Appendix I. Letter of Intent

April 30, 2020

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

Dear Managing Director:

The COVID-19 pandemic is having a significant negative impact on the Kenyan population and economy. Protecting public health is our priority. The economic impact was being felt well before our country's first case was confirmed on March 12: Trade was already declining rapidly and tourism arrivals had fallen dramatically. Activity in our typically resilient and important services sector has, in turn, sharply dropped off. At the same time, Kenya is experiencing a slowdown in its equally important agriculture sector as global demand for our agricultural exports slows and global shipping channels close.

The outlook for economic growth is highly uncertain. Our preliminary estimates suggest that growth could decline from 5.4 percent in 2019 to around 3 percent this year – down from a pre-pandemic projection of the IMF staff of 5.8 percent during the time of the IMF mission in February 2020—due to disruptions to trade, tourism, agriculture, and manufacturing. However, the risks to this projection are slanted heavily to the downside. To be conservative, and in view of this uncertainty, the framework underlying this request assumes growth of 0.8 percent in 2020.

While it is difficult at this stage to fully and accurately assess the impact of the pandemic on the budget, it will clearly be significant. Expenditures to directly fight COVID-19 in Kenya, as well as provision of support for affected sectors and individuals, will entail additional spending of at least 0.4 percent of GDP relative to the previous budget, including 0.1 percent of GDP in cash transfers to orphans, the elderly, and the most vulnerable. These costs could rise if the crisis worsens, and we are committed to approving any necessary funding. Tax reductions will also be implemented to help maintain economic activity and protect the vulnerable, which will reduce revenues by 0.4 percent of GDP this fiscal year relative to the previous budget. Specific measures include 100 percent tax relief for lower-income individuals; reduced income and corporate tax rates, from 30 to 25 percent; a reduced VAT rate, from 16 to 14 percent; and a reduced turnover tax rate, from 3 to 1 percent. To help offset the revenue impact of lower tax rates and to improve the efficiency of our tax system, we have undertaken to eliminate a long list of exemptions in the corporate income tax and VAT. We are closely monitoring the economic impact of COVID-19. Once economic activity recovers sufficiently, we will review our tax measures to fully restore revenues as a share of GDP as part of our efforts to strengthen the public finances. We remain committed to raising the ratio of tax revenue to GDP over the medium term.

The COVID shock and the policies we are undertaking to address it will make it necessary to implement our ambitious multi-year fiscal consolidation plan in a more gradual manner than originally envisaged. The plan will entail a mix of revenue and expenditure measures to reduce budget deficits and put public debt on a downward path.

Kenya's external vulnerabilities will rise as this global crisis continues. Significantly lower oil prices should help to offset weaker exports and foreign remittances and keep the current account stable. However, a drying up of international capital amid a general pullback from emerging and frontier markets will worsen Kenya's balance of payments. In that context, the balance of payments gap could reach up to 2.1 percent of GDP. In such a situation, we would expect international reserve coverage to decline significantly.

The Central Bank of Kenya (CBK) has taken a number of measures to help support the economy and maintain financial stability since the start of the crisis. These include 100 bps cuts in the policy rate and cash reserve ratio, an increase in reverse repo tenors, and increased flexibility for banks' loan classification and provisioning requirements—together, these measures should help to maintain the availability of liquidity and prevent abrupt financial dislocations. At the same time, the CBK remains mindful of its price stability mandate: At the moment, risks to inflation appear balanced, with low energy prices and weakening demand offsetting potential price pressures due to import disruptions. However, the CBK will continue to closely track inflation developments and its decisions will remain data-dependent. Parallel efforts by the CBK to strengthen its monetary policy framework—already in train before the crisis—will allow the CBK to provide an effective policy response that can support recovery. The CBK has also taken steps to extend maturity dates for bank borrowers affected by the pandemic, while remaining vigilant to ensure financial stability. Finally, the CBK remains committed to a flexible exchange rate regime, using the exchange rate as a shock absorber with FX intervention used selectively to minimize excess volatility.

We do not intend to introduce measures or policies that would exacerbate balance of payments difficulties. Kenya will continue to comply with the provisions of the IMF's Articles of Agreement, including those related to imposing new or intensifying existing restrictions on the making of payments and transfers for current international transactions and also bilateral payments under Article VIII, and will implement public policies under that framework and avoid additional trade restrictions for balance of payment purposes.

In this context, and given the urgent balance of payments financing need facing Kenya due to the pandemic, Kenya requests emergency financing from the IMF under the Rapid Credit Facility (RCF) of SDR 542.8 million, equivalent to 100 percent of our quota. We request that the funds be disbursed as direct budget support to the National Treasury's account at the CBK. In view of this, a memorandum of understanding has been signed between the National Treasury and the CBK on their respective responsibilities for servicing their financial obligations to the IMF. These disbursements will help to fill our expected fiscal financing gap and provide a cushion to our international reserves in 2020. IMF involvement in Kenya's response to this emergency will likely act as a catalyst for additional financing from other development partners. To this end, we have requested and expect to receive additional financing from the World Bank and are pursuing additional funds from the African Development Bank. We also plan to subsequently resume our discussions on a potential precautionary Stand-By Arrangement/Standby Credit Facility to support our economic program, which were initiated in February this year. Our reforms seek to support our continued objective of a growth-friendly fiscal adjustment that protects public investment and priority social spending, boosts revenue performance, and reduces public debt as a share of GDP.

In the context of the September 2019 update safeguards assessment, we remain committed to implementing IMF staff's recommendations in this area. We also commit to providing Fund staff with the most recently completed external audit reports.

We recognize the importance of safeguarding IMF and other financial assistance resources to ensure that such assistance is used for the very urgent purpose of resolving the current crisis. With that in mind, we commit to post-crisis auditing by our independent audit office of samples of crisis-related expenditures and publication of the results. More generally, we are strongly committed to ensuring effective and transparent use of public funds. To this end, we are working to strengthen our institutions and our capacity to detect illicit enrichment and to address conflict of interest in line with international best practices and Fund advice.

We authorize the IMF to publish this Letter and the staff report for the request for the disbursement under the RCF.

Sincerely yours,

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