October 2008
IMF Country Report No. 08/339

Kenya: 2008 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Kenya

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with Kenya, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 2, 2008, 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 August 20, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement on the joint IMF/World Bank debt sustainability analysis.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 10, 2008 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Kenya.

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

Selected Issues Paper
Ex Post Assessment of Longer-Term Program Engagement

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KENYA

Staff Report for the 2008 Article IV Consultation

Prepared by the African Department
(In consultation with other departments)

Approved by Saul Lizondo and Anthony R. Boote

August 20, 2008

Mission Date and Team	June 23–July 2, 2008. Messrs. Krueger (head), Atingi Ego, and Yang, Ms. Masha (all AFR), Ms. Everaert (FAD), and Mr. John (PDR). Mr. Rogers (Senior Resident Representative) assisted the mission. Mr. Gakunu and Ms. Gesami from the Executive Director's office participated in the policy discussions. The mission met with Prime Minister Raila Odinga, Finance Minister Amos Kimunya, Central Bank Governor Njuguna Ndung'u, other senior government officials as well as representatives of the business community, labor unions, civil society, and Kenya's development partners. The mission overlapped with a June 23–25 visit by Mr. Horton (FAD) to discuss the *Ex Post* Assessment of Kenya's Longer-Term Program Engagement with the Fund.
Background Papers	*Public Debt Thresholds for Kenya* and *Assessing Kenya's External Stability and Competitiveness*, which were discussed at a seminar with government officials.
Exchange Rate Regime	Kenya has accepted the obligations of Article VIII, Section 2, 3, and 4 and maintains an exchange system free of restrictions on payments and transfers for current international transactions.
Economic Statistics	Broadly adequate for surveillance purposes, but weaknesses in some areas hinder policy assessments, especially with respect to data on consumer prices, national accounts, and balance of payments (Information Annex).
Last Article IV Consultation	In concluding the 2006 consultation, Executive Directors commended the authorities for sound macroeconomic management and progress with structural reforms. They encouraged maintaining fiscal prudence, centering monetary policy around reserve money targets, and advancing structural and governance reforms. Policies (supported through November 2007 by a PRGF arrangement) were broadly in line with this advice, although there were at times slippages in meeting reserve money targets and advancing structural reforms.

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EXECUTIVE SUMMARY

The Article IV discussions focused on the policy agenda of the new grand coalition government. In light of the disruptions that followed the December 2007 elections, the discussions centered around policies to strengthen growth and address some of the social issues that emerged from the crisis, while preserving macroeconomic stability. There was broad agreement on key, but not all, policy issues and on economic prospects:

- **Economic prospects**: after a contraction in the first quarter of 2008, an economic rebound is underway. Notwithstanding considerable risks, staff expected that GDP growth would exceed 7 percent in 2008/09 (July/June); the authorities were somewhat more optimistic than staff that this rapid growth would continue over the medium term.

- **External stability**: the real exchange rate has appreciated considerably and the external current account widened. However, there was broad agreement that this seemed to reflect foremost fundamental factors, and exports, capital inflows, and foreign reserves remain robust.

- **Fiscal policy**: fiscal policy in 2008/09 needs to provide adequate resources for infrastructure and social objectives while preserving macroeconomic stability. With this in mind, staff saw merit in reducing the fiscal deficit to around 4½ percent of GDP—not least in light of expected high growth and inflationary pressures. The authorities' budget envisaged a higher deficit of about 5⅓ percent of GDP, and they emphasized infrastructure needs. The authorities were considering staff's proposal to move to a fiscal anchor of total public debt (including domestic and external), in light of increased external borrowing opportunities. Concerning a planned sovereign bond issue, the authorities agreed that its size, costs, and maturity profile needed to be carefully evaluated in order to mitigate potential risks.

- **Monetary policy**: recent measures to tighten monetary policy were in the right direction in the face of high money growth and inflationary pressures—and more steps are urgently needed to prevent second-round effects of higher food and fuel prices.

- **Structural reforms and Vision 2030**: the government's Vision 2030 aims for Kenya to reach middle-income status by 2030. There was agreement that for the private sector to play its envisaged lead role, substantial infrastructure investment as well as structural reforms would be required, including in the financial sector and on public financial management, governance, and trade policy.

The authorities agreed with the main findings of the ***Ex-Post* Assessment** and suggested several steps for a more effective and balanced partnership in the future.

I. Political Context

1. **A political crisis followed the December 2007 elections, resulting in major economic disruptions**. During the crisis, over 1,000 people were killed and more than 350,000 (about 1 percent of the population) displaced. The disruptions affected also neighboring countries dependent on transport links through Kenya.

2. **Following an internationally intermediated power-sharing agreement, a grand coalition government assumed office in April 2008**. Under the agreement, President Kibaki remained in office and Mr. Raila Odinga assumed the newly-created position of Prime Minister. Constitutional and land reforms are among the challenging political tasks of the new government. On the economic front, the government submitted the 2008/09 budget and launched Vision 2030, a long-term vision for Kenya. However, there have also been challenges, and the Minister of Finance stepped aside in July to allow investigation of alleged misconduct related to a property sale, with allegations also leveled against the Governor of the Central Bank of Kenya (CBK).

II. Economic Context

3. **After a long period of stagnation, growth rebounded strongly over the 5-year period preceding the recent crisis**. Important, if uneven, progress in addressing long-standing weaknesses—including in the areas of financial management, governance, and the business climate—underpinned the gains in recent years, combined with strong global growth. Kenya's GDP growth of 7 percent in 2007 was its highest in over two decades and caught up with growth in the rest of the East African Community (EAC).

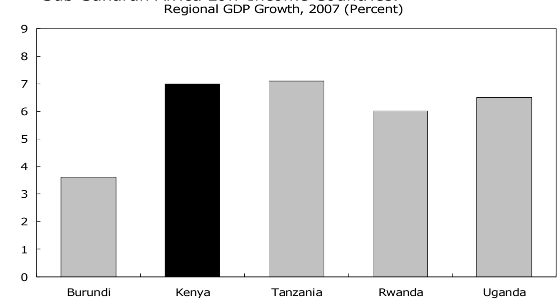
4. **Political instability took a toll on economic activity and exacerbated inflationary pressures in early 2008.** First quarter GDP contracted by 1.3 percent (year-on-year), with tourist arrivals down by over 50 percent and most sectors hampered by disruptions to supply chains and displacement of productive resources. The resulting shortages compounded inflation pressures arising from an earlier accommodative monetary policy as well as from rising international fuel and food prices. Inflation for the official headline consumer price index (CPI) was 26.5 percent in July (year-on-year); and even if the index appears to overstate inflation

Kenya: Comparative Macroeconomic Indicators
(Annual percentage change)

	1990-2002		2003-2007	
	Real GDP Growth	Inflation	Real GDP Growth	Inflation
Kenya	2.1	14.2	5.4	11.2
Uganda	6.2	13.9	5.7	6.6
Tanzania	3.8	17.8	6.5	4.3
SSA - LIC [1]	3.7	14.3	6.1	8.8
All Low Income	4.0	41.1	7.6	8.9

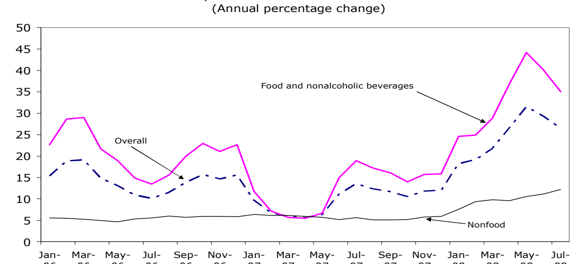
Sources: Country authorities; and IMF staff estimates.
[1] Sub-Saharan Africa Low-Income Countries.

Regional GDP Growth, 2007 (Percent)



Sources: Country authorities; and IMF staff estimates.

Kenya: Official Consumer Price Indices
(Annual percentage change)



Source: Kenya National Bureau of Statistics.

due to some methodological issues (see Box 1), correcting for the overstatement still left estimated inflation at around 15 percent in mid-2008—well above the authorities' target of 5 percent.

Box 1. Upward Bias in the CPI Inflation Rate

Kenya's official CPI imparts an upward bias to "true" inflation. This mainly reflects the chain-linked Carli index used to aggregate individual prices. The Carli index is not "transitive" (if a price increase in one period is reversed in the next, the index would still show an overall increase) and, especially in its chain-linked form, it creates a substantial upward bias, particularly when prices are volatile. For this reason, the International Labor Organization's CPI Manual (2004) strongly advises against using it for compiling the CPI.

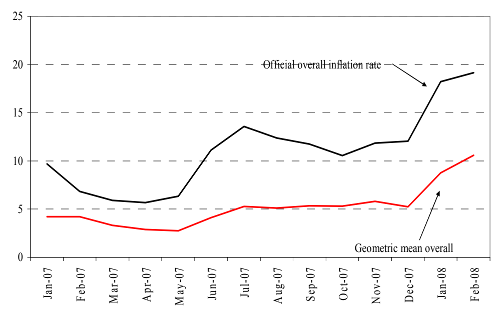
To provide a rough sense of the magnitude of the bias, staff applied one of the recommended methodologies (the so-called Jevons index). The results suggest that the overall CPI was overestimated over the past 1½ years by a factor of about 2. In line with the recommendations of a recent STA mission, the Kenya National Bureau of Statistics plans to switch to a formula consistent with international best practices later in 2008, together with a rebasing and reweighing of the CPI basket.

Illustration of Upward Bias in the Carli Index

	May	June	June/May
Price	(Shillings)		(Ratio)
Item A	20	25	1.25
Item B	25	20	0.8
Mean of prices	(Shillings)		(Ratio)
Arithmetic	22.5	22.5	1.0
Geometric	22.4	22.4	1.0
Derived indices	(May = 100)		(% change)
Carli	100	102.5	2.5
Dutot	100	100	0.0
Jevons	100	100	0.0

Source: IMF staff calculations.

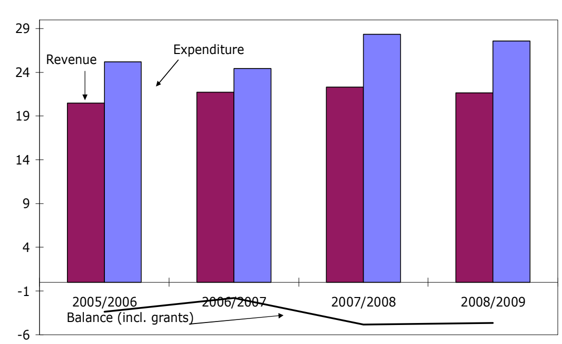
Comparison of CPIs: Official Series and Geometric Mean Estimates
(Annual percentage change)



Sources: KNBS for official series, and IMFstaff for geometric mean estimates.

5. The fiscal deficit (including grants) reached 4.8 percent of GDP for 2007/08 (July/June)—below the original budget target but more than twice the deficit of the previous year. The lower-than-budgeted deficit reflected mainly a shortfall in foreign-financed development spending, which had been anticipated under the now expired PRGF program (Table 2). Strong revenue performance benefited from continued tax administration improvements, a buoyant economy through end-2007, which boosted particularly income tax collections, and a 0.3 percent of GDP one-off transfer of collected road fees. Privatization receipts increased sharply to almost 4 percent of GDP. As a result, domestic financing declined and public debt fell below 40 percent of GDP.

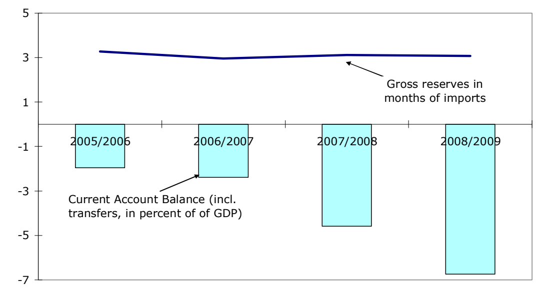
Kenya: Fiscal Developments (In percent of GDP)



Sources: Kenyan authorities; and IMF staff estimates.

6. **The external current account deficit almost doubled in 2007/08 to 4½ percent of GDP**. The widening deficit largely reflected the impact of higher oil prices, while exports held up well despite a strong shilling (see below). Strong capital inflows resumed after the crisis—partly driven by a heavily oversubscribed initial public offering (IPO) of Safaricom—and gross reserves increased.

Kenya: External Sector Developments



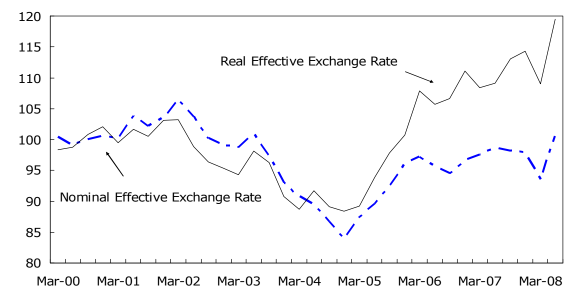
Sources: Kenyan authorities; and IMF staff estimates.

III. Policy Discussions

A. External Stability

7. **Indicators of external performance provide mixed signals.** The shilling appreciated by almost 32 percent in real effective terms since end 2004 (based on a corrected CPI series), a period over which the terms of trade deteriorated markedly and the current account deficit increased. However, export values have expanded somewhat faster than global exports, financial and FDI inflows have increased, external debt has declined and is fairly low, and reserves are at historically high levels.

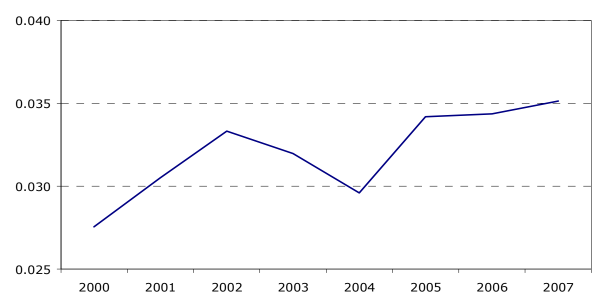
Kenya: Real and Nominal Effective Exchange Rates (2000 = 100)



Sources: Kenyan authorities; and IMF staff estimates.

8. **Overall, the authorities agreed with staff that the exchange rate level appeared broadly appropriate (Box 2).** The shilling's real appreciation since 2005 was likely driven by improving fundamentals, including rising tea and coffee prices, a strengthening net foreign asset position, and improved productivity—all of which helped attract large private financial inflows. Even so, there was agreement that the widening current account deficit entailed risks, and that developments in competitiveness and financial flows needed to be monitored carefully.

Kenya: Exports as Percent of World Exports, 2000-07 (percent)



Sources: IMF, *Direction of Trade Statistics*.

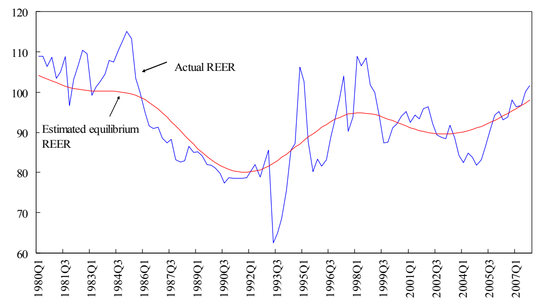
9. **The authorities considered that the managed float exchange rate system had served Kenya well.** Interventions in the foreign exchange market have been largely limited to meeting foreign reserve and monetary targets and reducing exchange rate volatility, with the *de facto* and *de jure* exchange rate regimes classified as a managed float. The authorities noted that further structural reforms would be important to keep the current account deficit at a sustainable level. The projected

further weakening of the terms of trade highlights the urgency to step up such reforms and address infrastructure bottlenecks, which impede trade.

Box 2. External Stability Assessment

The staff employed several methodologies to assess external stability (see the background study "Assessing Kenya's External Stability and Competitiveness"). Estimates of the equilibrium real effective exchange rate (REER) show the shilling's recent appreciation to be in line with fundamentals, particularly with higher prices for tea and coffee, a stronger net foreign asset position, and improved relative productivity. Recent work by the Central Bank of Kenya also found the REER level to be consistent with fundamentals. A second methodology, a variant of the macroeconomic balance approach, suggests that Kenya's current account deficit remains smaller than its estimated "norm" (although the gap has narrowed in recent years and these estimates are subject to considerable margins of uncertainty). Finally, results based on the level of the current account deficit that would stabilize external debt suggest that the present deficit was higher than the level stabilizing Kenya's relatively low external debt.

Kenya: Actual and Estimated REER, 1980-2007



Sources: Kenyan authorities; and IMF staff estimates.

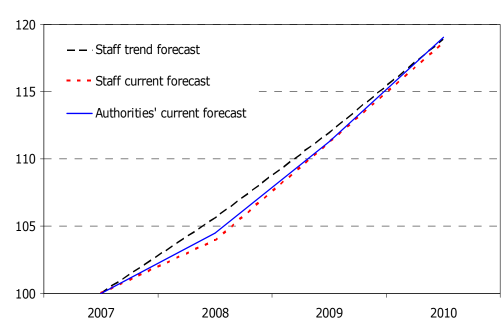
Taken together, the different methodologies do not indicate major risks to external stability. However, data and methodological weaknesses suggest caution in interpreting the results.

B. Growth Prospects

10. **The authorities and business leaders were confident that a robust economic recovery was already underway**. Although the political crisis took a heavy human toll, its damage to productive capacity appears limited, mainly the dislocation of residents and localized destruction of infrastructure. While tourism and agriculture will take some time to regain their strength, various indicators—including for revenues, traffic volumes, and capital inflows—suggest that a recovery has begun. Earlier repercussions on neighboring countries (notably Burundi, Rwanda, and Uganda) have also dissipated.

11. **Against this background, staff expects GDP growth to rebound strongly, from 3.9 percent in 2007/08 to 7.2 percent in 2008/09**. Much of the acceleration reflects the gradual return to trend growth, following the disruptions in the first part of 2008 (which affected fiscal year 2007/08). At the time of the mission, the authorities forecast slower GDP growth for 2008/09 (5.8–6.6 percent), but this did not yet incorporate the larger-than-anticipated output decline in the first quarter of 2008 nor the correspondingly stronger bounce-back from the weaker base assumed in the staff's projections for 2008/09.

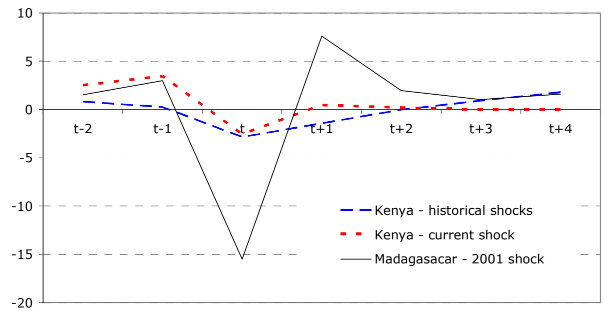
Kenya: Real GDP (2007 = 100)



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

12. **Over the medium term, the authorities and staff expect a fairly steady return to trend growth levels**. The Budget Strategy Paper (BSP) projects GDP growth to average about 7 percent over the medium term, with staff expecting somewhat lower growth (6½ percent) on current policies. The V-shaped recovery would be broadly in line with previous election-related disruptions in Kenya and elsewhere (such as in Madagascar in 2001-02), where growth tended to rebound quickly, but it took time—often some 4–5 years—for GDP levels to approach the pre-crisis trajectory.

