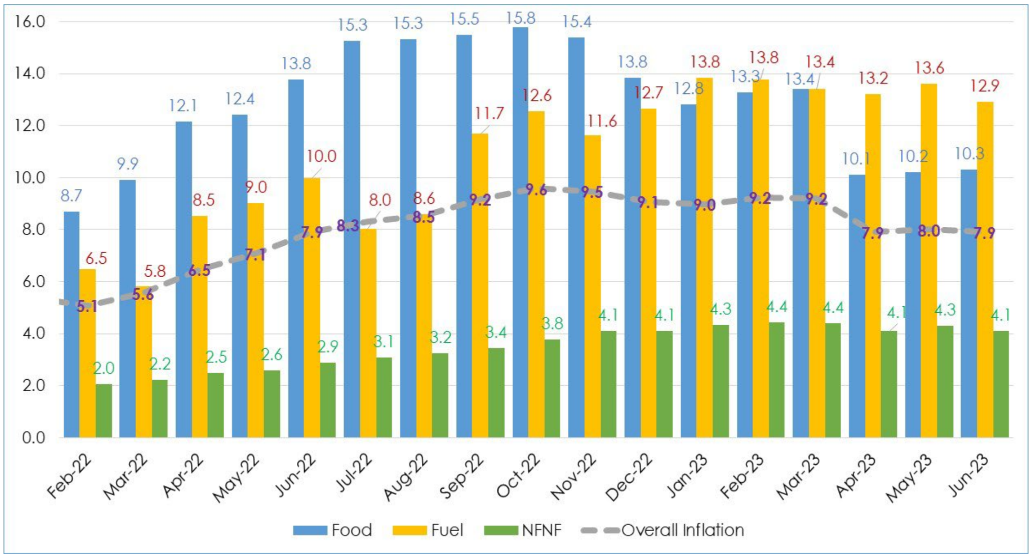
10. The CBK will continue to monitor the impact of the policy measures, as well as developments in the global and domestic economy, and stands ready to take additional measures as necessary, in fulfilment of the price stability objective.

/s/

Dr. Kamau Thugge
Governor, Central Bank of Kenya

Figure AI.1. Kenya: Inflation by Broad Category

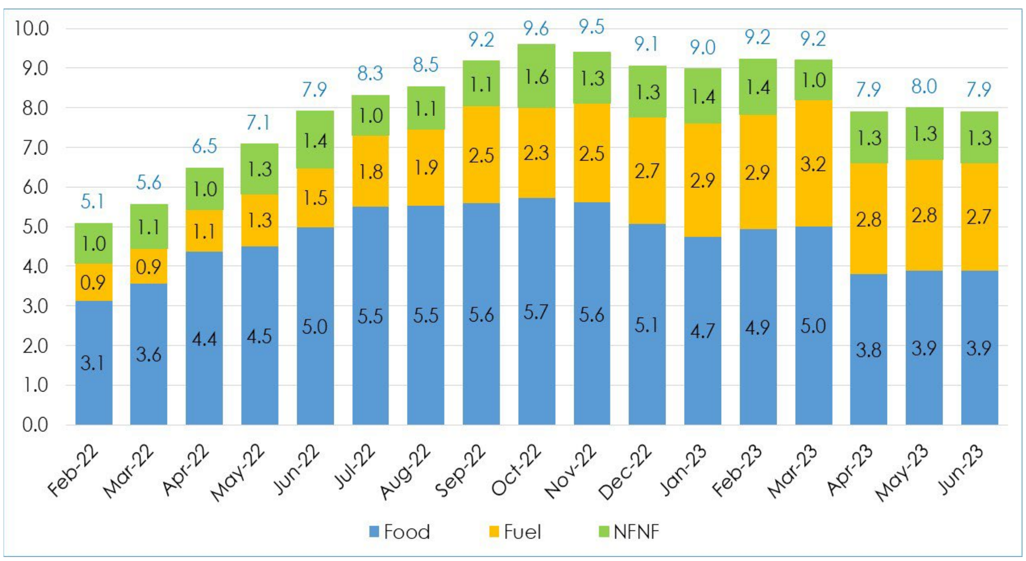
(Y/Y, percent)



