INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/83

KENYA

REQUEST FOR EXTENSION OF THE STAND-BY ARRANGEMENT—PRESS RELEASE AND STAFF REPORT

March 2018

In the context of the Request for Extension of the Stand-By Arrangement, the following documents have been released and are included in this package:

- A **Press Release.**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on | March 2, 2018, with the officials of Kenya on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 7, 2018.

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

Letter of Intent sent to the IMF by the authorities of Kenya*
*Also included in Staff Report

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 18/85
FOR IMMEDIATE RELEASE
March 13, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves 6-Month Extension of the Stand-By Arrangement with Kenya

On March 12, 2018, the Executive Board of the International Monetary Fund approved Kenyan authorities' request for a 6-month extension of the country's Stand-By Arrangement to allow additional time to complete the outstanding reviews. The reviews are expected to be completed by September 2018. Completion of the reviews will enable the Kenyan authorities to have access to funds available under the precautionary SBA.

The SBA was approved on March 14, 2016 (See Press Release no 16/110) for 24 months. Today's Board's decision was taken without a formal Board discussion.[1]

In support of this request, the authorities have committed to policies that will enable them to achieve the program objectives, including reducing the fiscal deficit and substantially modifying interest controls.

[1] The Executive Board takes some decisions without a meeting when it is agreed by its members that a proposal can be considered without convening formal discussions.

March 7, 2018

KENYA

REQUEST FOR AN EXTENSION OF THE STAND-BY ARRANGEMENT

Approved By
Michael Atingi-Ego (AFR) and Zuzana Murgasova (SPR)

Prepared by the African Department, in consultation with other departments.

1. **In the attached letter dated March 6, 2018, the Kenyan authorities are requesting an extension of the Stand-By Arrangement (SBA) for Kenya (EBS/16/11) to September 14, 2018.** On March 14, 2016, the Executive Board approved a 24-month SBA and a 24-month arrangement under the SCF for Kenya, which the authorities have been treating as precautionary, and are due to expire on March 13, 2018. The authorities are not requesting an extension of the SCF arrangement as this type of arrangement can be approved up to a maximum of 24-months.

2. **The extension is needed to provide additional time for the authorities to bring the program back on track and reach new understandings with IMF staff on policies and measures that would enable the completion of the pending reviews under the SBA for Kenya.** Since the approval of the SBA and SCF arrangement, only the first review under these arrangements has been completed on January 25, 2017. The second and third reviews have not been completed as the performance criteria on the primary balance for end-December 2016 and end-June 2017 were missed, due to revenue shortfalls and spending pressures partly on account of the drought, and no understandings could be reached on corrective policies to address the fiscal slippages due to the extended election period. In addition, the introduction by parliament of interest rate controls in September 2016 (after the program approval in March 2016) has weakened the performance under the program, dampening credit growth, bank profitability, and tax revenues, and reducing monetary policy effectiveness.

3. **The authorities have committed to strong corrective actions through adopting policies that will enable them to achieve program objectives and reduce near- and medium-term vulnerabilities**. These actions, would include, among others:

- *Fiscal consolidation*. The FY2016/17 fiscal deficit increased to 8.8 percent of GDP (from 7.3 percent the previous year), exceeding the program target by nearly 2 percent of GDP. This resulted from drought and election-related spending, higherthan-projected foreign-financed capital spending, and lower revenues. Without corrective action, staff expect public debt to reach nearly 60 percent of GDP this year. The authorities have committed to strong action to put the deficit and debt firmly on a downward path and reduce financing risks. This includes steps to rationalize expenditure in the near-term and measures to increase revenues over the medium-term. The authorities have committed to a reduction in the deficit to 7.2 percent of GDP by the end of this fiscal year (June 30, 2018). This would be achieved by postponement of lower-priority capital projects this FY and a further 1.5 percent of GDP adjustment in 2018/19 to reach a deficit of 5.7 percent of GDP, supported by a widening of the tax base by reducing exemptions in the VAT and income tax, as well as on-going improvements in revenue administration.