Kenya and Madagascar: Growth Deviations From Trend Rates (percentage points)



Sources: Kenyan authorities; and IMF staff estimates.

13. **The projections are subject to considerable risks**. Projected annual growth rates, while close to those before the crisis, are well above the average rate recorded over the past decade—and it was agreed that continued structural and governance reforms were needed to secure these rates. The authorities shared staff's concerns over downside risks, including those arising from the stability of the power sharing arrangement, challenges for the coalition government to implement much-needed reforms, further increases in global oil and food prices as well as world interest rates, and a more pronounced weakening of the global economy. However, they also emphasized the upside risks—for example, a faster-than-projected rebound in confidence, tourism, and donor support. The staff also noted longer-term constraints on growth, particularly infrastructure bottlenecks as well as relatively low levels of private saving and investment.

C. Fiscal Policy

Fiscal anchor—moving to a public debt target?

14. **The authorities recognized that evolving economic circumstances warranted a fresh look at the appropriate fiscal anchor**. In the past, a focus on net domestic debt (relative to GDP) had served Kenya well: it helped bring down domestic debt and provided room for private sector credit growth. However, plans for commercial external borrowing could potentially lead to large year-to-year fluctuations in spending for a given amount of domestic financing. The authorities' agreed that this would be an undesirable outcome.

15. **The authorities are considering staff's proposal of anchoring fiscal policy around a target for total public debt (both domestic and external)**. The target would ideally also include contingent liabilities and other debts for which the government could ultimately be liable. Cross-country evidence suggests that a public debt-to-GDP ratio of about 35 percent would be an appropriate target for Kenya.[1] With the debt ratio currently close to 40 percent, staff supported

[1] See background paper "Public Debt Thresholds for Kenya" and debt sustainability analysis in Supplement I.

aiming for a moderate decline over the medium term, particularly given the potential realization of contingent liabilities in the parastatal sector. Year-to-year fluctuations around such a target path could be accommodated if warranted by specific circumstances—for example, large privatization receipts, which should typically be spent gradually over time and result in faster debt reduction, whereas drought-related emergencies or weak output growth could entail a smaller adjustment in a given year. The authorities saw merit in this approach, including its potential flexibility, but stressed also that sufficient room was needed to address urgent spending priorities.

Fiscal policy for 2008/09—supporting growth while preserving macroeconomic stability

16. **The 2008/09 budget envisages a deficit of 5.3 percent of GDP and a rebalancing of spending toward public investment**. While revenues (in relation to GDP) are expected to fall back from their exceptionally high level in 2007/08, spending is considerably higher than the authorities had envisaged in their 2007 Budget Strategy Paper—resulting also in higher deficits. They saw this as warranted on two accounts: first, higher spending needs, notably to address infrastructure bottlenecks and new policy initiatives (for example, free secondary education) emerging out of the political tensions in early 2008; and, second, better financing opportunities than envisaged earlier, including access to commercial foreign financing (see below).

17. **Staff supported the emphasis on public investment, but saw merit in having a lower-than-budgeted deficit (of about 4½ percent of GDP)**. This would be consistent with the medium-term debt objective outlined above and allow for fiscal policy to play its part in preserving macroeconomic stability, in a context of strong economic growth and high inflation. Staff noted that this deficit was indeed achievable in the context of the authorities' budget plans, provided foreign-financed investment spending was executed in line with rates of the recent past (rather than the 100 percent execution rate assumed in the budget). This would still allow for real spending growth of some 2 percent (versus 5 percent in the budget). The authorities recognized that their plan for foreign-financed spending was ambitious, but were not convinced of the need to aim for a lower deficit target in light of post-crisis spending needs.

Kenya: Fiscal Scenario, 2007/08 - 20010/11
(In percent of GDP, unless otherwise indicated)

	2007/08	2008/09		2009/10	2010/2011
	Staff Estimate	Authorities' Budget [1/]	Staff Projection	Staff Projection	
		(In percent of GDP)			
Total revenue	22.3	21.4	21.6	21.6	21.6
Grants	1.2	1.4	1.3	1.3	1.3
Total expenditure and net lending	28.3	28.1	27.6	26.7	26.7
Overall balance (incl. grants)	-4.8	-5.3	-4.6	-3.8	-3.8
Memorandum items:					
Total public debt	38.8	...	38.0	38.6	38.6
Real GDP growth rate (percent)	3.9	5.8	7.2	6.0	6.6

Sources: Kenyan authorities; and IMF staff estimates and projections.
[1/] Government of Kenya, Budget Strategy Paper 2008.

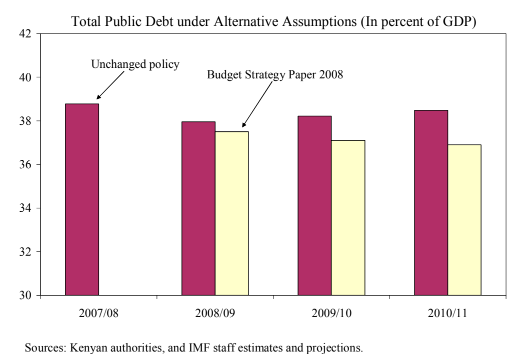
18. **The authorities outlined plans for financing some infrastructure spending from the proceeds of a sovereign bond**. Discussions were still at an early stage, with an envisaged amount of around US$ 500 million. While staff emphasized that concessional funds remained the first-best source of funding, there was agreement that if commercial funds were to be used, market conditions, funding costs, maturity, and the repayment profile needed to be carefully evaluated to maximize the benefits of the bond. Moreover, the size of the issue should not exceed what can effectively be absorbed in high-return projects ready for execution. The authorities indicated that they would cut back on domestically financed development spending, if the bond issuance were delayed. The staff also stressed the need for a comprehensive medium-term debt management strategy and encouraged steps to improve statistics on external financial flows.

19. **The authorities took several measures to mitigate the impact of rising world food prices**. These measures, which entailed very limited fiscal costs, included the zero-rating of VAT on bread and rice, reductions in customs duties for wheat, and steps to make fertilizer available at internationally competitive prices. The discussions covered also targeted support to the most vulnerable segments of the population—for example, an expansion of school feeding programs—but steps in these areas remain contingent on future price and supply developments.

Medium-term fiscal stance—agreement on gradual adjustment and on priority spending

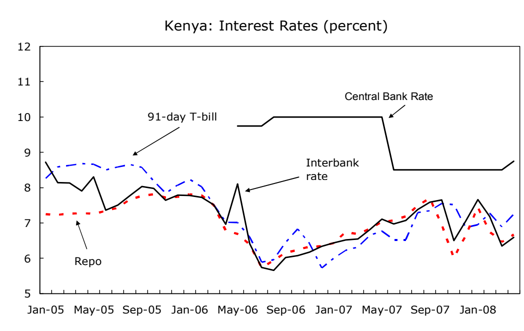
20. **On unchanged policies, little progress would be made in reducing the public debt ratio**. The authorities recognized the limited fiscal consolidation embedded in an unchanged policy scenario—a scenario that assumes no major policy initiatives beyond those already in place (Table 2)—and stressed their commitment to adjustment over the medium-term.

21. **The 2008 Budget Strategy Paper envisaged a gradual reduction of the public debt-to-GDP ratio toward 35 percent over the medium-term—an objective that staff supported**. The authorities underscored that while overall spending (relative to GDP) would decline over the medium-term, the composition would shift toward development spending, in particular to address urgent infrastructure needs. The specific measures to secure this adjustment still needed to be identified, however, in future budgets.



D. Monetary and Financial Sector Policy

22. **Monetary policy was fairly accommodative over much of the past three years**. During this period, monetary targets were frequently missed, and real interest rates on treasury bills (even if based on corrected inflation estimates) were often negative. In 2008, the CBK accommodated crisis-related liquidity needs in the early part of the year, but monetary



conditions tightened considerably thereafter. In early June, the Central Bank Rate (CBR) was raised by ¼ percentage point to 9 percent in response to continued inflationary pressures.

23. **Notwithstanding the recent monetary tightening, the CBK agreed that further steps would be required if inflationary pressures did not abate soon**. The authorities explained that the June increase in the CBR had signaled their intention to let market rates rise. Staff stressed the need to employ decisively all available instruments—including, as appropriate, term-deposit auctions and FX reserve sales—to slow reserve money growth to a rate consistent with preventing the second-round effects of higher food and fuel prices; in this regard, the planned introduction of the CBK's own bills could provide a further useful instrument. However, reserve money growth (19 percent, year-on-year, in July) has remained above the level that the CBK and staff had considered consistent with the envisaged decline in inflation during 2008/09.

24. **The discussions covered also alternatives to the money-based monetary framework, including moving to inflation targeting over the medium term**. While monetary policy would benefit from a strong and credible focus on a low inflation target, it was agreed that more work was needed before initiating steps toward alternative frameworks, including possibly inflation targeting. In particular, this would require the resolution of the methodological issues related to the CPI, but also a better understanding of the monetary transmission mechanism and alternative institutional arrangements for monetary policy—areas where the CBK planned further analytical work.

25. **Most indicators suggest a relatively healthy banking system, but the CBK had to help address liquidity shortfalls in a few smaller banks in the first half of 2008**. Market participants expected that the fallout from the economic downturn in the first quarter could somewhat weaken financial soundness indicators (Table 5) in the period ahead. The CBK had provided support to a few banks when interbank liquidity dried up in the context of the heavily oversubscribed Safaricom IPO—when the interbank market did not recycle IPO-related payments from receiving banks to some smaller banks in need of liquidity.

E. Vision 2030 and Structural Reforms

26. **The government's structural reform agenda is centered around its Vision 2030 program**. A key economic target of Vision 2030 is to accelerate annual GDP growth to 10 percent per year by 2012 and sustain this growth thereafter, making Kenya a middle-income country by 2030. A medium term plan that would guide the new poverty reduction strategy was recently derived from Vision 2030. Against this background, discussions focused on selective structural reforms in the Fund's core areas.

27. **The authorities considered a vibrant financial sector as critical for dynamic, broad-based growth**. To this end, they intended to finalize soon a Financial Sector Strategy. They also planned to move forward with a comprehensive revision of the Central Bank and the Banking Acts, including with steps that would bring mandatory and prompt corrective actions in line with international best practices. Moreover, the CBK expected improved efficiency in the money market following the recent dematerialization of treasury bill transactions and the adoption of the Master Repurchase Agreement governing horizontal repurchase agreements. An anti-money laundering bill

is before parliament—although its passage remained uncertain—and the privatization of the National Bank of Kenya is on the agenda.

28. **Concerning structural reforms in the fiscal area, discussions focused on public financial management and the role of public private partnerships (PPPs)**.

- **The authorities concurred with the need to reinvigorate their five-year public financial management reform program**. Plans included: (i) adoption and subsequent implementation of the Public Finance Administration Bill; (ii) expansion of the Integrated Financial Management Information System (IFMIS) to the few remaining ministries and all districts; (iii) introduction of a single treasury account; and (iv) adoption of program budgeting, where a pilot phase is presently underway. There was agreement that if plans to devolve more spending to subnational levels were proceeding, mechanisms needed to be put in place first that would ensure effective coordination with fiscal policy at the central level and strengthen budget reporting and control.

- **PPPs are to raise some of the funding for implementing Vision 2030**. Plans were advancing to finalize a solid framework for PPPs. The authorities recognized that PPPs could play a useful role in infrastructure development, but could also entail fiscal and implementation risks. They were considering staff's suggestion to start with smaller projects until more experience is gained, and agreed on the need to transparently record all PPPs and potential public liabilities.

29. **The authorities intend to update the Governance Action Plan**. The Plan for 2006/07 had provided a useful framework, and the authorities intended to publish outcomes for the actions envisaged under the Plan. This would show important progress in several areas, including on public procurement and business regulations, where improvements placed Kenya among the world's top 10 reformers in the World Bank's 2008 doing business report. The authorities recognized, however, that other objectives were not met. These included public access to the wealth declarations of senior public officials and ongoing verification of wealth declarations by the Kenya Anti-Corruption Commission—areas where staff encouraged progress under the next action program.

30. **Strong medium-term growth will require further regulatory and trade reforms**. While considerable progress has been made in streamlining business licenses, the World Bank's Doing Business Indicators continue to point to high costs in several key areas—findings that are supported by other indicators. On trade reform, the authorities noted the EAC's success in advancing trade integration, and took note of staff's suggestion to work with their partners to lower the common external tariff and remove nontariff barriers. These were expected to be covered in an EAC common market agreement, to be signed by

Kenya: Doing Business Indicators, 2007

Ease of...	World Rank [1]	SSA Rank [2]
Doing Business	*72*	*5*
Of which:		
Starting a Business	112	17
Registering Property	114	14
Paying Taxes	154	37
Trading Across Borders	148	30
Enforcing Contracts	107	19

Source: World Bank, *Doing Business Database.*

[1] Rankings are out of 178 countries. The lower the better.

[2] Rankings are out of 46 countries.

July 2009. Discussions on a full Economic Partnership Agreement with the EU were also to be finalized by mid-2009.

F. *Ex Post* Assessment

31. **The authorities welcomed the opportunity to draw lessons from the longer-term program engagement with the Fund and broadly agreed with most of the EPA conclusions**. They appreciated that the EPA highlighted Kenya's track record of relatively prudent macroeconomic management and its improved performance over the past five years. They also concurred that an earlier re-evaluation of the focus of the Fund's involvement in the governance area would have been helpful. Moreover, they considered that some conditionality, particularly in the governance area, had not reflected realistic timetables or the constraints of Kenya's legal and political systems, and an emphasis on legal and institutional governance reforms should have come earlier. Several non-governmental representatives, but also some among the authorities, expressed concern that the relationship between Kenya and the Fund had often been an unequal one, with the Fund taking advantage of difficult economic circumstances to push for adjustments, with negative consequences for growth and poverty reduction.

IV. Staff Appraisal

32. **Following the political crisis of early 2008, the new government has taken initial steps that, if sustained, could facilitate a relatively quick return to strong economic growth**. The post-election violence interrupted a remarkable five-year rebound, in which economic growth finally caught up with the region. The initial steps by the grand coalition government—including measures to safeguard fiscal stability in 2007/08 while addressing urgent spending needs—provide a good basis for advancing growth- and stability-oriented reforms. Improving political stability and security have already sparked a quick economic rebound and prospects are favorable, if supported by strong policies and provided the world economy does not weaken beyond current forecasts.

33. **While the external current account deficit has increased, there appear to be no major risks to external stability**. The appreciation of the real exchange rate seems broadly in line with economic fundamentals, with strong capital inflows financing the current account deficit and foreign reserves increasing. Under these circumstances, exchange market interventions should remain limited to smoothing excessive short-term volatility and meeting the foreign reserve target.

34. **While the tightening of monetary policy in mid-2008 was welcome, more steps are urgently needed to prevent second-round effects of food and fuel price increases**. This requires employing decisively the available instruments to limit monetary growth to rates consistent with the inflation objectives. Moreover, the methodological issues of the current consumer price index should be resolved quickly to allow an accurate inflation assessment. Over the medium term, broader reforms of the monetary framework could be considered, including moving to explicit inflation targeting, and planned analytical work on the issues is welcome.

35. **Fiscal policy needs to balance spending in support of growth and poverty reduction with preserving macroeconomic stability**. In this context, the 2008/09 budget rightly realigns spending

priorities toward infrastructure and several social objectives, such as free secondary education. More spending may also be needed eventually to provide targeted support to those most vulnerable to the increases in food and fuel prices. However, these spending priorities could be accommodated within an overall smaller-than-budgeted spending envelope. Indeed, in the face of strong growth and inflation pressures, it would seem appropriate to target some reduction in the fiscal deficit, to around 4½ percent of GDP—somewhat below the budget proposal. Importantly, this would also allow a reduction in the public debt-to-GDP ratio.

36. **Consideration could be given to making the public debt-to-GDP ratio a medium-term anchor for fiscal policy**. It would cover not only domestic but also external debt—an increasingly important consideration amid prospects of external commercial borrowing. A sovereign bond could help finance some high-return infrastructure projects, in cases where concessional resources—the first-best option—are not available. Size, timing, and modalities of the issuance are also important considerations to maximize the benefits of a sovereign bond.

37. **Vision 2030 provides appropriately ambitious targets for Kenya—and it is now imperative to advance the structural reforms needed for realizing this vision**. If the private sector is to play its envisaged lead role, further improvements in the investment climate are required. Accelerating financial sector reforms will be key, also to secure the needed increase in domestic resource mobilization. In addition, PPPs could play an important role, but smaller projects should precede larger ones to gain experience in limiting potential fiscal and implementation risks. The public sector also had its part to play in addressing infrastructure bottlenecks, and an important growth impulse could come from further trade reforms.

38. **Continued progress on governance and transparency would be important to achieve the Vision 2030 objectives.** Important progress was made in implementing the 2007/08 governance action plan, such as in public procurement and business regulation. The planned update of the plan should include steps in areas where the original objectives were not met, including for wealth declarations and verifications for senior public officials. Further improving public financial management will also be important to advance transparency, including with measures to expand IFMIS and ensure the efficient use of devolved public resources.

39. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Kenya: Selected Economic Indicators, 2005/06-2012/2013

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
			Estimate			Projection		
			(Annual percentage change, unless otherwise indicated)					
National accounts and prices								
Real GDP growth (market prices)	6.1	6.7	3.9	7.2	6.0	6.6	6.5	6.5
GDP deflator (average) [1]	6.4	5.5	12.0	11.6	4.8	5.1	5.1	5.1
Consumer price index (annual average) [1]	11.1	10.4	18.5	14.5	5.0	5.0	5.0	5.0
Consumer price index (end of period) [1]	10.9	11.1	29.3	8.0	5.0	5.0	5.0	5.0
Export volume, goods and services	6.4	4.7	3.7	6.3	10.2	9.6	9.7	9.5
Import volume, goods and services	16.7	15.2	3.5	1.1	7.8	9.6	9.8	9.4
Terms of trade, goods	-5.8	-3.0	-11.9	-7.6	-2.3	0.3	0.3	1.1
Ksh per US $ exchange rate (end of period)	69.3	62.6	64.6	...	...	...	...	...
Nominal effective exchange rate (- depreciation; end of period)	4.0	5.9	3.0	...	...	...	...	...
Real effective exchange rate (- depreciation; end of period)	11.8	14.2	7.8	...	...	...	...	...
Money and credit								
M3 (broad money, end of period)	18.0	16.0	18.3	21.8	17.2	16.2	16.1	16.1
M3X (broad money and foreign currency deposits, end period)	14.9	18.9	19.4	17.3	16.0	15.2	15.2	15.2
Reserve money (end of period)	14.0	17.5	19.6	15.0	14.6	14.1	14.1	14.1
			(In percent of GDP, unless otherwise indicated)					
Investment and saving								
Investment	18.0	19.1	20.0	22.0	22.1	22.4	23.1	23.6
Central government	4.2	4.6	6.7	7.4	7.3	7.4	7.8	7.8
Other	13.8	14.5	13.3	14.6	14.8	15.0	15.3	15.8
Gross national saving	16.0	16.7	15.4	15.3	16.6	17.2	17.9	18.3
Central government	0.0	2.0	1.2	1.8	2.3	2.4	2.3	2.1
Other	16.0	14.8	14.3	13.5	14.3	14.8	15.6	16.2
Central government budget								
Total revenue	20.5	21.7	22.3	21.6	21.6	21.6	21.6	21.6
Total expenditure and net lending	25.2	24.4	28.3	27.6	26.7	26.7	27.3	27.5
Overall balance (commitment basis) excluding grants	-4.7	-2.7	-6.0	-5.9	-5.2	-5.2	-5.7	-5.9
Overall balance (commitment basis) including grants	-3.4	-1.8	-4.8	-4.6	-3.8	-3.8	-4.2	-4.3
Net domestic borrowing	1.9	2.0	1.1	2.2	2.5	2.5	2.6	2.7
Total donor support (grants & loans)	1.9	1.5	2.5	2.6	2.8	2.9	3.3	3.3
Balance of payments								
Exports value, goods and services	26.6	25.5	24.9	25.2	25.1	25.2	25.4	26.9
Imports value, goods and services	35.9	35.2	36.6	39.2	37.6	37.1	36.9	38.6
Current external balance, including official transfers	-2.0	-2.4	-4.6	-6.7	-5.4	-5.2	-5.2	-5.3
Current external balance, excluding official transfers	-2.3	-2.4	-4.8	-6.7	-5.4	-5.2	-5.2	-5.3
Gross international reserve coverage								
in months of next year imports (end of period)	3.3	2.9	3.1	3.1	3.1	3.1	3.1	3.2
Public Debt								
Total government debt (end of period)	45.1	42.3	38.8	38.0	38.6	38.6	38.7	39.6
of which: external debt	26.7	22.8	20.3	20.3	20.2	19.6	19.2	19.4
NPV of central government debt (end of period)	37.9	35.6	32.5	31.9	32.8	32.9	33.2	34.0
of which: NPV of external debt	19.5	16.1	14.0	14.2	14.3	14.0	13.7	13.8

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

[1] Up to 2007/08, GDP Deflator and Consumer Price Index are overestimated (see Box 1).

Table 2a. Kenya: Central Government Financial Operations, 2005/06-2012/13 1/

	2005/06	2006/07	2007/08		2008/09		2009/10	2010/11	2011/12	2012/13
	Actual	Actual	Program	Staff Projection	Budget	Staff Projection	Projection			
	(In billions of Kenyan shillings, unless otherwise indicated)									
Revenue	311.3	373.0	427.2	442.2	512.7	513.7	569.3	637.6	715.8	801.5
Income tax	113.9	131.5	151.8	165.1	194.0	190.5	211.8	237.1	265.3	296.8
Import duty (net)	20.5	27.5	32.3	32.9	36.5	38.6	42.0	46.6	53.2	60.4
Excise duty	50.3	56.4	65.6	61.9	72.9	72.4	80.9	91.2	102.8	114.7
Value-added tax	76.3	96.3	112.2	111.9	133.9	135.4	149.8	167.6	188.2	210.6
Investment income	2.2	6.6	2.7	3.1	5.7	5.7	6.3	7.1	7.9	8.8
Other	25.2	28.4	30.6	29.8	34.7	35.9	39.9	44.8	50.1	56.1
Ministerial and Departmental Fees (AIA)	22.8	26.4	32.0	37.4	35.1	35.1	38.6	43.2	48.4	54.1
Expenditure and net lending	382.8	419.5	557.3	562.0	673.0	654.5	705.6	790.5	903.4	1,019.6
Recurrent expenditure	315.1	339.2	403.8	422.1	471.7	472.0	508.2	566.7	641.0	724.4
Interest payments	41.2	42.5	49.7	47.9	56.7	57.0	61.7	72.0	87.4	98.9
Domestic interest	31.4	36.9	44.0	42.2	49.4	49.4	54.3	62.4	76.3	85.5
Foreign interest due	9.8	5.7	5.7	5.7	7.2	7.6	7.4	9.6	11.1	13.4
Wages and benefits (civil service)	112.3	127.3	144.0	146.4	162.0	162.0	174.7	195.8	219.1	245.3
Civil service reform	1.3	1.4	0.5	0.8	0.2	0.2	0.2	0.2	0.2	0.2
Pensions, etc.	19.8	20.4	24.4	24.3	27.1	27.1	31.6	36.7	42.2	48.6
Other	111.8	119.0	139.6	157.1	171.4	171.4	187.7	209.1	232.8	265.2
Defense and NSIS 2/	29.3	28.7	45.7	45.8	50.8	50.8	52.3	52.9	59.2	66.3
Pending bills	-0.5	-0.1	0.0	-0.2	3.6	3.6	0.0	0.0	0.0	0.0
Development and net lending	67.7	80.3	147.8	140.0	198.3	179.4	194.3	220.6	259.0	291.7
Domestically financed	40.5	53.5	81.1	87.8	113.3	113.3	118.1	132.3	148.1	165.8
Foreign financed	23.1	26.1	60.3	45.8	81.2	62.4	74.2	86.2	108.9	123.8
Net lending	1.0	1.4	2.4	2.4	2.1	2.1	2.0	2.0	2.0	2.0
Pending bills	-1.0	-0.7	0.0	0.0	1.6	1.6	0.0	0.0	0.0	0.0
Drought Development Expenditure	4.0	0.0	4.0	4.0	0.0	0.0	0.0	0.0	0.0	0.0
Civil Contingency Fund	0.0	0.0	2.0	0.0	2.0	2.0	2.0	2.0	2.0	2.0
Drought expenditures	0.0	0.0	3.7	0.0	1.0	1.0	1.1	1.2	1.4	1.6
Balance (commitment basis, excluding grants)	-71.6	-46.5	-130.1	-119.8	-160.2	-140.8	-136.4	-152.9	-187.6	-218.1
Grants	20.1	15.5	30.7	24.2	33.8	30.4	35.1	39.5	48.3	58.3
Food/debt relief grants 3/	0.0	0.0	0.4	0.4	0.0	0.5	0.5	0.5	0.5	0.5
Project grants	15.7	15.5	26.5	20.3	33.8	30.0	34.6	39.1	47.9	57.8
Program grants	4.4	0.0	3.7	3.4	0.0	0.0	0.0	0.0	0.0	0.0
Balance (commitment basis, including grants)	-51.5	-31.0	-99.4	-95.7	-126.4	-110.4	-101.3	-113.4	-139.3	-159.8
Adjustments to cash basis	14.2	1.6	0.4	0.4	-0.4	0.0	0.0	0.0	0.0	0.0
Balance (cash basis, including grants)	-37.2	-29.4	-99.0	-95.3	-126.9	-110.4	-101.3	-113.4	-139.3	-159.8
Financing	35.0	35.5	99.0	99.2	126.9	110.4	101.3	113.4	139.3	159.8
Net foreign financing	-0.2	-3.1	29.0	9.9	58.8	43.4	34.1	40.7	53.8	58.2
Project loans	7.4	10.6	33.4	25.1	47.4	32.0	39.1	46.7	60.6	65.6
Program loans	1.6	0.0	1.3	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Commercial (incl. security refinancing) 4/	0.0	0.0	20.2	0.0	33.6	35.1	13.9	13.9	13.9	14.6
Repayments due	-27.5	-16.7	-17.1	-15.7	-16.6	-17.3	-18.9	-19.8	-20.7	-22.0
Change in arrears	12.7	0.7	-8.8	-0.7	-6.1	-6.4	0.0	0.0	0.0	0.0
Rescheduling	5.6	2.2	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0
Privatization proceeds and other 5/	7.0	4.0	44.9	76.4	13.7	13.7	0.0	0.0	0.0	0.0
Bank restructuring costs 6/	0.0	-20.0	-1.1	-1.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization costs	0.0	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Telkom restructuring costs (cash) 7/	…	…	-8.8	-8.8	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring costs (bond) 8/	…	…	-11.5	-9.0	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring costs (tax arrears) 9/	…	…	-15.0	-19.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank restructuring financing 6/	…	20.0	1.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization financing	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring financing 8/	…	…	11.5	9.0	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring financing (tax arrears) 9/	…	…	15.0	19.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic financing	28.3	34.7	34.0	21.8	54.5	53.3	67.2	72.7	85.5	101.7
Financing gap (stat. discrepancy for outturns)	2.2	-6.2	0.0	-3.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nominal GDP	1,519.4	1,717.5	2,077.8	1,983.3	2,393.2	2,373.8	2,637.9	2,955.5	3,308.6	3,703.1
Primary budget balance	4.0	13.2	-49.3	-47.4	-70.2	-53.4	-39.6	-41.4	-51.9	-61.0
Stock of domestic debt, net (end of period)	280.1	334.7	381.3	366.5	421.0	419.8	487.0	559.6	645.1	746.8
NPV of total public debt	576.0	611.9	…	643.7	…	756.4	864.9	972.6	1,097.5	1,257.7
Total public debt	686.0	725.8	…	768.9	…	901.0	1,018.6	1,140.3	1,281.1	1,465.4

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

1/ Fiscal year ending June 30. Projections from 2009/10 onward are based on the unchanged policy scenario (see text).
2/ Includes a one-time allocation for payment of security-related arrears of Ksh 2 billion in 2007/08 budget.
3/ Includes debt relief from a debt swap deal with Italy.
4/ In 2008/09, this includes a US$ 500 million sovereign bond, of which some proceeds will be used to clear security related arrears.
5/ In 2008/09, this includes repayment from parastatals of expenditures that are pre-financed during 2008/09 by the central government budget.
6/ Operation consists of recapitalization of National Bank of Kenya and financing this through issuance of a special purpose bond.
7/ Operation consists of recapitalization of Kenya Telkom on account of its pension obligations and restructuring operation and financing this through cash injection.
8/ Operation consists of recapitalization of Kenya Telkom on account of its pension obligations and restructuring operation and financing this through issuance of a special purpose bond.
9/ Operation consists of clearance of tax arrears of Kenya Telkom to KRA and Ministry of Finance.

Table 2b. Kenya: Central Government Financial Operations (percent of GDP), 2005/06-2012/13 [1/]

	2005/06	2006/07	2007/08		2008/09		2009/10	2010/11	2011/12	2012/13
	Actual	Actual	Program	Staff Projection	Budget	Staff Projection	Projection			
	(In percent of GDP, unless otherwise indicated)									
Revenue	20.5	21.7	20.6	22.3	21.4	21.6	21.6	21.6	21.6	21.6
Income tax	7.5	7.7	7.3	8.3	8.1	8.0	8.0	8.0	8.0	8.0
Import duty (net)	1.3	1.6	1.6	1.7	1.5	1.6	1.6	1.6	1.6	1.6
Excise duty	3.3	3.3	3.2	3.1	3.0	3.1	3.1	3.1	3.1	3.1
Value-added tax	5.0	5.6	5.4	5.6	5.6	5.7	5.7	5.7	5.7	5.7
Investment income	0.1	0.4	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	1.7	1.7	1.5	1.5	1.4	1.5	1.5	1.5	1.5	1.5
Ministerial and Departmental Fees (AIA)	1.5	1.5	1.5	1.9	1.5	1.5	1.5	1.5	1.5	1.5
Expenditure and net lending	25.2	24.4	26.8	28.3	28.1	27.6	26.7	26.7	27.3	27.5
Recurrent expenditure	20.7	19.8	19.4	21.3	19.7	19.9	19.3	19.2	19.4	19.6
Interest payments	2.7	2.5	2.4	2.4	2.4	2.4	2.3	2.4	2.6	2.7
Domestic interest	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.3	2.3
Foreign interest due	0.6	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Wages and benefits (civil service)	7.4	7.4	6.9	7.4	6.8	6.8	6.6	6.6	6.6	6.6
Civil service reform	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pensions, etc.	1.3	1.2	1.2	1.2	1.1	1.1	1.2	1.2	1.3	1.3
Other	7.4	6.9	6.7	7.9	7.2	7.2	7.1	7.1	7.0	7.2
Defense and NSIS 2/	1.9	1.7	2.2	2.3	2.1	2.1	2.0	1.8	1.8	1.8
Pending bills	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0	0.0
Development and net lending	4.5	4.7	7.1	7.1	8.3	7.6	7.4	7.5	7.8	7.9
Domestically financed	2.7	3.1	3.9	4.4	4.7	4.8	4.5	4.5	4.5	4.5
Foreign financed	1.5	1.5	2.9	2.3	3.4	2.6	2.8	2.9	3.3	3.3
Net lending	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Pending bills	-0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Drought Development Expenditure	0.3	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Civil Contingency Fund	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Drought expenditures	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance (commitment basis, excluding grants)	-4.7	-2.7	-6.3	-6.0	-6.7	-5.9	-5.2	-5.2	-5.7	-5.9
Grants	1.3	0.9	1.5	1.2	1.4	1.3	1.3	1.3	1.5	1.6
Food/debt relief grants 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	1.0	0.9	1.3	1.0	1.4	1.3	1.3	1.3	1.4	1.6
Program grants	0.3	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Balance (commitment basis, including grants)	-3.4	-1.8	-4.8	-4.8	-5.3	-4.6	-3.8	-3.8	-4.2	-4.3
Adjustments to cash basis	0.9	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance (cash basis, including grants)	-2.5	-1.7	-4.8	-4.8	-5.3	-4.6	-3.8	-3.8	-4.2	-4.3
Financing	2.3	2.1	4.8	5.0	5.3	4.6	3.8	3.8	4.2	4.3
Net foreign financing	0.0	-0.2	1.4	0.5	2.5	1.8	1.3	1.4	1.6	1.6
Project loans	0.5	0.6	1.6	1.3	2.0	1.3	1.5	1.6	1.8	1.8
Program loans	0.1	0.0	0.1	0.1	0.0	0.0	0	0.0	0.0	0.0
Commercial (incl. security refinancing) 4/	0.0	0.0	1.0	0.0	1.4	1.5	0.5	0.5	0.4	0.4
Repayments due	-1.8	-1.0	-0.8	-0.8	-0.7	-0.7	-0.7	-0.7	-0.6	-0.6
Change in arrears	0.8	0.0	-0.4	0.0	-0.3	-0.3	0.0	0.0	0.0	0.0
Rescheduling	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization proceeds and other 5/	0.5	0.2	2.2	3.9	0.6	0.6	0.0	0.0	0.0	0.0
Bank restructuring costs 6/	0.0	-1.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring costs (cash) 7/	...	...	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring costs (bond) 8/	...	...	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring costs (tax arrears) 9/			-0.7	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank restructuring financing 6/	...	1.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization financing	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring financing 8/	...	...	0.6	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Telkom restructuring financing (tax arrears) 9/	...	...	0.7	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic borrowing	1.9	2.0	1.6	1.1	2.3	2.2	2.5	2.5	2.6	2.7
Financing gap (stat. discrepancy for outturns)	0.1	-0.4	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nominal GDP (billion of Ksh)	1,519.4	1,717.5	2,077.8	1,983.3	2,393.2	2,373.8	2,637.9	2,955.5	3,308.6	3,703.1
Primary budget balance	0.3	0.8	-2.4	-2.4	-2.9	-2.2	-1.5	-1.4	-1.6	-1.6
Stock of domestic debt, net (end of period)	18.4	19.5	18.4	18.5	17.6	17.7	18.5	18.9	19.5	20.2
NPV of total public debt	37.9	35.6	...	32.5	...	31.9	32.8	32.9	33.2	34.0
Total public debt	45.1	42.3	...	38.8	...	38.0	38.6	38.6	38.7	39.6

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

1/ Fiscal year ending June 30. Projections from 2009/10 onward are based on the unchanged policy scenario (see text).
2/ Includes a one-time allocation for payment of security-related arrears of Ksh 2 billion in 2007/08 budget.
3/ Includes debt relief from a debt swap deal with Italy.
4/ In 2008/09, this includes a US$ 500 million sovereign bond, of which some proceeds will be used to clear security related arrears.
5/ In 2008/09, this includes repayment from parastatals of expenditures that are pre-financed during 2008/09 by the central government budget.
6/ Operation consists of recapitalization of National Bank of Kenya and financing this through issuance of a special purpose bond.
7/ Operation consists of recapitalization of Kenya Telkom on account of its pension obligations and restructuring operation and financing this through cash injection.
8/ Operation consists of recapitalization of Kenya Telkom on account of its pension obligations and restructuring operation and financing this through issuance of a special purpose bond.
9/ Operation consists of clearance of tax arrears of Kenya Telkom to KRA and Ministry of Finance.