Sources: Kenya National Bureau of Statistics and CBK

Figure AI.2. Kenya: Contributions to Overall Inflation by Broad Category

(Percentage Points)



Sources: Kenya National Bureau of Statistics and CBK

**Statement by the Executive Director, Mr. Willie Nakunyada,
the Senior Advisor of the Executive Director, Mr. James Alic Garang, and by the
Advisor of the Executive Director, Mr. Morekwa Esman Nyamongo
July 17, 2023**

I. Introduction

1. Our Kenyan authorities appreciate the fruitful discussions with staff during the mission on the fifth reviews under the Extended Fund Facility and Extended Credit Facility (EFF/ECF) arrangements, as well as the candid negotiations on the 20-month Resilience and Sustainability Trust (RST). They broadly concur with the thrust of staff's appraisal and policy recommendations.

2. The economy of Kenya has exhibited remarkable resilience to shocks from a severe drought in recent years, and a difficult global context. While the tightening of global financial conditions, and the negative spillovers from the war in Ukraine, amplified domestic vulnerabilities, the diversified economic base helped weather the repercussions of the strong external headwinds. Despite the challenging domestic and external environment characterized by elevated food security risks and rising cost of living, the authorities pressed ahead with reforms which delivered strong performance under the EFF/ECF arrangements. They have taken decisive actions to tighten fiscal and monetary policies to preserve macroeconomic stability and realize the objectives of the new administration's bottom-up economic transformation agenda, designed to foster private sector dynamism. Nevertheless, the authorities require ample time to place public debt on a firm declining path, and further resources to bridge additional BOP needs created by lack of market access. **In this vein, they request program extension, and augmentation of access under the EFF/ECF arrangement. To build climate resilience and catalyze complementary resources, the authorities also seek Fund support under the Resilience and Sustainability Trust (RST).**

II. Program Performance

3. All end–December 2022 Quantitative Performance Criteria (QPCs) and the continuous PCs since the fourth EFF/ECF reviews were met. The QPC on tax collection and the primary balance overperformed by 0.3 and 1.3 percentage points of GDP, respectively. Similarly, the QPC on Net International Reserves (NIR) overperformed. While the end-December 2022 target on priority social expenditure was met, the target on exchequer requests outstanding for more than 90 days was missed due to tight liquidity conditions, and the end-December 2022 inflation target was missed as the three-month average of inflation (9.4 percent) fell outside the inflation target range of 2.5–7.5 percent, triggering the MPCC clause.

4. Structural Benchmarks (SBs) for end-December 2022-June 2023 were completed. A FY2022/23 supplementary budget (end-January 2023 SB) and a FY2023/24 Budget (end-

April 2023 SB) were submitted on time to Parliament consistent with program objectives. The end-June 2023 SB on submission to the National Assembly of the draft AML/CFT amendments and the end-December 2022, SB on action plan for Kenya Power and Lighting Company (KPLC) were completed with a delay, while the SB on review of the fuel pricing mechanism remains outstanding and the authorities are proposing to reset it to end-August 2023. In light of their firm commitment and pursuant to taking corrective measures, the authorities have already constituted a task force to review the fuel pricing mechanism.

5. Considering the strong program performance and the corrective actions taken, our authorities seek Executive Directors' support for the completion of the fifth reviews under the EFF/ECF arrangements, and associated requests.

III. Recent Economic Developments and Outlook

6. The economy is recovering well from the devastating effects of COVID-19 pandemic and the ongoing conflict in Ukraine, and the prolonged drought. As a result, economic activity expanded robustly by 7.6 percent and 4.8 percent in 2021 and 2022, respectively, mainly supported by the services sector, including transport and storage, information and communication, financial and insurance, and public administrative and support services. In the first quarter of 2023, the economy expanded by 5.3 percent mainly supported by the strong rebound in agriculture and continued strengthening of activity in the services sector. High frequency indicators for the second quarter, show improved growth prospects on account of favorable rains, and supportive policies of the current administration. As such, the authorities are optimistic that the economy is poised to grow much stronger in 2023.