- *Removal or significant modification of interest rate controls.* Interest rate controls, which were adopted in September 2016, have contributed to a collapse in bank lending to the private sector and lower tax revenues from the banking sector, and have also reduced the effectiveness of the monetary policy framework. To minimize their adverse impact, the authorities are committed to eliminating or significantly modifying interest rate controls such that they no longer block lending and access to finance, or hinder the conduct of monetary policy.
- *Monetary policy framework modernization.* Following either the removal or modification of interest rate caps, the authorities will introduce an interest rate corridor around the central bank's policy rate. This will help to strengthen the monetary policy transmission channel and allow the central bank to move toward a full inflation-targeting regime.
- *Other reforms*. The authorities are taking steps to deepen financial sector reforms, improve the transparency and efficiency of public spending, and strengthen the quality of macroeconomic statistics.

Furthermore, the authorities remain committed to bringing the program back on track by implementing measures that build a strong track record of program performance in the coming months to enable completion of the remaining program reviews. The authorities are committed to working with staff on additional measures that may be required to meet program objectives, and, if needed, have indicated their intention to request a further six-month extension of the program and commensurate re-phasing of access at the next program review. The authorities have also indicated that they intend to continue to treat the SBA as precautionary.

4. **Staff supports the authorities' request for an extension of the March 14, 2016 Stand-By Arrangement for Kenya to September 14, 2018.** Accordingly, the following decision is proposed for adoption by the Executive Board on a lapse-of-time basis (LOT).

Letter of Intent

Nairobi, Kenya
March 6, 2018

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

Dear Ms. Lagarde,

On March 14, 2016, The IMF Executive Board approved a 24-month arrangement under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) for SDR 709.259 million and SDR 354.629 million, respectively, to support our economic and financial program. The SBA and SCF are scheduled to expire on March 13, 2018.

The completion of the second and third reviews under the program was delayed owing to the prolonged election period in 2017. Nonetheless, an extensive drought coupled with the election related expenditures, impacted negatively on our meeting the performance criteria on the primary fiscal balance for end-December 2016 and end-June 2017. The introduction of interest rate controls in September 2016, which were aimed at addressing the high cost of credit, has had unintended adverse consequences on credit growth and monetary policy effectiveness.

In order to allow for sufficient time to complete the remaining reviews under the program and provide a strong policy anchor, we wish to request for an extension of the SBA through September 14, 2018. In making this request, we commit to strong policies to achieve our program objectives. These include: (1) a reduction in the fiscal deficit from 8.8 percent of GDP in 2016/17 to 7.2 percent of GDP by the end of this fiscal year (June 30, 2018) and a further reduction to 5.7 percent of GDP during the next fiscal year (ending June 30, 2019); (2) a significant modification of interest rate controls to avoid their adverse impact on credit to the private sector, monetary policy effectiveness, and financial stability; and (3) strengthening the monetary policy framework, including the introduction of an interest rate corridor following the significant modification of interest rate controls.

In light of the revenue shortfalls so far this year, to achieve the fiscal deficit target for 2017/18, we have introduced specific revenue administration measures that are under implementation, and identified specific spending cuts, including a delay in the implementation of lower-priority investment projects. To achieve the fiscal deficit for 2018/19, we commit to introduce through the Finance Bill 2018, revenue raising measures, including removal of some tax exemptions and improvements in tax administration.

We are committed to working with IMF staff on additional measures that may be required to meet program objectives, and, if needed, we will request a further six-month extension of the program and commensurate rephasing of access at the next program review.

We consent to publication of this letter and the related staff report.

Yours Sincerely,

/s/
Henry Rotich, EGH
Cabinet Secretary
The National Treasury & Planning

/s/
Patrick Njoroge
Governor
Central Bank of Kenya