Table 3. Kenya: Monetary Survey, 2005-2009

	Jun-05	Jun-06	Jun-07	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
						Projection		
				(In Billions of Kenya Shillings)				
Central Bank of Kenya (CBK)								
Net foreign assets 1/	95.7	159.5	174.2	213.9	211.6	213.9	216.2	228.9
In Millions of US $	1,212	2,159	2,357	2,896	3,067	3,078	3,089	3,192
Net domestic assets	-1.2	-51.8	-47.7	-62.7	-58.7	-31.8	-47.6	-55.0
Net domestic credit	1.7	-37.0	-16.8	-21.5	-17.3	11.9	-3.7	-9.8
Government (net)	5.1	-15.8	-3.5	-28.4	-5.6	21.3	7.5	9.5
Private sector credit (CBK staff loans)	2.0	2.2	2.3	2.4	2.4	2.5	2.5	2.5
Commercial banks (net)	-5.3	-23.4	-15.7	4.5	-14.2	-11.9	-13.8	-21.8
Other items (net)	-2.9	-14.8	-30.9	-41.2	-41.3	-43.7	-43.8	-45.2
Reserve money (RM)	94.4	107.7	126.5	151.2	153.0	182.1	168.6	173.9
Currency outside banks	59.3	67.2	78.1	84.0	95.3	115.2	99.9	98.1
Bank reserves	35.1	40.5	48.3	67.2	57.7	66.9	68.7	75.8
Required Reserves 2/	25.9	30.0	35.2	42.2	46.6	49.1	52.4	54.6
Excess Reserves	1.2	1.5	1.5	8.8	3.1	9.8	9.0	9.3
Cash in till	8.0	9.0	11.7	16.2	8.0	8.0	7.3	11.9
Banks								
Net foreign assets 1/	52.8	32.1	65.6	102.1	96.0	93.3	87.6	80.6
Reserves	35.1	40.5	48.3	67.2	57.7	66.9	68.7	75.8
Credit to CBK	5.3	23.4	15.7	-4.5	14.2	11.9	13.8	21.8
Net domestic assets	374.2	442.3	512.0	610.4	609.5	645.8	703.4	731.5
Domestic credit	459.2	535.3	608.3	738.7	696.8	743.8	810.5	852.4
Government (net)	107.2	133.7	160.6	161.1	163.8	164.4	165.1	162.4
Other public sector	10.3	12.2	12.5	10.1	13.0	14.8	16.0	10.4
Private sector	341.7	389.5	435.2	567.6	520.0	564.6	629.4	679.6
Other items (net)	-85.0	-93.0	-96.3	-128.4	-87.3	-98.0	-107.1	-120.9
Total deposits	467.5	538.3	641.7	775.2	777.4	817.9	873.5	909.6
Monetary survey								
Net foreign assets 1/	148.4	191.6	239.8	316.0	307.6	307.2	303.8	309.5
Net domestic assets	378.3	413.9	480.0	543.1	565.0	625.9	669.6	698.3
Domestic credit	466.3	521.7	607.1	712.8	693.6	767.6	820.6	864.4
Government (net)	112.3	117.9	157.2	132.7	158.2	185.7	172.6	171.9
Rest of the economy	354.0	403.8	450.0	580.1	535.4	581.9	647.9	692.5
Other public sector	10.3	12.2	12.5	10.1	13.0	14.8	16.0	10.4
Private	343.7	391.6	437.5	570.0	522.4	567.1	631.9	682.2
Other items (net)	-88.0	-107.8	-127.1	-169.6	-128.6	-141.7	-150.9	-166.2
Money and quasi money (M3)	442.4	522.0	605.5	716.4	745.4	803.4	841.1	872.8
M3 and foreign currency deposits (M3X)	526.8	605.5	719.8	859.2	872.7	933.1	973.5	1,007.8
Currency outside banks	59.3	67.2	78.1	84.0	95.3	115.2	99.9	98.1
Deposits	467.5	538.3	641.7	775.2	777.4	817.9	873.5	909.6
of which: foreign currency deposits	84.4	83.5	114.3	142.8	127.2	129.8	132.4	135.0
Memorandum items:								
				(In Percent of Annual Change)				
Money and quasi money (M3)	8.6	18.0	16.0	18.3	18.1	20.5	20.7	21.8
M3 and foreign currency deposits (M3X)	11.3	14.9	18.9	19.4	17.3	17.0	17.1	17.3
Reserve Money	4.7	14.0	17.5	19.6	16.5	17.0	12.0	15.0
Currency outside banks	6.6	13.3	16.2	7.5	19.0	20.0	17.6	16.9
Net domestic assets of the banking sector	7.0	9.4	16.0	13.2	12.2	18.8	21.0	28.6
Domestic credit	7.8	11.9	16.4	17.4	13.6	14.2	15.9	21.3
Government (net)	-19.3	5.0	33.3	-15.6	-1.4	32.2	5.6	29.6
Rest of the economy	20.6	14.1	11.4	28.9	19.0	9.5	19.1	19.4
Non-bank holdings of government debt, billions of Ksh	137	159.9	175.1	196.4	184.2	170.0	196.4	210.4
Stock of domestic debt, billions of Ksh	249	277.8	332.3	329.1	342.4	355.7	369.0	382.3
Multiplier (M3/RM)	5.7	5.6	5.7	5.7	5.7	5.1	5.8	5.8
Velocity (GDP/M3)	2.6	2.5	2.5	2.4	2.4	2.4	2.4	2.4

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

1/ From September 2008, use of program exchange rate stopped.

2/ Calculated as 6% of total deposit excluding those at NBK, up to 2008.

Table 4. Kenya: Balance of Payments, 2005/06-2012/13
(In millions of U.S. dollars, unless otherwise indicated)

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
		Est.	Prel.			Projection		
Current account	-404	-586	-1,391	-2,283	-2,069	-2,232	-2,479	-2,696
Excluding official transfers	-466	-586	-1,446	-2,283	-2,069	-2,232	-2,479	-2,696
Exports, f.o.b.	3,508	3,835	4,701	5,460	6,095	6,881	7,765	8,796
Coffee	134	155	160	162	173	183	195	216
Tea	612	675	801	849	830	879	948	1,060
Horticulture	472	559	699	827	921	1,066	1,253	1,447
Imports, f.o.b.	-6,295	-7,461	-9,453	-11,256	-12,153	-13,503	-15,101	-16,847
Oil	-1,545	-1,833	-2,489	-3,244	-3,509	-3,746	-4,027	-4,282
Balance on goods	-2,787	-3,626	-4,752	-5,796	-6,057	-6,621	-7,336	-8,051
Services (net)	855	1,239	1,200	1,064	1,308	1,562	1,819	2,087
Credit	1,988	2,419	2,838	3,064	3,451	3,880	4,338	4,841
Foreign travel credit 1/	631	794	801	742	875	1,019	1,172	1,348
Debit	-1,133	-1,180	-1,638	-2,000	-2,142	-2,318	-2,520	-2,753
Balance on goods and services	-1,932	-2,387	-3,552	-4,732	-4,749	-5,059	-5,517	-5,964
Income (net)	-38	-44	-24	52	56	18	32	1
Credit	86	106	147	188	204	221	243	273
Debit	-124	-150	-171	-136	-148	-203	-211	-272
of which : official interest payments	-86	-82	-92	-59	-73	-129	-138	-198
Other	-58	-68	-79	-77	-75	-74	-73	-74
Current transfers (net)	1,566	1,844	2,185	2,396	2,624	2,809	3,006	3,267
Private (net)	1,504	1,844	2,131	2,396	2,624	2,809	3,006	3,267
of which: remittances	625	816	1,010	1,197	1,341	1,435	1,535	1,667
Official (net)	63	0	55	0	0	0	0	0
Capital and financial account	910	839	2,086	2,615	2,485	2,753	3,085	3,385
Capital account (incl. capital transfers)	215	227	320	428	498	563	671	811
Financial account	694	612	1,766	2,187	1,987	2,189	2,414	2,574
Investment assets and liabilities (net)	634	139	734	1,884	1,426	1,503	1,810	2,115
Official, medium and long term	-38	6	235	769	717	679	845	831
Inflows	185	248	499	1,016	976	930	1,106	1,159
Program loans	21	0	20	0	0	0	0	0
Project loans	101	155	395	458	720	674	850	920
Commercial loans 2/	21	21	0	500	200	200	200	200
Government guaranteed/parastatal	42	72	83	58	56	56	56	39
Outflows	-222	-242	-264	-247	-260	-251	-261	-329
Commercial banks (net)	234	-454	-493	257	-188	-199	-230	0
Private (net)	438	587	993	858	897	1,023	1,194	1,284
Short-term (net) and net errors and omissions 3/	61	473	1,032	302	561	686	604	459
Overall balance	506	252	695	332	416	521	606	690
Financing items	-506	-252	-695	-332	-416	-521	-606	-690
Reserve assets (gross)	-766	-370	-720	-227	-398	-493	-572	-644
Use of Fund credit and loans to the Fund (net)	-9	49	51	-14	-18	-28	-34	-45
Change in arrears 4/	150	19	-26	-91	0	0	0	0
Rescheduling	118	50	0	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0	0
Tentatively identified program support	0	0	0	0	0	0	0	0
Memorandum items:								
Gross official reserves (end of period)	2,353	2,723	3,443	3,670	4,068	4,561	5,134	5,778
in months of next year's imports of goods and services	3.3	2.9	3.1	3.1	3.1	3.1	3.1	3.2
Current account balance (excl. official transfers, percent of GDP)	-2.3	-2.4	-4.8	-6.7	-5.4	-5.2	-5.2	-5.3
Import volume growth, goods (percent)	11.7	9.7	3.5	2.8	8.8	11.6	11.6	10.5
Import value growth, goods (percent)	28.7	18.5	26.7	19.1	8.0	11.1	11.8	11.6
Export volume growth, goods (percent)	7.9	3.8	11.5	11.8	12.7	13.0	12.2	11.0
Export value growth, goods (percent)	13.1	9.3	22.6	16.1	11.6	12.9	12.8	13.3
Change in the terms of trade (goods, percent)	-5.8	-3.0	-11.9	-7.6	-2.3	0.3	0.3	1.1
Public and publicly guaranteed external debt (percent of GDP)	26.7	22.8	20.3	20.3	20.2	19.6	19.2	19.4

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

1/ The foreign travel credit is comprised of two components, recorded tourism inflows and an estimate of additional under-reported tourism receipts.

2/ Includes 2008/09 sovereign bond issuance, which would be used for infrastructure and to clear arrears on suppliers' credits for security-related and other contracts.

3/ This entry is believed to include unrecorded capital flows and remittances from Kenyans working abroad not captured above.

4/ Beginning in 2006/07, the table does not show accumulation of arrears on disputed security-related and other contracts, consistent with the government's budget presentation. Arrears clearance amount in 2008/09 reflects estimate from Kenyan authorities based on an audit of security-related and other contracts.

Table 5. Kenya: Financial Soundness Indicators, December 2003 - May 2008
(In percent)

	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Mar-08	May- 08[1]
Capital Adequacy							
Regulatory capital to risk-weighted assets	17.3	16.6	16.4	16.5	18.0	19.5	17.4
Regulatory Tier I capital to risk-weighted assets	16.3	16.2	16.0	16.4	16.8	18.3	16.2
Capital (net worth) to assets	11.8	11.9	12.1	12.4	12.6	12.7	11.4
Asset quality							
Nonperforming loans to gross loans [2]	34.9	29.3	25.6	21.3	10.9	10.5	9.6
Nonperforming loans net of provisions to total capital	60.7	52.7	40.1	28.6	15.1	15.5	15.4
Earnings and Profitability							
Return on assets	2.3	2.1	2.4	2.8	3.0	3.6	3.2
Return on equity	23.2	22.0	25.0	28.6	27.5	33.3	33.7
Liquidity							
Liquid assets to total assets	33.2	32.4	33.1	30.5	35.1	36.1	38.6
Liquid assets to total short-term liabilities	48.9	41.5	40.6	44.4	40.2	40.2	41.0
Customer deposits to total (non-interbank) loans	131.6	135.7	125.1	129.0	138.6	142.6	140.2
Foreign currency liabilities to total liabilities	14.3	17.8	15.9	16.1	16.3	16.4	15.6
Sensitivity to market risk							
Net open positions in FX to capital	12.0	8.0	6.0	7.1	5.4	7.0	7.3
Net open positions in equities to capital	7.9	7.7	10.3	8.7	5.8	5.5	5.6

Source: Central Bank of Kenya; and Fund Staff calculations.

[1] Provisional.

[2] The ratios were computed using gross non-performing loans and gross loans. After 2006, the decline in NPLs refelects the impact of government recapitalization of the National Bank of Kenya (NBK)

Table 6. Kenya: Millennium Development Goals, 1990 - 2005

	1990	1995	2000	2005
Goal 1: Eradicate extreme poverty and hunger				
Income share held by lowest 20%	3.4	6.0	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	22.5	21.2	19.9
Poverty gap at $1 a day (PPP) (%)	12.8	5.9	..	..
Poverty headcount ratio at $1 a day (PPP) (% of population)	33.5	22.8	..	..
Poverty headcount ratio at national poverty line (% of population)	..	40.0	..	..
Prevalence of undernourishment (% of population)	39	36	..	31
Goal 2: Achieve universal primary education				
Literacy rate, youth total (% of people ages 15-24)	90	..	..	80
Persistence to grade 5, total (% of cohort)	77	..	..	83
Primary completion rate, total (% of relevant age group)	..	..	..	95
School enrollment, primary (% net)	..	..	67	80
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliament (%)	1	3	4	7
Ratio of girls to boys in primary and secondary education (%)	..	..	97	94
Ratio of young literate females to males (% ages 15-24)	93	..	..	101
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	21.4	26.6	33.2	38.7
Goal 4: Reduce child mortality				
Immunization, measles (% of children ages 12-23 months)	78	83	75	69
Mortality rate, infant (per 1,000 live births)	64	72	77	79
Mortality rate, under-5 (per 1,000)	97	111	117	120
Goal 5: Improve maternal health				
Births attended by skilled health staff (% of total)	50	45	44	42
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	1,000	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Contraceptive prevalence (% of women ages 15-49)	27	33	39	39
Incidence of tuberculosis (per 100,000 people)	108	217	436	641
Prevalence of HIV, female (% ages 15-24)	..	..	..	5.2
Prevalence of HIV, total (% of population ages 15-49)	..	..	..	6.1
Tuberculosis cases detected under DOTS (%)	..	55	46	43
Goal 7: Ensure environmental sustainability				
CO2 emissions (metric tons per capita)	0.2	0.3	0.3	0.3
Forest area (% of land area)	7	..	6	6
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	2.2	2.3	2.1	2.1
Improved sanitation facilities (% of population with access)	40	..	..	43
Improved water source (% of population with access)	45	..	..	61
Nationally protected areas (% of total land area)	..	..	..	12.6
Goal 8: Develop a global partnership for development				
Aid per capita (current US$)	50	27	17	22
Debt service (PPG and IMF only, % of exports of G&S, excl. workers' remittances)	28.6	24.9	17.2	4.0
Fixed line and mobile phone subscribers (per 1,000 people)	7	10	14	143
Internet users (per 1,000 people)	..	0	3	32
Personal computers (per 1,000 people)	0	1	5	9
Total debt service (% of exports of goods, services and income)	35.4	30.4	20.9	4.4
Unemployment, youth female (% of female labor force ages 15-24)	..	..	..	..
Unemployment, youth male (% of male labor force ages 15-24)	..	..	..	..
Unemployment, youth total (% of total labor force ages 15-24)	..	..	..	..
Other				
Fertility rate, total (births per woman)	5.8	5.2	5.0	5.0
GNI per capita, Atlas method (current US$)	380	270	430	540
GNI, Atlas method (current US$) (billions)	8.8	7.5	13.2	18.4
Gross capital formation (% of GDP)	24.2	21.8	17.4	16.8
Life expectancy at birth, total (years)	58	53	48	49
Literacy rate, adult total (% of people ages 15 and above)	71	..	..	74
Population, total (millions)	23.4	27.2	30.7	34.3
Trade (% of GDP)	57.0	71.7	51.2	62.3

Source: World Development Indicators database.

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL MONETARY FUND

KENYA

Joint IMF/World Bank Debt Sustainability Analysis

Prepared by the Staffs of the International Monetary Fund and
the World Bank

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August 20, 2008

The debt sustainability analysis (DSA) was prepared jointly by Bank and Fund staffs in accordance with the standardized methodology for low-income countries. It is based on the general framework approved by the Executive Boards of the Fund and the World Bank in April 2005 and subsequently modified, including combining the external and public debt templates in a single file.[1] *The DSA has also benefited from consultation with African Development Bank staff. As in the previous DSA, the findings indicate the risk of external debt distress is low. Risks are somewhat greater for public debt, particularly in the event of lower growth.*

A. Methodology

1. **Debt sustainability is assessed in relation to policy-dependent debt burden thresholds**. Kenya is classified as a medium performer in terms of the quality of its policies and institutions as measured by a three-year average of Kenya's score on the World Bank's Country Policy and Institutional Assessment (CPIA) index.[2,3]

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[1] http://www.imf.org/external/pubs/ft/dsa/lic.aspx

[2] http://go.worldbank.org/AXO6I14PK0

[3] For a medium performer, the indicative thresholds for external debt sustainability are an NPV of debt-to-GDP ratio of 40 percent, an NPV of debt-to-exports ratio of 150 percent, an NPV of debt-to-revenue ratio of 250 percent, a debt service-to-exports ratio of 20 percent, and a debt service-to-revenue ratio of 30 percent.

2. **The DSA is based on: updated data provided by the authorities, available data on private sector borrowing, and estimates by the staffs**. The DSA uses non-reconciled debt data and a single discount rate.

3. **This DSA consists of two parts—external and fiscal**. The external DSA covers borrowing by the central government (including parastatal borrowing with a government guarantee) and the central bank, and also includes estimates for private sector borrowing based on available information. The fiscal DSA aims at assessing the sustainability of total debt—external and domestic—incurred or guaranteed by the central government.[4]

4. **Key assumptions underlying the DSA are consistent with the 2008 Article IV Staff Report:**

- Average annual real GDP growth of 6.2 percent for 2008 through 2013, which is somewhat below the 7.0 percent growth recorded in 2007, followed by 6.0 percent growth from 2014 through 2028. Although the assumed growth level is below that achieved in 2007, it is well above the recent historical average for Kenya. There is a risk that constraints to growth—including infrastructure bottlenecks and the need for further improvements in the business environment—will prove binding in the medium-term. Accordingly, an additional scenario that assumes real growth for 2009-2013 is one standard deviation lower than in the baseline scenario is included (average real growth for 2009-2013 in this scenario would be 4.4 percent).

- Average inflation of about 5.6 percent for 2008-2013 as measured by a GDP deflator, which falls to 4.9 percent for the 2014-2028 period.

- A constant real exchange rate through 2013, followed by some real appreciation for the remainder of the forecast period, which would be consistent with sustained high growth. WEO exchange rate projections are used.

- Annual goods and services export growth in U.S. dollar terms of about 12-13 percent such that goods and services exports as a share of GDP rise from about 25 percent to 31 percent over the forecast period. The non-interest external current account deficit rises to about 6.3 percent of GDP in 2008 before falling to an average of 3.3 percent of GDP over the 2014-2028 period.

- Fiscal projections are in line with those of the Article IV staff report, which are based on an unchanged policies scenario. Under this assumption, revenues remain constant as a share of GDP at 21.6 percent; expenditure developments are characterized by constant domestically financed development spending of 4.5 percent of GDP, which is slightly below the 2008/09 budgeted level which includes special one-off projects;

[4] Public domestic debt includes central government debt. External public debt includes public and publicly guaranteed central government and central bank debt. In this analysis, total public debt refers to the sum of public domestic and public external debt, but does not cover the entire public sector (e.g., parastatal borrowing without a government guarantee is not covered).

a constant wage bill of 6.6 percent of GDP, and a gradual decline in other recurrent spending from 7.2 percent of GDP to 7.0 percent of GDP over the medium-term in line with ongoing improvements in procurement. The primary fiscal deficit is 2.5 percent of GDP in 2008 and narrows to a deficit of 1.5 percent by 2013 and remains near that level through the forecast period. Interest on short-term public domestic debt is assumed at 8 percent, whereas medium- and long-term debt carry an assumed interest rate of about 10.5 percent.

- New external borrowing increases (including nonconcessional borrowing described below) from about 2 percent of GDP in 2007 to 3.2 percent in 2009 followed by a decline to just under 2 percent of GDP by the end of the forecast period. The NPV of domestic debt is assumed to be equal to its face value.

- New external borrowing assumptions include the issuance of an initial sovereign bond of $500 million in 2009 and $200 million in annual sovereign bond issuance from 2010 through 2013, which is consistent with the authorities' medium-term budget framework. Annual external sovereign bond issuance would then rise gradually beginning in 2014 to about $500 million by 2028. Assumptions on terms include an 8 percent interest rate and a bullet amortization in year ten (implying a nine year grace period on principal payments).

- The only debt relief assumed under the DSA is an existing swap agreement with Italy, which would cancel about Euro 44 million in external obligations.

- Continued eligibility for concessional borrowing from IDA is assumed although achievement of assumed growth rates could imply graduation during the forecast period.