7. Inflation peaked at 9.6 percent in October 2022, driven by increases in global food and energy prices. The severe and prolonged drought experienced during the period of analysis undermined food production and shored-up food inflation. Nevertheless, inflation has started to decline in recent months reaching 8.0 percent in June 2023 and is expected to revert to the target band by September, owing to easing international commodity prices. In addition, the tight monetary policy is expected to contain demand side inflation while moderating second-round effects and anchoring inflation expectations.

8. Current account performance strengthened in 2022 spurred by robust exports, tourist receipts and remittances that counterbalanced the rising import bill. The current account deficit is projected to improve to 4.8 percent of GDP in 2023 from 5.1 percent of GDP in 2022. The negative spillovers from the global developments and continued weakening of the Kenya Shilling, had significant impact on reserves levels which declined from 4.5 months of import cover in July 2022 to 4.1 months of import cover in June 2023. Despite the decline in reserves, the external buffers meet the CBK's statutory requirement of 4.0 months but fall short of the EAC region's convergence target of 4.5 months of import cover.

IV. Fiscal Policy and Debt Management

9. Our authorities are committed to a fiscal consolidation path consistent with program objectives. To this end, the Parliament approved a tight Supplementary Budget II for FY2022/23, which targets an overall fiscal deficit of 5.8 percent of GDP compared to 6.2 percent of GDP in FY2021/22. Broadly, this reflects the authorities' efforts to enhance revenue mobilization and reprioritize expenditures while protecting social spending.

10. Reflecting strong commitment to high quality fiscal consolidation, the authorities have intensified revenue mobilization efforts, and efficient execution of the budget while protecting the most vulnerable. The Kenya Revenue Authority (KRA) has adopted several Rapid Revenue Initiatives (RRIs) to sustain collection and minimize potential revenue shortfalls. In addition, the revenue administration reforms at the KRA—aimed at improving compliance and taxpayer services—will continue to play a major role in the fiscal strategy.

11. On the expenditure side, as enunciated in the Supplementary Budget II for FY2022/23, the authorities introduced expenditure cuts of 0.2 percentage points of GDP mainly for undisbursed development project funds where absorptive capacity was deemed to be low. In addition, the Government has taken steps to ensure that decisions on domestic fuel prices are aligned with budgeted resources. In this context, overall fuel subsidies were eliminated in March 2023 while cross-subsidies were eliminated in May 2023. Further, a taskforce has been established—comprising members from National Treasury, Ministry of Energy, and Petroleum and the Energy and Petroleum Regulatory Authority (EPRA)—to ensure that fuel pricing actions are consistently aligned with the approved budget, while ringfencing social outlays.

12. While Kenya's public debt is sustainable in a forward-looking sense, the authorities are proactively taking steps to reduce debt vulnerabilities. In this connection, they are maintaining steadfast fiscal consolidation under the IMF supported program to ensure debt sustainability. More generally, the authorities are implementing the 2023 Medium-Term Debt Management Strategy (MTDS) to strengthen public debt management and reduce refinancing risks. Looking ahead, they will continue to rely on concessional external financing to minimize interest rate risk.

V. Monetary, Exchange Rate, and Financial Sector Policies

13. The Central Bank of Kenya (CBK) has tightened monetary policy over the course of the year to bring down inflation towards the target range. Accordingly, the Central Bank Rate (CBR) was raised by 250 basis points from 7.0 percent in May 2022 to 9.5 percent in May 2023. Despite the incipient waning of inflationary pressures, the CBK recently increased the CBR further by 100 basis points to 10.5 percent, to preempt potential elevated global inflation risks. Going forward, the CBK will continue to monitor the impact of its previous actions, as well as developments in the global and domestic economy, and stands ready to take further action as necessary, to bring inflation within the band and anchor expectations.