B. Recent Developments

5. **At end-2007, the face value of public external debt is estimated at $6.2 billion (25 percent of GDP).**[5] About 60 percent of this debt is to multilateral creditors (including 47 percent owed to the World Bank). About 39 percent of the debt is owed to bilateral creditors (largely Paris Club), and a small share (2 percent) is owed to commercial creditors, some of which is for disputed security-related contracts and in arrears (see below).

6. **Kenya has managed its debt burden relatively well and has regularly met its obligations to most creditors**. Limited external borrowing has left Kenya with more manageable debt ratios than many of its low-income country peers. Kenya's income level led it to be considered in the context of the Enhanced HIPC Initiative, but due to a sustainable level of debt, Kenya did not qualify to receive HIPC relief. Apart from disputed commercial arrears, described in greater detail below, Kenya has regularly serviced its debts.

[5] The face value of public external debt as a share of GDP is significantly lower than for end-2005, which was the base year for the last DSA. This reflects better data—the 2005 stock figure overstated Kenya's debt—as well as very strong growth and significant exchange rate appreciation against the U.S. dollar in 2006 and 2007.

7. **Kenya has benefited from Paris Club reschedulings**. In addition to rescheduling agreements in 1994 and 2000, Kenya received a rescheduling on Houston terms in 2004 covering US$353 million falling due from 2004 through 2006. Bilateral agreements with Paris Club creditors were finalized for all three phases of the 2004 treatment, although agreement on amounts to be covered in 2006 (roughly US$100 million) entered into force somewhat late due to delays in the completion of Kenya's second review under the PRGF arrangement.

8. **Kenya's end-2007 external arrears of about $91 million were to commercial creditors and are under dispute**. The arrears stem from non-payment on commercial credits for security-related contracts, many of which have been found by Kenya's Controller and Auditor-General to be fraudulent or deeply flawed (these projects are often referred to as the "Anglo-Leasing" scandal). The authorities are disputing the validity of the claims based on the contracts not being fulfilled, have obtained an external audit to determine the value of the goods and services provided, and intend to renegotiate the amounts owed based on the audit results. Once agreement on the amounts to be paid is reached, it is expected that Kenya will refinance these payments through issuance of new nonconcessional external debt—potentially commercial bank loans initially, although the proceeds of planned sovereign bond issuance described above could ultimately be used to finance arrears clearance.

9. **Kenya's net domestic debt declined to 18.5 percent of GDP at end-June 2008**. Since end-June 2003, domestic debt has gradually declined as a percent of GDP thanks to strong economic growth, prudent fiscal policies, and lower interest rates, despite primary surpluses below historical averages and the realization of some one-off contingent liabilities in the last two years.[6] However, Kenya's relatively low reported domestic debt-to-GDP ratio masks vulnerabilities from further realization of contingent liabilities. In response, the government has launched a study of contingent liabilities in 24 parastatals and the National Social Security Fund. Results from this study will be incorporated into future debt sustainability analyses. In addition, the government's current pay-as-you-go pension scheme for civil servants has accumulated claims that were estimated at Ksh 271 billion (11.4 percent of 2008/09 GDP) in an August 2005 actuarial study. About 70 percent of Kenya's domestic debt is longer-term borrowing with maturities extending up to 20 years. Fiscal data, which are based on a July-June fiscal year, are converted to calendar year data for the purposes of the DSA.[7]

C. External Debt Sustainability

10. **Under the baseline scenario, Kenya's external debt indicators show a low risk of debt distress**. Kenya's initial debt ratios are well below all of the indicative thresholds for a medium performer and decline somewhat through the forecast period (see Figure 1 and

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[6] In 2006/07, the National Bank of Kenya was recapitalized and in 2007/08 contingent liabilities from Kenya Telkom were realized.

[7] Averaging fiscal year data into calendar year data explains differences with Tables 2a and 2b in the staff report.

Table 1a). Although external borrowing is projected to rise sharply in 2009 to 3.2 percent of GDP, new obligations would fall gradually as a share of GDP thereafter. In addition to reasonably contained borrowing (although on less concessional terms than in the past as shown in panel a of Figure 1), the improvement in the baseline scenario reflects favorable real output and export growth projections in comparison to longer-term historical performance. Growth has accelerated significantly since 2003, and the authorities are undertaking substantial infrastructure investments (financed partly through an assumed increase in external assistance) and structural reforms intended to support export and overall growth. It should be noted that the authorities' *Kenya Vision 2030* targets much faster growth than assumed in the DSA. Although Kenya would remain well below its indicative thresholds in the baseline scenario, panels e and f of Figure 1 show how issuance of a sovereign bond with a bullet amortization structure could create a spike in debt service. An amortizing bond or a means for saving in advance of the amortization could lessen budgetary pressures and rollover risks.

11. **The alternative scenarios and stress tests indicate that Kenya's external debt situation is generally resilient although shocks would lead to a sharp initial worsening in debt stock indicators (see Table 1b)**. Kenya would remain under its indicative debt stock and debt service thresholds under all alternative scenarios and stress tests. The most extreme stress tests are shown in Figure 1 and described here. A shock combining lower GDP growth, weaker exports, a lower GDP deflator, and a fall in non-debt creating flows would push the NPV of public external debt as a share of GDP from 14 to 28 percent, the NPV of debt-to-exports from 55 to 105 percent, and the NPV of debt-to-revenue from 64 to 126 percent. Despite an immediate worsening, the three debt stock measures would then improve with ratios only somewhat worse than under the baseline scenario by the end of the projection period. The combined shock described above would also raise the debt service-to-exports and debt-service-to-revenue ratios, but would not push the debt service burden particularly high. The scenario of lower growth for 2009-13 shows external debt indicators only marginally above those in the baseline scenario. Perhaps surprisingly, a "historical" scenario, which uses the recent performance of key economic variables instead of the baseline assumptions, yields debt ratios that are better than in the baseline scenario. While growth is much lower under the historical scenario and foreign direct investment is also lower, the historical current account deficit is much lower than the deficit in the baseline. The latter factor reduces the borrowing need and thus leads to lower debt ratios than under the baseline scenario.

Summary -- External Debt Sustainability Assessment
(in percent of GDP)

	2008	2009	2010	2011	2012	2013
NPV of PPG External Debt						
In percent of GDP (threshold=40)						
Baseline	13.7	13.8	14.2	13.2	13.6	13.5
Combined shocks	13.7	20.3	28.1	25.7	25.9	25.3
In percent of exports (threshold=150)						
Baseline	53.2	56.2	54.9	52.9	52.0	50.0
Combined shocks	53.2	77.3	105.2	99.5	95.8	90.5
PPG External Debt Service						
In percent of exports (threshold=20)						
Baseline	4.5	3.9	4.0	3.9	3.7	3.4
Combined shocks	4.5	4.1	5.2	5.8	5.4	5.0

D. Public Debt Sustainability

12. **Under the baseline scenario, the inclusion of domestic debt substantially increases the NPV of public debt-to-GDP, even though all debt indicators remain within comfortable levels** (see Figure 2 and Table 2a). The NPV of total public debt-to-GDP, at 34 percent in 2008, remains broadly stable at that level up to 2028 as the gradual decline of NPV of external debt is offset by a small increase in the domestic debt-to-GDP ratio. Throughout the projection period, the NPV of total public debt remains below 40 percent under the baseline scenario. Given Kenya's relatively strong revenue performance, the NPV of debt-to-revenue ratio remains well below 250 percent, and is broadly unchanged during the period 2008-2028 at below 150 percent. The debt service-to-revenue ratio, which takes into account debt service on longer-term domestic and external debt, is 25 percent in 2008, and gradually declines after that.

13. **Alternative scenarios and stress tests indicate that Kenya's debt indicators are particularly vulnerable to slower growth, while being broadly resilient under other alternative assumptions** (see Figure 2 and Table 2b). A two-year growth shock leads to a rise in the NPV of debt-to-GDP ratio to 57 percent by 2028, an NPV of debt-to-revenue ratio just below 250 percent by 2028, and a rise in the debt service-to-revenue ratio to over 30 percent by 2012, indicating some risk of debt distress under this scenario. Permanently lower growth would also increase the NPV of debt-to-GDP beyond 40 percent, and would raise the debt service-to-revenue ratio to about 30 percent, even though the NPV of debt-to-revenue ratio would remain below 250 percent. The NPV of debt-to-GDP ratio also breaches the 40 percent level under a scenario with primary balances unchanged from 2008, and a combination of a two year growth and primary balance shock. The scenario of lower growth for 2009-2013 results in debt indicators that are somewhat higher than the baseline in the medium-term and a good deal higher in the long-term (e.g., by the end of the forecast period, the NPV of debt-to-GDP ratio would be 52 percent versus 34 percent in the baseline scenario). This result reinforces the importance of expanding productive capacity in the medium term, in addition to a prudent borrowing approach, to avoid a rising debt burden.

E. Conclusions

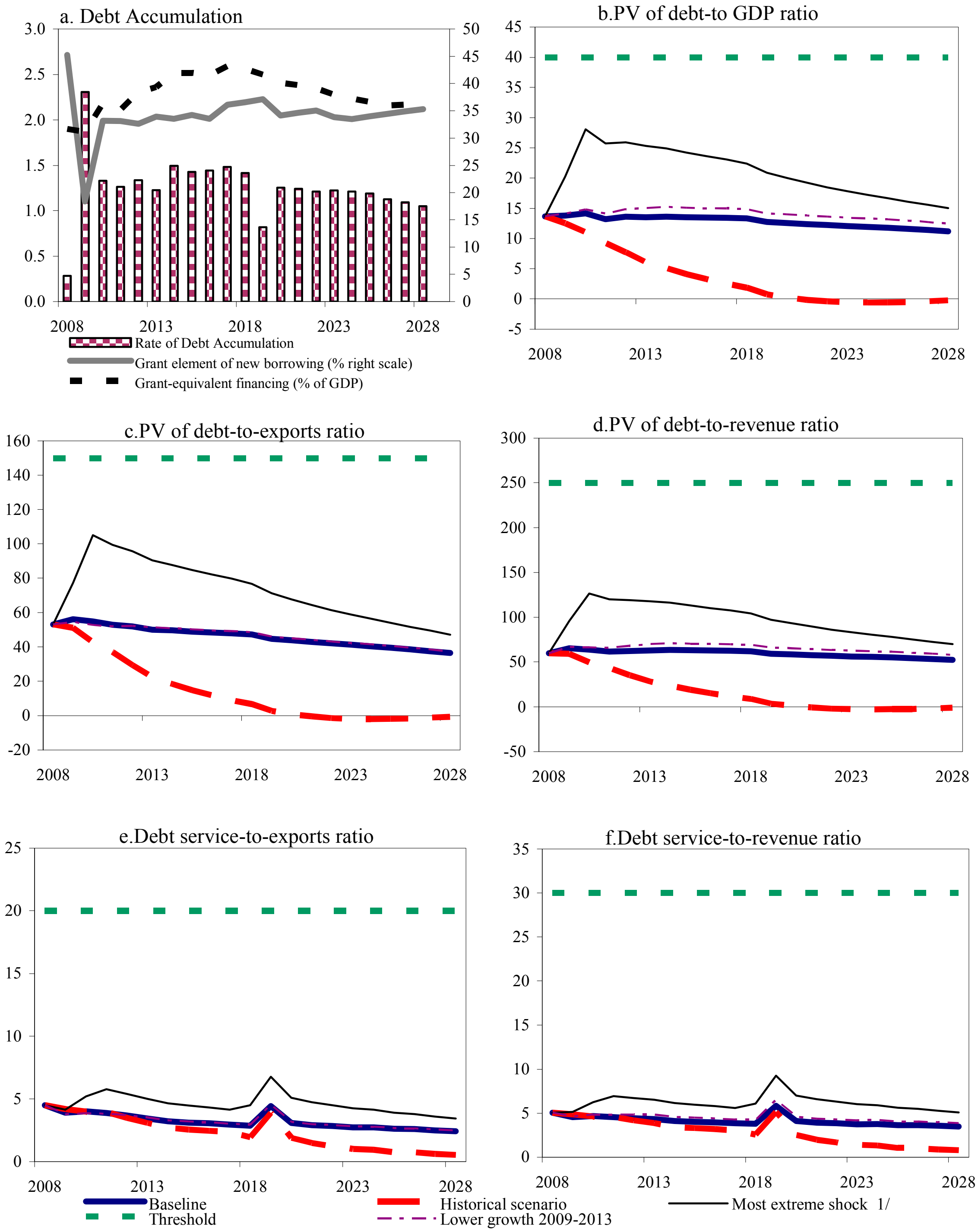
14. **Reflecting relatively limited reliance on external borrowing and an expected improvement in macroeconomic performance, Kenya faces a low risk of external debt distress**. All external public debt indicators remain below the relevant country-specific debt burden thresholds. Standard stress tests reveal an initial upward trend for the debt indicators but do not result in a breach of the thresholds during the projection period.

15. **Taking all public debt into account, however, the DSA shows greater risk of unfavorable debt developments, especially under a shock to GDP growth**. Even temporarily lower GDP growth would set the NPV of public debt-to-GDP, the NPV of debt-to-revenue, and the ratio of debt service-to-revenue on a sharply increasing trend as shown in Figure 2. Considering that the nominal value of public debt would be near, and in some years above the 40 percent of GDP that staff has recommended as an anchor for fiscal policy, unchanged policies would indeed imply some risk of debt distress. Potentially large but unreported contingent liabilities also pose additional risks to the sustainability of public debt.

16. **The sustainability of Kenya's debt depends on macroeconomic performance and a prudent borrowing strategy**. Achieving the ambitious growth and export figures in the baseline scenario depends on: policies to sustain macroeconomic stability, substantial investment in infrastructure, and regulatory and governance reforms to improve the investment climate. Additionally, Kenya's success in avoiding unsustainable debt to date reflects good management, but also limited willingness on the part of creditors to provide financing, at times due to governance concerns. As Kenya is likely to have greater access to external financing, it will be important to avoid excessive borrowing and to limit nonconcessional borrowing.

17. **The staffs encourage Kenya to use tools such as the joint Fund-Bank DSA template to develop a prudent borrowing strategy to maintain both external and fiscal debt sustainability**. Efforts to use the DSA template and to develop a debt management strategy, including through a workshop in 2007, are welcome. Such a strategy should consider the total concessionality and interest costs of Kenya's borrowing, the return on individual projects and overall growth impact, and steps that would help guard against volatility, whether due to shocks such as droughts or to fluctuations in external assistance. Strategies to guard against shocks could include some further build-up in international reserves. A better understanding of holdings of shilling-denominated debt by non-residents would also help guide efforts to assess and potentially reduce vulnerabilities.

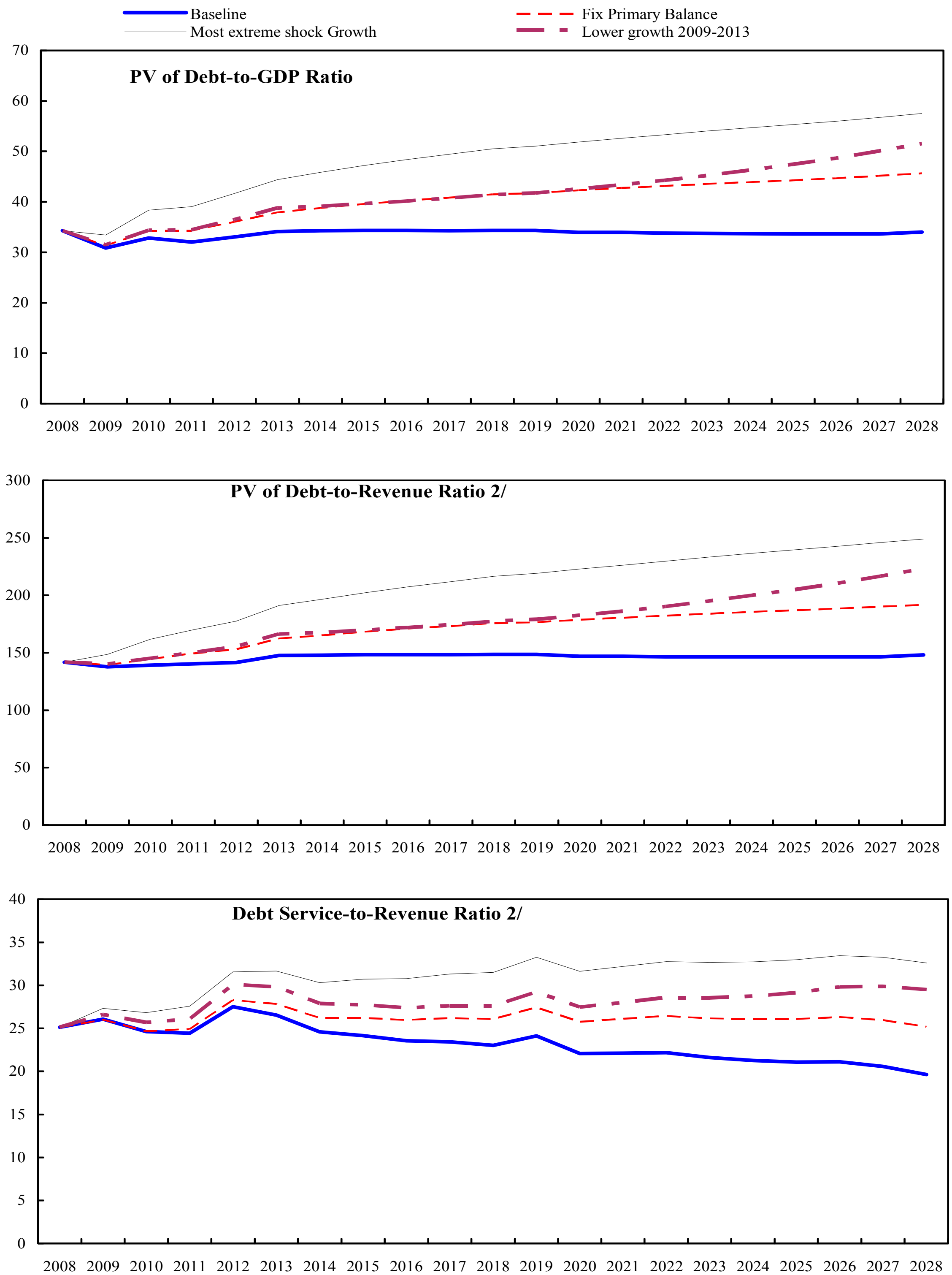
Figure 1. Kenya: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2008-2028 1/



Sources: Country authorities and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2018. In figure b. it corresponds to a Combination shock; in c. to a Combination shock; in d. to a Combination shock; in e. to a Combination shock and in picture f. to a Combination shock.

Figure 2. Kenya: Indicators of Public Debt Under Alternative Scenarios, 2008-2028 1/



Sources: Country authorities and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2018.

2/ Revenues are defined inclusive of grants.

Table 1a. Kenya: External Debt Sustainability Framework, Baseline Scenario, 2005-2028 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 2/	Standard Deviation 2/	Projections									
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008-2013 Average	2018	2028	2014-2028 Average
External debt (nominal) 1/	**31.3**	**26.8**	**24.7**			**21.4**	**20.6**	**20.9**	**19.6**	**20.3**	**20.2**		**19.5**	**16.3**	
o/w public and publicly guaranteed (PPG)	28.9	24.9	22.8			19.9	19.4	19.9	18.6	19.1	19.0		19.1	16.3	
Change in external debt	-3.4	-4.5	-2.1			-3.3	-0.8	0.3	-1.2	0.7	-0.1		-0.1	-0.3	
Identified net debt-creating flows	-5.2	-5.2	-4.8			3.3	2.0	1.9	1.5	1.8	1.8		1.1	0.5	
Non-interest current account deficit	**0.1**	**1.8**	**2.6**	**0.6**	**1.8**	**6.3**	**5.5**	**4.8**	**4.9**	**4.9**	**4.9**		**3.7**	**2.3**	3.3
Deficit in balance of goods and services	7.5	9.9	10.5			13.9	12.8	12.2	11.7	11.7	11.7		10.1	8.2	
Exports	28.4	25.1	25.4			25.7	24.6	25.8	25.0	26.2	27.0		28.2	30.7	
Imports	35.9	35.0	35.9			39.6	37.4	38.1	36.7	37.9	38.7		38.3	39.0	
Net current transfers (negative = inflow)	-7.0	-7.7	-7.6	-6.0	1.5	-7.1	-6.9	-6.9	-6.4	-6.4	-6.4		-6.0	-5.1	-5.7
o/w official 3/	0.0	-0.3	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	-0.3	-0.4	-0.3			-0.4	-0.5	-0.5	-0.5	-0.4	-0.4		-0.5	-0.9	
Net FDI (negative = inflow)	**-1.0**	**-2.2**	**-3.4**	**-1.0**	**1.0**	**-2.6**	**-2.5**	**-2.4**	**-2.2**	**-2.3**	**-2.3**		**-1.9**	**-1.3**	-1.7
Endogenous debt dynamics 4/	**-4.3**	**-4.7**	**-4.0**			**-0.5**	**-1.0**	**-0.5**	**-1.2**	**-0.8**	**-0.8**		**-0.7**	**-0.6**	
Contribution from nominal interest rate	0.7	0.5	0.4			0.4	0.3	0.4	0.4	0.4	0.4		0.4	0.3	
Contribution from real GDP growth	-1.7	-1.7	-1.6			-0.9	-1.3	-0.9	-1.5	-1.2	-1.2		-1.1	-0.9	
Contribution from price and exchange rate changes	-3.2	-3.5	-2.9			…	…	…	…	…	…		…	…	
Residual (3-4) 5/	**1.8**	**0.7**	**2.7**			**-6.6**	**-2.9**	**-1.6**	**-2.7**	**-1.2**	**-1.9**		**-1.3**	**-0.8**	
o/w exceptional financing	-1.0	-0.9	0.0			0.0	0.2	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 6/	...	...	17.7			15.2	15.0	15.1	14.3	14.8	14.7		13.7	11.2	
In percent of exports	...	...	69.6			59.1	60.9	58.6	57.0	56.5	54.5		48.7	36.5	
PV of PPG external debt	**...**	**...**	**15.7**			**13.7**	**13.8**	**14.2**	**13.2**	**13.6**	**13.5**		**13.3**	**11.2**	
In percent of exports	**...**	**...**	**62.0**			**53.2**	**56.2**	**54.9**	**52.9**	**52.0**	**50.0**		**47.3**	**36.4**	
In percent of government revenues	**...**	**...**	**70.0**			**59.8**	**65.3**	**63.7**	**61.7**	**62.4**	**62.9**		**62.2**	**52.2**	
Debt service-to-exports ratio (in percent)	**6.9**	**7.0**	**6.1**			**5.4**	**4.8**	**4.7**	**4.4**	**4.2**	**3.9**		**3.0**	**2.4**	
PPG debt service-to-exports ratio (in percent)	**6.0**	**6.0**	**5.0**			**4.5**	**3.9**	**4.0**	**3.9**	**3.7**	**3.4**		**2.9**	**2.4**	
PPG debt service-to-revenue ratio (in percent)	**8.0**	**7.1**	**5.7**			**5.1**	**4.5**	**4.7**	**4.5**	**4.4**	**4.3**		**3.8**	**3.5**	
Total gross financing need (billions of U.S. dollars)	0.2	0.3	0.2			1.6	1.5	1.4	1.7	1.8	2.0		2.4	4.7	
Non-interest current account deficit that stabilizes debt ratio	3.5	6.3	4.7			9.6	6.3	4.5	6.1	4.3	5.0		3.8	2.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.8	6.4	7.0	3.8	2.3	4.1	6.9	4.7	8.6	6.6	6.6	6.2	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	10.2	12.8	12.2	3.9	8.9	12.5	8.3	2.0	7.4	0.4	3.0	5.6	5.0	5.0	4.9
Effective interest rate (percent) 7/	2.2	2.0	2.0	1.8	1.0	1.8	1.6	2.0	2.0	2.1	2.1	1.9	2.3	2.1	2.2
Growth of exports of G&S (US dollar terms, in percent)	23.3	6.0	21.3	9.2	10.3	18.6	10.6	12.3	13.1	11.9	13.3	13.3	12.1	12.5	12.2
Growth of imports of G&S (US dollar terms, in percent)	27.4	17.0	22.9	10.9	15.5	29.4	9.4	8.7	12.6	10.3	12.2	13.7	11.2	11.7	11.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	45.3	18.4	33.2	33.1	32.6	33.9	32.7	36.5	35.3	34.7
Government revenues (excluding grants, in percent of GDP)	21.2	21.1	22.5			22.8	21.1	22.2	21.4	21.8	21.5		21.4	21.4	21.4
Aid flows (in billions of US dollars) 8/	0.2	0.2	0.3			0.8	1.6	2.4	3.3	4.3	5.4		13.3	41.6	
o/w Grants	0.2	0.2	0.3			0.4	0.5	0.5	0.6	0.7	0.9		1.5	4.0	
o/w Concessional loans	0.0	0.0	0.0			0.4	1.1	1.9	2.6	3.6	4.6		11.8	37.6	
Grant-equivalent financing (in percent of GDP) 9/	...	...	...			1.9	1.9	2.2	2.1	2.3	2.4		2.6	2.2	2.4
Grant-equivalent financing (in percent of external financing) 9/	...	...	...			72.5	41.6	57.2	59.3	59.1	62.4		63.4	64.8	62.9
Memorandum items:															
Nominal GDP (billions of US dollars)	18.8	22.5	27.0			31.7	36.7	39.2	45.7	48.8	53.6		90.6	264.3	
Nominal dollar GDP growth	16.6	20.0	20.0			17.2	15.8	6.8	16.6	6.9	9.8	**12.2**	11.3	11.3	11.2
PV of PPG external debt (in billions of US dollars)			4.3			4.3	5.1	5.5	6.0	6.7	7.2		12.1	29.6	
(PVt-PVt-1)/GDPt-1 (in percent)						0.3	2.3	1.3	1.3	1.3	1.2	1.3	1.4	1.0	1.2

Sources: Country authorities and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
3/ Includes only program grants.
4/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
5/ 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.
6/ Assumes that PV of private sector debt is equivalent to its face value.
7/ Current-year interest payments divided by previous period debt stock.
8/ Defined as grants (program and project), concessional loans, and debt relief.
9/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-2028
(In percent)

										Projections											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	**2018**	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of debt-to GDP ratio																					
Baseline	14	14	14	13	14	14	14	14	13	13	**13**	13	13	12	12	12	12	12	12	11	11
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2008-2028 1/	14	13	11	9	8	6	5	4	3	3	**2**	1	0	0	0	-1	-1	-1	-1	0	0
A2. New public sector loans on less favorable terms in 2008-2028 2	14	13	15	14	15	15	15	16	16	16	**16**	16	16	16	16	16	16	15	15	15	15
A3. Alternative Scenario: Growth lower by one standard deviation 2009-2013	14	14	15	14	15	15	15	15	15	15	15	14	14	14	14	13	13	13	13	13	12
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	14	15	15	14	15	15	15	15	15	15	**14**	14	14	13	13	13	13	13	13	12	12
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	14	16	20	18	19	18	18	18	17	17	**17**	16	15	15	14	14	14	13	13	12	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	14	16	17	16	17	17	17	17	16	16	**16**	16	15	15	15	15	15	14	14	14	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	14	17	21	19	19	19	19	18	18	18	**17**	16	16	15	15	14	14	13	13	13	12
B5. Combination of B1-B4 using one-half standard deviation shocks	14	20	28	26	26	25	25	24	24	23	**22**	21	20	19	18	18	17	17	16	16	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	14	19	20	18	19	19	19	19	19	19	**18**	18	17	17	17	17	17	16	16	16	15
PV of debt-to-exports ratio																					
Baseline	53	56	55	53	52	50	50	49	48	48	**47**	45	44	43	42	41	40	40	39	38	36
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2008-2028 1/	53	51	43	37	29	22	18	15	12	9	**7**	3	1	0	-1	-2	-2	-2	-2	-1	-1
A2. New public sector loans on less favorable terms in 2008-2028 2	53	54	57	56	57	56	56	57	57	57	**57**	56	55	54	54	53	53	52	51	50	49
A3. Alternative Scenario: Growth lower by one standard deviation 2009-2013	53	55	53	52	52	51	51	50	50	49	49	46	45	44	43	42	41	41	40	39	37
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	53	56	55	53	52	50	50	49	48	48	**47**	45	44	43	42	41	40	40	39	38	36
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	53	71	98	93	90	86	84	81	79	78	**75**	70	68	65	62	60	58	56	54	52	50
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	53	56	55	53	52	50	50	49	48	48	**47**	45	44	43	42	41	40	40	39	38	36
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	53	70	81	77	74	70	69	67	65	63	**61**	57	55	52	50	48	47	45	43	41	40
B5. Combination of B1-B4 using one-half standard deviation shocks	53	77	105	99	96	91	88	85	82	80	**77**	71	68	65	62	59	56	54	52	49	47
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	53	56	55	53	52	50	50	49	48	48	**47**	45	44	43	42	41	40	40	39	38	36
PV of debt-to-revenue ratio																					
Baseline	60	65	64	62	62	63	64	63	63	63	**62**	59	58	58	57	56	56	55	54	53	52
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2008-2028 1/	60	59	50	43	35	28	24	19	15	12	**9**	4	1	-1	-2	-3	-3	-3	-2	-2	-1
A2. New public sector loans on less favorable terms in 2008-2028 2	60	62	66	66	68	70	72	73	74	75	**75**	73	73	73	73	73	72	72	72	71	70
A3. Alternative Scenario: Growth lower by one standard deviation 2009-2013	60	67	67	66	68	70	71	70	70	70	69	66	65	64	64	63	62	61	60	59	58
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	60	69	69	67	68	68	69	69	68	68	**68**	64	64	63	62	61	61	60	59	58	57
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	60	74	90	86	85	85	84	83	81	80	**78**	73	71	69	66	65	63	61	60	58	56
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	60	74	78	76	76	77	78	77	77	77	**76**	73	72	71	70	69	68	67	66	65	64
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	60	81	94	90	89	89	88	86	84	82	**80**	75	73	70	68	66	64	62	61	59	57
B5. Combination of B1-B4 using one-half standard deviation shocks	60	96	126	120	119	118	116	113	110	108	**104**	97	93	90	86	83	80	78	75	73	70
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	60	90	88	85	86	87	88	87	87	87	**86**	82	81	80	79	78	77	76	75	74	72

Table 1b. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-2028 (continued)
(In percent)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	**2018**	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
									Projections												
Debt service-to-exports ratio																					
Baseline	4	4	4	4	4	3	3	3	3	3	**3**	4	3	3	3	3	3	3	3	3	2
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2008-2028 1/	4	4	4	4	3	3	3	3	2	2	**2**	4	2	1	1	1	1	1	1	1	1
A2. New public sector loans on less favorable terms in 2008-2028 2	4	4	4	4	4	4	4	4	4	4	**4**	3	3	3	3	3	3	3	3	3	3
A3. Alternative Scenario: Growth lower by one standard deviation 2009-2013	4	4	4	4	4	4	3	3	3	3	3	5	3	3	3	3	3	3	3	3	2
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	4	4	4	4	4	3	3	3	3	3	**3**	4	3	3	3	3	3	3	3	3	2
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	4	4	5	6	5	5	5	5	4	4	**4**	7	5	5	4	4	4	4	4	4	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	4	4	4	4	4	3	3	3	3	3	**3**	4	3	3	3	3	3	3	3	3	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	4	4	4	5	4	4	4	4	4	3	**4**	5	4	4	4	3	3	3	3	3	3
B5. Combination of B1-B4 using one-half standard deviation shocks	4	4	5	6	5	5	5	4	4	4	**4**	7	5	5	4	4	4	4	4	4	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	4	4	4	4	4	3	3	3	3	3	**3**	4	3	3	3	3	3	3	3	3	2
Debt service-to-revenue ratio																					
Baseline	5	5	5	5	4	4	4	4	4	4	**4**	6	4	4	4	4	4	4	4	4	3
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2008-2028 1/	5	5	5	5	4	4	3	3	3	3	**3**	5	3	2	2	1	1	1	1	1	1
A2. New public sector loans on less favorable terms in 2008-2028 2	5	5	4	5	5	5	5	5	5	5	**5**	4	4	4	4	4	4	4	4	4	4
A3. Alternative Scenario: Growth lower by one standard deviation 2009-2013	5	5	5	5	5	5	5	4	4	4	4	7	5	4	4	4	4	4	4	4	4
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	5	5	5	5	5	5	4	4	4	4	**4**	6	4	4	4	4	4	4	4	4	4
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	5	5	5	5	5	5	5	5	5	4	**5**	7	5	5	5	5	4	4	4	4	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	5	5	6	6	5	5	5	5	5	5	**5**	7	5	5	5	5	5	4	4	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	5	5	5	5	5	5	5	5	5	4	**5**	7	5	5	5	5	5	4	4	4	4
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	6	7	7	7	6	6	6	6	**6**	9	7	7	6	6	6	6	5	5	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	5	6	6	6	6	6	6	6	5	5	**5**	8	6	5	5	5	5	5	5	5	5
Memorandum item:																					
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	29	29	29	29	29	29	29	29	29	29	**29**	29	29	29	29	29	29	29	29	29	29

Sources: Country authorities and staff estimates and projections.

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

Table 2a. Kenya: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005-2028
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate					Projections				
	2005	2006	2007	Historical Average 5/	Standard Deviation 5/	2008	2009	2010	2011	2012	2013	2008-13 Average	2018	2028	2014-28 Average
Public sector debt 1/	46.4	42.9	40.6			39.7	36.7	38.8	37.5	38.8	39.5		40.1	39.1	
o/w foreign-currency denominated	28.9	24.9	22.8			19.9	19.4	19.9	18.6	19.1	19.0		19.1	16.3	
Change in public sector debt	-7.5	-3.4	-2.4			-0.8	-3.0	2.1	-1.3	1.3	0.7		0.1	0.1	
Identified debt-creating flows	-6.0	-4.2	-5.0			-0.5	-3.6	1.7	-1.3	1.2	0.6		-0.1	-0.2	
Primary deficit	-0.6	0.1	1.0	-1.3	1.4	2.5	1.9	1.5	1.5	1.6	1.5	1.7	1.4	1.4	1.4
Revenue and grants	22.4	22.2	23.6			24.2	22.4	23.6	22.8	23.4	23.1		23.1	22.9	
of which: grants	1.2	1.1	1.1			1.3	1.3	1.4	1.4	1.5	1.6		1.7	1.5	
Primary (noninterest) expenditure	21.8	22.3	24.6			26.6	24.3	25.1	24.3	25.0	24.6		24.6	24.4	
Automatic debt dynamics	-5.2	-4.5	-4.4			-0.9	-5.2	0.2	-2.8	-0.5	-0.9		-1.6	-1.6	
Contribution from interest rate/growth differential	-2.5	-2.4	-1.8			-1.5	-2.9	0.2	-2.1	-0.6	-1.3		-1.0	-1.2	
of which: contribution from average real interest rate	0.5	0.4	1.0			0.1	-0.3	1.8	1.0	1.7	1.1		1.2	1.0	
of which: contribution from real GDP growth	-3.0	-2.8	-2.8			-1.6	-2.6	-1.7	-3.1	-2.3	-2.4		-2.3	-2.2	
Contribution from real exchange rate depreciation	-2.7	-2.1	-2.6			0.6	-2.3	0.0	-0.7	0.1	0.4		...	...	
Other identified debt-creating flows	-0.3	0.3	-1.6			-2.1	-0.3	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	-0.3	-2.2			-2.2	-0.3	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.6	0.6			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-1.5	0.8	2.7			-0.3	0.6	0.4	0.0	0.1	0.1		0.2	0.3	
Other Sustainability Indicators															
PV of public sector debt	17.5	18.0	32.5			34.2	30.8	32.8	32.0	33.0	34.1		34.4	34.0	
o/w foreign-currency denominated	0.0	0.0	14.7			14.4	13.5	13.9	13.1	13.4	13.7		13.3	11.2	
o/w external	...	...	14.7			14.4	13.5	13.9	13.1	13.4	13.7		13.3	11.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	11.0	11.6	11.0			12.1	12.1	11.8	11.7	11.3	12.6		11.6	11.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	78.0	81.2	137.8			141.7	137.6	138.9	140.3	141.4	147.7		148.4	148.0	
PV of public sector debt-to-revenue ratio (in percent)	82.5	85.5	144.5			149.8	145.9	147.5	149.4	151.3	158.9		160.2	158.5	
o/w external 3/	…	…	65.3			62.9	64.0	62.5	61.1	61.2	63.6		62.2	52.2	
Debt service-to-revenue and grants ratio (in percent) 4/	31.6	30.0	26.7			25.1	26.1	24.6	24.4	27.5	26.5		23.0	19.6	
Primary deficit that stabilizes the debt-to-GDP ratio	6.9	3.5	3.4			3.3	4.9	-0.6	2.8	0.3	0.8		1.3	1.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.8	6.4	7.0	3.8	2.3	4.1	6.9	4.7	8.6	6.6	6.6	6.2	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	1.6	1.6	1.5	1.6	1.0	1.5	1.3	1.8	1.9	2.0	2.1	1.8	2.3	2.1	2.2
Average real interest rate on domestic debt (in percent)	5.3	4.8	7.6	8.7	5.8	4.0	8.6	14.9	9.6	17.5	13.7	11.4	9.4	8.0	9.1
Real exchange rate depreciation (in percent, + indicates depreciation)	-12.4	-12.3	-17.3	-6.6	7.1	1.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	10.2	12.8	12.2	3.9	8.9	12.5	8.3	2.0	7.4	0.4	3.0	5.6	5.0	5.0	4.9
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.1	0.2	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	45.3	18.4	33.2	33.1	32.6	33.9	32.7	36.5	35.3	...