Further, to modernize the monetary policy framework, our authorities are continuously bolstering their framework benefitting from Fund technical support provided over the years and they remain open to further support.

14. The authorities are committed to maintaining a flexible exchange rate system to absorb external shocks. Presently, the exchange rate is market-determined in line with the medium-term fundamentals and program objectives. Consequently, the Kenya shilling has moved significantly in recent months, while our authorities are addressing attendant challenges through the recently launched Kenya FX Code. In addition, they are proactively implementing innovative approaches in the forex market.

15. The banking sector has remained stable and resilient to shocks, but the authorities remain attentive to potential credit risks. The CBK is also closely monitoring other risks, including from spillovers and spillbacks from local banks' regional expansion as well as their operational risks from digitalization. To green the banking sector, the CBK has issued guidance on climate-related risk management to enable banks to integrate climate-related risks into their governance, strategy, risk management and disclosure frameworks. In the meantime, the CBK is working closely with banks on building capacity and integrating climate-related risk management in their operations.

VI. Structural, Governance, and Transparency Reforms

16. Structural reforms aimed at strengthening governance and oversight of state-owned enterprises (SOEs), and state corporations (SCs) continue to assume high priority on the authorities' reform agenda. In this vein, they have identified key policy priorities for reforming the SOEs, including submitting to Parliament a new privatization bill in 2023 which focuses on accelerated privatization of SOEs, streamlined governance structures, efficient utilization of budgetary resources, better management of fiscal risks and enhanced accountability. Meanwhile, they are taking concrete steps to reform Kenya Airways (KQ), and KPLC, as well as strengthening governance and oversight of the SCs while safeguarding their profitability.

17. The Kenyan authorities are strengthening their anti-corruption legal framework and safeguarding financial integrity in line with their LOI commitments. They commenced publication of beneficial ownership information for companies awarded tenders and have strengthened the beneficial ownership framework. To enhance the AML/CFT legal framework, our authorities submitted the AML/CFT amendment Bill to Parliament. Relatedly, they are taking decisive actions to address the strategic deficiencies identified in the Kenya 2022 Mutual Evaluation Report by ESAAMLG to safeguard financial integrity.

18. In collaboration with development partners, the authorities have earmarked budgetary resources aimed at upscaling pandemic preparedness infrastructure. In this connection, they are making concerted efforts to construct the National Biosafety Laboratory through support of partners and establishing the National Pandemic Response Centre, in coordination with the

African Development Bank. The proposed budget also supports the construction of the National Data Centre, co-financed by the European Union grant, and establishment of the National Cybersecurity Authority, with the help from the Swedish International Development Cooperation Agency (SIDA).

VII. Building Resilience to Climate-Change

19. Our authorities are conscious of the risks associated with climate change and count on their track record in implementing climate policies and mobilizing climate finance. As such, they have developed a long-term policy and legislative framework to guide the robust climate agenda. Presently, our authorities are building capacity on climate matters, and they are working closely with development partners to mobilize investments in renewable energy and energy efficiency projects and raise awareness on climate change and its impact.

20. Despite the vibrant enabling policy environment for climate action, our authorities face significant challenges in attracting climate finance flows. They have committed to reducing their greenhouse gas emission by 32 percent by 2030, but substantial resources are required. Going forward, they are committed to enhancing mobilization of both local and international resources to meet the updated NDC targets, while foregoing the benefits of exploiting fossil fuel resources. Importantly, they consider Fund support under the RST as critical to unlock additional climate financing.

VIII. Conclusion

21. Our Kenyan authorities remain committed to maintaining macroeconomic stability and resilience, preserving fiscal and debt sustainability, and augmenting buffers against external shocks. They view policy efforts to unlock their growth potential as vital to achieve key development objectives articulated in the program, and in line with the Vision 2030 blueprint and National Development Plan. They look forward to the Executive Directors' support to conclude the fifth program review, approve their request for support under the RST, and augmentation of access.