Sources: Country authorities and staff estimates and projections.
1/ Public sector debt includes domestic central government debt and external debt issued or guaranteed by the central government and central bank.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b. Kenya: Sensitivity Analysis for Key Indicators of Public Debt 2008-2028

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
PV of Debt-to-GDP Ratio								
Baseline	34	31	33	32	33	34	34	34
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	29	29	27	26	26	19	11
A2. Primary balance is unchanged from 2008	34	31	34	34	36	38	41	46
A3. Permanently lower GDP growth 1/	34	31	33	33	35	36	41	52
A4. Alternative Scenario: Growth lower by one standard deviation 2009-2013	34	31	34	34	36	39	41	52
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	34	33	38	39	42	44	50	57
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	34	29	30	29	31	32	33	33
B3. Combination of B1-B2 using one half standard deviation shocks	34	30	31	31	34	36	41	44
B4. One-time 30 percent real depreciation in 2009	34	35	37	35	36	37	36	35
B5. 10 percent of GDP increase in other debt-creating flows in 2009	34	40	42	40	41	42	40	37
PV of Debt-to-Revenue Ratio 2/								
Baseline	142	138	139	140	141	148	148	148
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	142	128	121	117	112	111	82	45
A2. Primary balance is unchanged from 2008	142	139	145	149	153	162	176	192
A3. Permanently lower GDP growth 1/	142	138	141	144	148	157	175	227
A4. Alternative Scenario: Growth lower by one standard deviation 2009-2013	142	140	145	150	155	166	178	223
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	142	149	162	170	177	191	217	249
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	142	130	127	129	131	138	141	144
B3. Combination of B1-B2 using one half standard deviation shocks	142	132	129	136	143	154	172	184
B4. One-time 30 percent real depreciation in 2009	142	157	156	155	155	162	156	152
B5. 10 percent of GDP increase in other debt-creating flows in 2009	142	178	176	176	175	181	173	161

Table 2b. Kenya: Sensitivity Analysis for Key Indicators of Public Debt 2008-2028 (continued)

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
Debt Service-to-Revenue Ratio 2/								
Baseline	25	26	25	24	28	27	23	20
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	25	27	25	24	27	24	16	6
A2. Primary balance is unchanged from 2008	25	26	25	25	28	28	26	25
A3. Permanently lower GDP growth 1/	25	26	25	25	28	28	26	29
A4. Alternative Scenario: Growth lower by one standard deviation 2009-2013	25	27	26	26	30	30	28	30
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	25	27	27	28	32	32	31	33
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	25	26	24	23	26	25	22	19
B3. Combination of B1-B2 using one half standard deviation shocks	25	27	26	24	27	27	26	24
B4. One-time 30 percent real depreciation in 2009	25	27	26	26	29	29	26	23
B5. 10 percent of GDP increase in other debt-creating flows in 2009	25	26	26	30	32	32	26	22

Sources: Country authorities and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period.
2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

KENYA

Staff Report for the 2008 Article IV Consultation

Information Annex

Prepared by the African Department
(In consultation with other departments)

Approved by Saul Lizondo and Anthony R. Boote

August 20, 2008

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I. Kenya: Relations with the Fund

(As of July 31, 2008)

I. Membership Status: Joined February 3, 1964; Article VIII.

II.	**General Resources Account:**	**SDR million**	**Percent of quota**
	Quota	271.40	100.00
	Fund holdings of currency	258.59	95.28
	Reserve position in Fund	12.82	4.73
III.	**SDR Department:**	**SDR million**	**Percent of allocation**
	Net cumulative allocation	36.99	100.00
	Holdings	1.96	5.29
IV.	Outstanding Purchases and Loans:		**Percent of quota**
	Poverty Reduction and Growth Facility (PRGF) arrangements	166.80	61.46

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	11/21/03	11/20/07	150.00	150.00
PRGF	8/4/00	8/3/03	190.00	33.60
ESAF	4/26/96	4/25/99	149.55	24.93
ESAF	2/22/93	12/21/94	45.23	45.23
ESAF	5/15/89	3/31/93	261.40	216.17

The last three-year PRGF arrangement was approved on November 21, 2003, in the amount of SDR 175 million. Access was augmented to SDR 225 million at the time of the first review on December 20, 2004, to address the impact of a drought and higher oil prices. In light of a balance of payments improvement and at the request of the authorities, access was reduced to SDR 150 million at the time of the second review. The arrangement expired on November 20, 2007.

VI. Projected Obligations to Fund

(SDR million; based on existing use of resources and present holdings of SDRs):

	2008	2009	2010	2011	2012
Principal	3.36	11.72	16.72	15.00	18.75
Charges/interest	0.95	1.87	1.80	1.71	1.63
Total	4.31	13.59	18.52	16.71	20.38

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Safeguards Assessments

Under the Fund's safeguards assessment policy, the Central Bank of Kenya (CBK) was subject to a safeguards assessment with respect to the augmentation of access under the existing PRGF Arrangement approved on December 20, 2004. The assessment, completed on September 8, 2005, noted that the CBK has taken steps to implement the recommendations of the earlier safeguards assessments and proposed measures to address the remaining vulnerabilities. There was one outstanding issue from previous recommendations to modify the CBK act to state that the Bank will follow IFRS in its financial reporting framework, this is to be part of the audit program for follow up with CBK.

X. Exchange Arrangements

The currency of Kenya is the Kenyan shilling. Kenya has adopted a unitary exchange rate structure in which the exchange rate is determined in the interbank market. The official exchange rate, which is set at the previous day’s average market rate, applies only to government and government-guaranteed external debt-service payments and to government imports for which there is a specific budget allocation. The exchange rate regime is a managed float, in which the U.S. dollar is the principal intervention currency. Kenya maintains an exchange system that is free of restrictions on the making of payments and transfers for international current transactions. On August 18, 2008, the exchange rate was Kshs 67.42 =US$1.00.

XI. Article IV Consultations

Upon expiration of the PRGF program in November 2007, Kenya has now reverted back to a standard 12-month cycle for Article IV consultations. The last Article IV consultation was concluded on April 11, 2007.

XII. FSAP Participation

The joint IMF-World Bank Financial Sector Assessment Program (FSAP) missions took place in Nairobi in July and October, 2003. The staff report on the Financial Sector Stability Assessment (FSSA) was issued on November 29, 2004.

XIII. Technical Assistance

Department	Purpose	Time of Delivery
MFD	Banking Sector Restructuring	January/February 2003
FAD	World Bank/AFRITAC East PEM Assessment and Action Plan (AAP) Mission	March 2003
STA	Government Finance Statistics (GDDS)	September 2003
FAD	AFRITAC East classifications mission (implementation follow up in June 2004, January, July and October 2005, and January 2006)	November 2003
MFD	Central Bank Accounting	February 2004
STA	Government Finance Statistics (GDDS)	February 2004
FAD	Customs Administration	March 2004
FAD	Tax Administration	March/April 2004
FAD	2nd World Bank/AFRITAC East PEM Assessment and Action Plan (AAP) Mission	May 2004
FAD	AFRITAC East Treasury Reforms mission (implementation follow up in July 2004, February-March 2005, September 2005, September 2006)	June 2004
MFD	Banking Supervision/Deposit Insurance /Legislation	July 2004
FAD	AFRITAC East Aid Flow Tracking Mission	July 2004
FAD	Revenue Administration	September/October 2004
MFD	Deposit Insurance/Legislation (with LEG)	October 2004
MFD	Public Debt Management and Monetary	November 2004

	Policy Implementation	
STA	ROSC Mission	January 2005
MFD	Monetary Framework, Monetary Operations, and Banking Supervision	October 2005
FAD	Revenue Administration	November 2005
FAD	AFRITAC East Semi-Autonomous Agencies and EBFs/Fiscal Reporting Mission	March 2006
FAD	HQ Mission: Strengthening the Budget and Reporting System	August 2006
FAD	AFRITAC East TA: Revision of Public Finance Management Act	October/November 2006
MCM	AFRITAC East TA: Review of Risk-Based Supervision Manual	November/December 2006
MCM	Monetary Operations TA	January 2007
STA	External Debt Statistics Workshop	February / March 2007
FAD	AFRITAC East TA: Customs Administration	July 2007
FAD	Fiscal ROSC	July 2007
MCM	Payment Systems	February 2008
STA	Consumer Price Statistics	March 2008
MCM	Monetary Operations/Banking	April 2008
STA	National Accounts	April 2008
FAD	AFRITAC East TA: Budget	May 2008
STA/MCM	Financial Soundness Indicators	June 2008
FAD	Budgeting	July 2008
MCM	Bond-Pricing Techniques Workshop	July 2008
FAD	AFRITAC East TA: Regional PFM Advisor: Budget and Tax review	August 2008
FAD	AFRITAC East TA: Customs Administration	
MCM	Payment Systems	August 2008
STA	AFRITAC East TA: Monetary and Financial Statistics	August 2008

XIV. Resident Representative

The Fund has had a resident representative in Kenya since December 1993. Mr. W. Scott Rogers is the current Senior Resident Representative.

II. Kenya: IMF-World Bank Joint Management Action Plan 2008 - 2009

Title	Products /Activity	Provisional timing of mission (if relevant)	Expected delivery date
	I. Mutual Information on Relevant Work Program		
Bank Work Program	A. Strategy and Analytical Work		
	Country Assistance Strategy (and Joint Portfolio Performance Review)	September/October 2008	March 2009
	Country Economic Memorandum (Growth Report)	June/July 2008	August 2008
	Poverty and Inequality Assessment	July 2008	August 2008
	Public Expenditure Notes	To be decided	March 2009
	Staff Advisory Note on the Medium-Term (2008–2012) Strategy for National Transformation	No mission needed	
	Agricultural Policy Review	To be decided	December 2008
	Land Reforms Study		June 2009
	Parliament's Role in Governance		December 2008
	Police Oversight Mechanisms		December 2008
	B. Ongoing and New Projects		
	Several projects on public sector reforms including legal and judicial, capacity building, agriculture, natural resource management, transportation, energy, urban services, small and medium scale enterprises, education and health (including HIV/AIDS)	Several	Ongoing
IMF Work Program	A. Missions		
	Article IV Consultation and Ex Post Assessment	June 23 – July 2	September 2008
	Possible discussion of an IMF-supported program	March 2009	June 2009
	B. Analytical Work		
	Selected Issues Paper on External Stability and Competitiveness	No mission needed	September 2008
	Selected Issues Paper on Public Debt Thresholds	No mission needed	September 2008
	EAC Selected Issues Paper on Inflation and Exchange Rate Pass-Through in the EAC	No mission needed	
	EAC Selected Issues Paper on Capital Markets, Capital Accounts Integration and Monetary Policy in the EAC	No mission needed	
	C. Technical Assistance		
	Budget (General)	August 2008	October 2008
	Tax Review	August 2008	October 2008
	Customs Administration (6)	August 2008 - 2009	
	Kenya School of Monetary Study Workshop (3)	August - December 2008	
	Organic Budget law		
	Payment System Regulatory Interface	September 2008	

Title	Products /Activity	Provisional timing of mission (if relevant)	Expected delivery date
	Bank Supervision: Capital Adequacy rules	September 2008	
	Government Finance Statistics	September 2008	
	Balance of Payments Statistics	November 2008	
	Monetary and Capital Markets	February 2009	
	II. Request for Work Program Inputs (as needed)		
Bank Request to Fund	Medium-term macro-economic and fiscal framework to inform Public Expenditure Notes	To share when requested	Ongoing
	Profile of government's contingent liabilities in non-financial public sector	To share data when available	2008/09
Fund Request to Bank	Food and fuel price increases – impact on poverty and growth, policy assessment and response.	To share work done for the Region; No Kenya-specific work planned.	Ongoing
	Investment needs and their implications for development spending; quality of spending	To share work being done in response to specific requests.	Ongoing
	MTEF for growth and equity and PFM issues relating to key social sectors	Some analytical work already shared. Other work as described in Bank Work Program will be made available once completed.	Ongoing
	Financial sector development issues	Work in partnership with other donors such as DFID will be shared.	Ongoing
	Regional trade policy in the context of the EAC, COMESA and EPA	To share TA/Analytical work being prepared for the EAC secretariat.	Ongoing
	III. Agreement on Joint Products		
Joint products	Public and External Debt Sustainability Analysis		September 2008

III. Kenya: Key Statistical Issues

1. Data provision has some shortcomings, but is broadly adequate for surveillance and program monitoring. Weaknesses in macroeconomic statistics reflect organizational and skill shortcomings, and inadequate resources. In line with the new Statistics Law, the government established the autonomous Kenya National Bureau of Statistics (KNBS) in 2007 to replace the Central Bureau of Statistics (CBS).

2. The Report on the Observance of Standards and Codes—Data Module (IMF Country Report No. 05/388) published on October 31, 2005 stated that methodological soundness is uneven across datasets and significant improvement is required in government finance statistics and national accounts. Accuracy and reliability do not receive adequate attention in any of the datasets, while accessibility of the disseminated macroeconomic statistics are adequate, except for the balance of payments statistics.

3. Kenya participates in the Fund's General Data Dissemination System (GDDS) and the GDDS project for Anglophone Africa. Metadata and detailed plans for improving the data over the short and medium term are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). Kenya has received Fund technical assistance. Further assessment of capacity building requirements has been undertaken by the AFRITAC East Statistical Advisor.

4. Monetary, exchange rate, and some external data are published on a monthly and biannual basis by the KNBS in its *Monthly Economic Review*. Core financial data are also made available to the Fund on a regular basis. A detailed account of various sectoral activities and the corresponding statistical data are published annually by the KNBS in its *Economic Survey.*

National accounts

5. Data quality has deteriorated significantly because of budgetary and staff constraints at the KNBS. GDP is believed to be significantly underestimated, as important and increasing parts of the economy, such as the informal sector, nonagriculture subsistence, horticulture, and self-employed professionals are not properly covered. An STA peripatetic advisor assisted the authorities in rebasing the national accounts estimates at constant 2001 prices and compiling institutional accounts for the general government sector. As a result, national accounts estimates for the years 1996–2005 in current and constant (2001) prices) have been published. Quarterly national accounts are being developed with the assistance of the AFRITAC East. Quarterly GDP estimates are now published.

Prices and production

6. In early 2002, the KNBS (then CBS) began publication of a new national CPI (covering 13 urban towns), with 1997 as reference year and outdated weights and basket of items derived from the 1993-94 Household Budget Survey (HBS). Indices are produced for lower and middle/upper income groups in Nairobi and other cities. The index is compiled and published on a timely basis. No producer, export, or import price indices are produced. In March 2008, a TA mission assisted the authorities in identifying the methodological issues relating to the measurement of inflation. The current methodology of aggregating prices at the elementary level was found to impart a substantial upward bias on CPI measurement. In line with STA recommendations, the KNBS plans to switch to a formula consistent with international best practices later in 2008, together with a rebasing and reweighing of the CPI basket.

Government finance statistics (GFS)

7. The data ROSC mission emphasized a number of key areas in GFS compilation that should be improved, including: (i) migration to the *GFSM 2001* methodology; (ii) broadening the coverage to include extrabudgetary and social security funds and report on a general government level; (iii) reconciliation of fiscal statistics from various sources to limit discrepancies; (iv) improve information on external financing, particularly on expenditure directly financed from abroad; (v) compilation and dissemination of monthly and quarterly budget execution data; and (vi) training of Ministry of Finance (MOF) staff in the GFS methodology.

8. Since the beginning of FY 2005/06, Kenya has followed a new economic classification of the budget based on *GFSM 2001* (with assistance from the AFRITAC-East). However, serious delays have emerged in reporting, reflecting difficulties in establishing budget execution and accounting systems consistent with the new classification. To ensure timely reconciliation and monitoring of budget execution, the existing systems would need to be promptly upgraded and made operational. Progress has been made toward moving to the IFMIS. There are still important gaps in ensuring proper reconciliation of fiscal data from different sources, including from various units within the MOF. The discrepancies in budget outturn data (between deficit/surplus and financing) remain significant, and the recording of external financing and expenditure directly financed from abroad is still an important area for improvement. The government has taken some steps to initiate a project to rationalize/eliminate extrabudgetary funds, but the progress in compiling consolidated fiscal statistics has remained limited.

9. The country reports data to STA for the budgetary central government for inclusion in the *GFS Yearbook*, albeit with a significant lag—the last data reported were for the year ending June 2005. The KNBS compiles the aggregate annual GFS revenue and expenditure data for the budgetary central government based on detailed data in the reports of the

Controller and Auditor General. The data submitted for publication in the *2007 GFS Yearbook* was reported in *GFSM 2001* format, using bridge tables developed by the technical assistance missions. The recent steps taken in the migration to *GFSM 2001* may help reduce the significant differences between KNBS data and the data compiled by the MOF and reported to AFR for surveillance and program monitoring purposes. Monthly and quarterly data are regularly reported for inclusion in the IFS.

Monetary statistics

10. Progress has been shown in the implementation of the *Monetary and Financial Statistics Manual* (*MFSM*)and development of the standardized report forms (SRFs). The authorities submitted SRF test data; however, there has not been further progress. In March 2007, a STA mission established the standardized report form for the data on the central bank; reviewed and revised the reporting form and compilation notes for the other depository corporations (ODCs) in line with *MFSM* data requirements; and identified the coverage of the ODC subsector. The mission found misclassification of a number of central government deposits as private sector deposits. A major issue for future work relates to the expansion of the coverage of the ODCs to include the Savings and Credit Cooperatives (SACCOS). As of end-March, 2007, there were 3,800 SACCOs, accounting for about 30 percent of the total deposits of the banking system. When implemented, a new bill providing for increased supervision over SACCOs would generate data as part of the supervisory function. A follow-up mission in June 2007 conducted a workshop for officials of ODCs and established a system for reporting Form 1SR to the IMF. The new Standardized Reporting System for reporting ODCs' data to the central bank was also finalized.

External sector statistics

11. The KNBS compiles annual balance of payments statistics in Kenya shillings that are regularly reported to STA, although with considerable delay. In addition, the Central Bank of Kenya (CBK) compiles a complete set of annual balance of payments statistics in U.S. dollars, which are reported to AFR and used for programming and surveillance purposes. The two datasets are not entirely consistent, and Fund staff has strongly encouraged the authorities to reconcile them. More recently, the CBK also started to compile and publish quarterly balance of payments estimates.

12. Although the overall quality of trade data may be reasonably good, data for other current account and many financial account transactions are rather weak. Following the liberalization of the exchange system in 1993–94, gaps emerged in coverage. The compilation system (other than that used for compiling customs statistics), used since 1994, relies on reports from domestic banks and may result in a substantial under-recording of current earnings, including tourism receipts; investment flows of the private sector; as well as transactions that are settled via accounts held abroad.

13. Present estimates of direct and portfolio investment are believed to be substantially understated. The large positive errors and omissions in the central bank data that have emerged in the balance of payments since 1994 give rise to uncertainties as to the potential size of external obligations. The MOF compiles data covering public and publicly guaranteed external debt obligations to official and commercial creditors. This database does not take into account nonresident purchases of the government's domestic currency-denominated debt securities. In developing the loan-by-loan debt sustainability analysis (DSA) in 2002, Fund and World Bank staff identified several significant debt data problems that have been addressed by the authorities. Nevertheless, significant debt data management problems remain, along with more general issues in the area of external debt management and its integration in the budget formulation and expenditure management systems.

14. To help address these issues, in 2006 a technical assistance mission recommended introducing a foreign investment survey, enhancing the foreign exchange statistics survey, and using a common methodology, including for estimations, in the use of available data in the KNBS and CBK. In 2007, a DFID funded enterprise survey failed to materialize. There are plans to conduct a foreign investment survey in 2008, which planned DFID-funded and STA external sector missions will support.

15. Kenya does not report international investment position statistics to STA.

KENYA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(as of August 19, 2008)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items[7]: Data Quality – Methodological soundness[8]	Memo Items[7]: Data Quality – Accuracy and reliability[9]
Exchange Rates	8/18/08	8/18/08	D	D	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	8/18/08	8/18/08	D	D	M		
Reserve/Base Money	8/18/08	8/18/08	D	D	M		
Broad Money	6/30/08	7/15/08	M	M	M	LO, LO, LO, LO	LO, LO, O, O, NO
Central Bank Balance Sheet	8/18/08	8/18/08	D	D	M		
Consolidated Balance Sheet of the Banking System	6/30/08	7/15/08	M	M	M		
Interest Rates[2]	6/30/08	7/20/08	D	D	M		
Consumer Price Index	6/30/08	7/20/08	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	6/2008	7/2008	NA	NA	NA	LNO, LNO, LNO, LO	LNO, LO, LO, LO, NO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	6/2008	7/2008	Q	I	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	6/30/08	7/15/08	Q	Q	Q		
External Current Account Balance	December 2007	6/08	M	A	A	O, LO, O, LO	LNO ,LO, LO, LO, LO
Exports and Imports of Goods and Services	December 2007	6/08	M	Q	A		
GDP/GNP	2008 Q1	6/07	M	A	A	O, LNO, LNO, LO	LNO, LO, LNO, LO, LNO
Gross External Debt	March 2008	6/07	M	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] These columns should only be included for countries for which a Data ROSC (or a Substantive Update) has been prepared.
[8] Reflects the assessment provided in the data ROSC, published on October 31, 2005, and based on the findings of the mission that took place during January 2005, for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/127
FOR IMMEDIATE RELEASE
October 1, 2008

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with Kenya

On September 10, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kenya.[1]

Background

Kenya's macroeconomic performance continued to improve until violence erupted in the aftermath of the general elections of December 2007. GDP growth reached 7.0 percent in 2007, the highest in more than two decades. Economic activity weakened, however, in the wake of the political instability in early 2008 and real GDP is expected to have slowed to about 4 percent in 2007/08 (July/June). Inflation increased sharply in recent months, in part related to developments in global food and fuel prices.

The fiscal deficit (including grants) for 2007/08 is estimated at 4.8 percent of GDP. This was below the original budget target, reflecting foremost a strong revenue performance. For 2008/09, the budget envisages a deficit of 5.3 percent of GDP, with spending shifting toward infrastructure and other priority areas.

Monetary policy was tightened in June 2008 to address rising inflationary pressures. For much of 2007/08, reserve money growth had exceeded the authorities' target and private sector credit growth had also remained robust.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The external current account deficit almost doubled in 2007/08 to 4.6 percent of GDP, due largely to higher oil import prices. Sizable capital inflows contributed to an appreciation of the Shilling against most major currencies and a strengthening of the overall balance of payments position, with gross international reserve increasing to the equivalent of 3.1 months of imports.

An Ex Post Assessment of IMF's longer-term program engagement with Kenya found that macroeconomic policy during 1993-2007 was generally appropriately designed with sound implementation. The assessment also found, however, that the approach to governance reform was overly reactive and programs were overloaded—even though governance issues deserved the attention. The authorities considered the draft report to be balanced and objective, and noted that conditionality, particularly in the governance area, did not reflect realistic timetables or the constraints of Kenya's legal system and political environment. Looking forward, the authorities suggested that both sides needed to learn lessons from the past and to aim for a "partnership" rather than a "supervisory" relationship.

Executive Board Assessment

Executive Directors commended the Kenyan authorities for maintaining economic stability in the wake of post-election turmoil in early 2008, and for their sound macroeconomic policies and progress with economic reform in recent years, which have contributed to strong economic growth and poverty reduction. Directors regretted the interruption of economic activity that resulted from the post-election turmoil, but were encouraged that a recovery seems to be underway following the return to political stability.

Directors noted, however, that downside risks remain, particularly from rising food and fuel prices and weakening global demand. They underscored that sound policies and continued structural and governance reforms are essential to maintain macroeconomic stability, restore strong growth, and advance toward the Millennium Development Goals.

Directors supported the focus of the 2008/09 budget on removing growth bottlenecks and improving social cohesion. At the same time, they stressed the importance of fiscal restraint in light of the strong recovery and inflationary pressures, and urged the authorities to accommodate spending priorities within a smaller-than-budgeted deficit. Directors encouraged the authorities to adopt a fiscal anchor based on the ratio of total public debt to GDP in light of the planned sovereign bond issue. They advised that the size, timing, and modalities of the planned international sovereign bond issue be carefully considered to safeguard debt sustainability, and that the proceeds be used for high-return infrastructure projects. In this context, Directors stressed the importance of establishing a comprehensive debt management strategy, and advised the authorities to continue to seek concessional financing as the best source for public investment.

Directors welcomed the recent tightening of monetary policy and the authorities' readiness to tighten further to prevent the second-round effect of rising food and fuel prices. They urged the authorities to take more decisive steps to reduce monetary growth to rates consistent with their inflation objective. They called for quick action to address the upward methodological bias in the compilation of the consumer price index. Directors supported the authorities' plans to reform the monetary operations framework, including through the introduction of inflation targeting. However, they stressed that more analytical work is needed and institutional and statistical pre-conditions should be put in place before inflation targeting is adopted.

Directors observed that the managed float exchange rate regime has served Kenya well. They considered that the appreciation of the real exchange rate is broadly consistent with Kenya's improving economic fundamentals, which have helped to attract financial inflows. Nevertheless, Directors stressed the importance of monitoring developments in competitiveness in view of the widening external current account deficit.

Directors agreed that far-reaching structural reforms and infrastructure improvements will be required to achieve the authorities' Vision 2030 growth objectives. Priority reforms should include those in the financial sector, public financial management, and the regulatory and trade regimes. Directors believed that public-private partnerships can play a useful role in building Kenya's infrastructure, provided the contractual arrangements are transparent and the contingent liabilities are fully assessed.

Directors stressed the importance of continued progress on governance and transparency reforms. They welcomed the authorities' intention to update the 2006/07 Governance Action Plan, under which advances had been made in important areas, including public procurement and business regulation. Directors encouraged more progress in areas where original objectives have not been met, including for wealth declarations and verifications for senior public officials. Further improvements in public financial management would also be important.

Directors broadly concurred with the findings and recommendations of the Ex Post Assessment of Kenya's long-term program engagement with the Fund. They agreed that macroeconomic policy design under past programs was broadly appropriate and that implementation was generally sound. However, they noted that aspects of the past engagement were disappointing—in particular, the protracted focus on governance issues. Directors were concerned that program conditions on governance were not always macro-critical, did not take into consideration constraints of Kenya's legal and political systems, or paid sufficient attention to program ownership. Directors welcomed the improved ownership and performance in recent years and believed that the Fund should continue to play a key role in helping the authorities design and implement sound policies. In this regard, they welcomed the consideration being given by the authorities to modalities for future engagement with the Fund, possibly in the context of a Policy Support Instrument.

Directors welcomed the authorities' decision to publish all reports, including the reports for the 2008 Article IV consultation and Ex Post Assessment of Kenya's longer-term program engagement with the Fund.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Kenya: Selected Economic Indicators, 2005/06-2009/10					
	2005/06	2006/07	2007/08	2008/09	2009/10
	Actual	Actual	Estimate	Projection	
	(Annual percentage change, unless otherwise indicated)				
National accounts and prices					
Real GDP growth (market prices)	6.1	6.7	3.9	7.2	6.0
Consumer price index (annual average)	11.1	10.4	18.5	14.5	5.0
Consumer price index (end of period)	10.9	11.1	29.3	8.0	5.0
Ksh per US $ exchange rate (end of period)	69.3	62.6	64.6	...	...
Money and credit					
M3 (broad money, end of period)	18.0	16.0	18.3	21.8	17.2
M3X (broad money and foreign currency deposits, end period)	14.9	18.9	19.4	17.3	16.0
Reserve money (end of period)	14.0	17.5	19.6	15.0	14.6
	(In percent of GDP, unless otherwise indicated)				
Investment and saving					
Investment	18.0	19.1	20.0	22.0	22.1
Central government	4.2	4.6	6.7	7.4	7.3
Other	13.8	14.5	13.3	14.6	14.8
Gross national saving	16.0	16.7	15.4	15.3	16.6
Central government	0.0	2.0	1.2	1.8	2.3
Other	16.0	14.8	14.3	13.5	14.3
Central government budget					
Total revenue	20.5	21.7	22.3	21.6	21.6
Total expenditure and net lending	25.2	24.4	28.3	27.6	26.7
Overall balance (commitment basis) excluding grants	-4.7	-2.7	-6.0	-5.9	-5.2
Overall balance (commitment basis) including grants	-3.4	-1.8	-4.8	-4.6	-3.8
Balance of payments					
Exports value, goods and services	26.6	25.5	24.9	25.2	25.1
Imports value, goods and services	35.9	35.2	36.6	39.2	37.6
Current external balance, including official transfers	-2.0	-2.4	-4.6	-6.7	-5.4
Current external balance, excluding official transfers	-2.3	-2.4	-4.8	-6.7	-5.4
Gross international reserve coverage					
in months of next year imports (end of period)	3.3	2.9	3.1	3.1	3.1
Public Debt					
Domestic debt, net (end of period)	18.4	19.5	18.5	17.7	18.5
Nominal central government debt (end of period)	45.1	42.3	38.8	38.0	38.6
of which: external debt (end of period)	26.7	22.8	20.3	20.3	20.2

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

Statement by Mr. Peter Gakunu, Executive Director, and Mrs. Rachel Gesami, Senior Advisor to the Executive Director for Kenya

September 10, 2008

My authorities express their appreciation to the Fund for continuous engagement and support for their ambitious macroeconomic and structural reform agenda. They particularly wish to thank management and the staff for valuable consultations, constructive dialogue, and comprehensive and informative assessment on Kenya's economic achievements, challenges and prospects. They broadly agree with the thrust of the useful analyses, advice and recommendations in the staff reports.

Macroeconomic performance

The authorities' strong commitment to sustaining macroeconomic stability and implementing structural reforms, as well as Fund TA support, has underpinned the county's recent achievements, including robust growth, reduction and substantial reserves accumulation. Real GDP grew by 7 percent in 2007, the highest rate in over two decades. This owed much to sound macroeconomic policies and progress on structural reforms, coupled with a favorable external environment. The strong growth momentum was interrupted, however, by the post-election turbulence of early 2008. This inflicted a huge loss of life and severe human suffering, with economic effects evident not only in Kenya, where tourism, agriculture, and transport were particularly adversely affected, but also in the region as transport links were interrupted.

With the formation of the grand coalition government in February 2008, the economy is regaining its footing. While a full recovery in some sectors is likely to take time, especially tourism, the economy as a whole is rebounding. Overall real GDP is expected to grow by 4 percent in 2007/08—significantly better than had been envisaged, given the events of the first quarter—and rebound to 7.2 percent in 2008/09, which is also consistent with the authorities' Vision 2030.

On external stability, the real exchange rate has appreciated considerably and the external current account widened. However, the authorities are aware and agree that this seems to reflect foremost economic fundamentals, as exports, capital inflows, and foreign reserves remain robust. In addition, inflation increased sharply at the beginning of the year mostly due to post election political turmoil and the impact of high food prices as well as rising fuel prices. The authorities have taken steps to expeditiously implement policies that would bring the CPI-compilation in line with international best practice and measures needed to deal with the second –round effects of food and fuel prices.

Fiscal policy

The country's fiscal stance continues to be prudent**.** The fiscal deficit (after grants) reached. 4.8 percent of GDP in 2007/08, below the original budget target but more than twice the deficit of the previous year. The lower-than-budgeted deficit reflected mainly a shortfall in foreign-financed development spending. Strong revenue performance benefited from continued improvements in tax administration, a buoyant economy that boosted income tax collections, and one-off transfer of collected road fees. As privatization receipts increased sharply to almost 4 percent of GDP, domestic financing declined and public debt fell below 40 percent of GDP.

On the expenditure side, the authorities plan to shift spending in support of growth and poverty reduction, while preserving macroeconomic stability. In this context, the 2008/09 budget rightly realigns spending priorities toward infrastructure and several social objectives, such as free secondary education. More spending will also be needed to provide targeted support to those most vulnerable to the increases in food and fuel prices. The authorities plan to accommodate spending priorities within an overall smaller-than-budgeted spending envelope. In that connection, and in the face of strong growth and inflation pressures, they intend to target some reduction in the fiscal deficit to around 4½ percent of GDP—somewhat below the budget proposal. Importantly, this would also allow a further reduction in the public debt-to-GDP ratio.

Consistent with the objectives of vision 2030, my authorities continued to reinvigorate their five-year public financial management reform program to promote transparency and accountability. Devolution of more spending to subnational levels would require mechanisms that would ensure effective coordination with fiscal policy at the central level and strengthen budget reporting and control.

In the medium term, the government is considering making the public debt-to-GDP ratio a medium-term anchor for fiscal policy. This would cover not only domestic but also external debt—an increasingly important consideration amid prospects of external commercial borrowing. A sovereign bond could help finance some high-return infrastructure projects, in cases where concessional resources—the first-best option—are not available. Size, timing, and modalities of the issuance are also important considerations that the authorities are grappling with to maximize the benefits of a sovereign bond. The authorities have also prepared a comprehensive Debt Management Framework to help preserve gains made recently in debt sustainability. The DSF is providing guidance on the borrowing strategy, procedures, and acceptance terms and conditions of loans, their disposition and servicing.

Monetary and financial sector policy

The monetary policy of the Central Bank of Kenya (CBK) is geared towards the containment of inflationary pressures arising mostly from the impact of food as well as rising fuel prices. It is worthwhile to note that the policy has recently been accommodative including crisis-related liquidity needs in the early part of the year. However, monetary conditions tightened considerably thereafter. The Central Bank Rate (CBR) was raised by ¼ percentage point to 9 percent in response to continued inflationary pressures. While the tightening of monetary policy in mid-2008 was important, the authorities have come up with more steps needed to deal with the second-round effects of food and fuel price increases.

Looking forward, monetary policy during 2008/09 will continue to focus on the primary objective of price stability. The authorities plan to achieve this through employing more decisively the available instruments to limit monetary growth to rates consistent with the inflation objectives. Moreover, the methodological issues of the current consumer price index will be resolved to allow an accurate inflation assessment. Over the medium-term, the authorities are considering broader reforms of the monetary framework, including planned analytical work on the issues. At the same time, coordination between fiscal and monetary policies will be strengthened to avoid undue volatility in the market. The CBK will seek to attain an appropriate mix of its available monetary instruments to ensure orderly developments in the markets.

On the financial reform, the authorities consider a vibrant financial sector as critical for dynamic, broad-based growth. To this end, they plan to finalize soon a Financial Sector Strategy. They also plan to move forward with a comprehensive revision of the Central Bank and the Banking Acts, including steps that would bring mandatory and prompt corrective actions in line with international best practices.

Structural reforms and Vision 2030

The government's structural reform agenda is centered around its Vision 2030 program which aims to accelerate annual GDP growth to 10 percent per year by 2012 and sustain this growth thereafter, making Kenya a middle-income country by 2030. The authorities recently derived a medium- term plan that would guide the new poverty reduction strategy from Vision 2030. They rightly believe that for the private sector to play its envisaged lead role, substantial infrastructure investment as well as structural reforms are required, including in the financial sector and on public financial management, governance, and trade policy. Their vision therefore, provides appropriately ambitious targets to advance the structural reforms needed for achieving the goals of Vision 2030. The envisaged acceleration in financial sector reforms mentioned earlier will be key also to secure the needed increase in domestic resource mobilization.

The authorities recognize the need for continued progress on governance and transparency. In this connection, they have made important progress in implementing the 2007/08 governance action plan, particularly in the areas of public procurement and business regulation. Further improving public financial management will also be important to advance transparency, including with measures to expand IFMIS and ensure the efficient use of devolved public resources.

Trade reforms

The authorities recognize that regional cooperation will continue to play an important role towards sustaining sound macroeconomic policies and enhancing strong growth. The government continues to participate actively in efforts to strengthen the existing regional trading arrangements, especially within the East African Community (EAC). The government recognizes that the EAC will continue to be the primary vehicle in its efforts to strengthen regional cooperation. The authorities will work closely with other EAC partner states to formulate a coordinated approach to investment and trade liberalization. Meanwhile, efforts will continue to be made to address the issue of lowering the common external tariff and the removal of nontariff barriers. These were expected to be covered in an EAC common market agreement to be signed by July 2009, after which discussions on a full Economic Partnership Agreement with the EU would also be scheduled to be finalized.

Debt sustainability analysis

The authorities are satisfied that the DSA has reflected the country's relatively limited reliance on external borrowing and the expected improvement in macroeconomic performance. Kenya, in this regard, faces a low risk of external debt distress as all external public debt indicators remain below the relevant country-specific debt burden thresholds.

Ex post assessment

The authorities welcomed the opportunity to draw lessons from the longer-term program engagement with the Fund and broadly agreed with most of the EPA conclusions. They appreciated that the EPA highlighted Kenya's track record of relatively prudent macroeconomic management and its improved performance over the past five years. They also concurred that an earlier re-evaluation of the focus of the Fund's involvement in the governance area would have been helpful. They considered that some conditionality, particularly in the governance area, had not reflected realistic timetables or the constraints of Kenya's legal and political systems, and an emphasis on legal and institutional governance reforms should have come earlier. Several non-governmental representatives, and also my authorities, expressed concern that the relationship between Kenya and the Fund had often been an unequal one, with the Fund taking advantage of difficult economic circumstances to push for adjustments, with negative consequences for growth and poverty reduction. It is therefore imperative to ensure program ownership and to always consider the macro criticality of conditionality when designing programs with countries.

Conclusion

The authorities remain committed to the continued implementation of prudent policies and deepening of the reform agenda. This will be achieved through effective implementation of the policies spelt out in the Vision 2030, which seeks to attain macroeconomic stability, enhance public resource mobilization and efficiency in spending, and strengthen the contribution of the financial sector to overall growth to make Kenya a middle-income country by 2030. The authorities will continue to take measures to improve the business environment. Consistent with the Vision 2030, the government will, in particular, continue to limit domestic financing to reduce inflation, and facilitate expansion in private sector credit for productive purposes. Our authorities are grateful for the support they continue to enjoy from the Fund and the international community as a whole and count on their continued support.