INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/358

KENYA

December 2013

SIXTH AND FINAL REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

In the context of the Sixth and Final Review Under the Three-Year Arrangement Under the Extended Credit Facility, the following documents have been released and are included in this package:

- **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 2, 2013, following discussions that ended on October 2, 2013, with the officials of Kenya on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on November 18, 2013.
- A **Press Release** including a statement by the Chair of the Executive Board.

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

Letter of Intent sent to the IMF by the authorities of Kenya*
Poverty Reduction Strategy Paper—Second Medium-Term Plan

*Also included in the Staff Report

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

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KENYA

November 18, 2013

SIXTH AND FINAL REVIEW UNDER THE THREE–YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

EXECUTIVE SUMMARY

Background: Kenya's recent reforms have introduced a more comprehensive system of checks and balances, including accountability and transparency in expenditure control and management. In this context, the new government has taken decisive steps towards devolution supported by a renovated institutional framework and solid macroeconomic management. Fiscal policy has focused on sustainability, while allowing for infrastructure investment in key sectors such as roads and power generation, and expanding protection of the vulnerable population. Policies have laid the ground for sustainable economic growth, with domestic and foreign investors expanding their scale of operations in a market-friendly environment. Foreign investment flows have risen and boosted the stock market, allowing for a sustained accumulation of international reserves. Commercial prospects of oil discoveries are promising, and the discovery of aquifers holding a potentially substantial supply of water in Northern Kenya could have a huge impact on the lives of future generations. Kenya leads the way in the process of regional integration, having become the second largest African investor in other Sub-Saharan African countries, with a number of regional banks rapidly expanding operations through the rest of Africa. Financial institutions are moving ahead of schedule in adopted prudential guidelines issued by the central bank in line with international best practices. The International Criminal Court trial of President Kenyatta for crimes against the humanity has been postponed until February 5, 2014. The impact of the September 21 terrorist attack has been limited, so far circumscribed to the tourist sector.

Program: The Executive Board approved a three-year Extended Credit Facility (ECF) program for Kenya on January 31, 2011 (120 percent of quota), which was augmented on December 9, 2011, for a total of SDR 488.520 (180 percent of quota). All end-June 2013 quantitative targets were met. NDA and NFA were comfortably within the program bounds. The authorities' primary fiscal balance outcome was in line with the program, and Priority social expenditure was above the program's indicative target. The structural benchmark on auditing of compliance with VAT obligations by 50 large taxpayers before June 2013 was fulfilled, and the VAT Act was approved by the Parliament and enacted by the President.

Staff views: The staff recommends completion of the review. The authorities have consented to publication of the staff report and Letter of Intent and its attachments.

Approved By
Roger Nord (AFR) and Dan Ghura (SPR)

A staff team comprising Messrs. Fanizza (head), Alper, Morales, (all AFR); Alshahrani (FAD) and Ms. Bouza (SPR) visited Nairobi during September 19–October 2, 2013. Mr. Gudmundsson (Resident Representative) participated in the discussions, and Ms. Rose Ngugi from the Executive Director's office joined the mission. The mission met National Treasury Cabinet Secretary Rotich, Central Bank Governor Ndung'u, other senior officials, representatives of the private sector including financial institutions, and the donor community.

TABLES

APPENDIXES

BACKGROUND, PERFORMANCE UNDER THE PROGRAM AND MACROECONOMIC OUTLOOK

A. Background

1. **Three years ago Kenya faced significant challenges resulting from shocks that hit the economy in 2008 and 2009**. Elections-related social strife, the global financial crisis, and two consecutive droughts had substantially reduced growth, and weakened the external position. Lingering uncertainty hurt investors' confidence. Moreover, while expansionary fiscal policy had helped to mitigate the impact of the global downturn, it also boosted public debt, complicating the prospects for increasing infrastructure investment to sustain growth.

2. **In 2011, the authorities put in place an economic program supported by an ECF aiming at (Box 1):** (a) boosting international reserves to cushion against external shocks; and, (b) gradually reducing the fiscal deficits, thereby lowering the public debt burden. At the same time, the economic program aimed at supporting the implementation of the new constitution adopted in the 2010 referendum, which provided the opportunity to address deep-seated social and institutional problems. Notably, the program supported the planned decentralization and the stepped-up investment in geothermal power capacity to deal with climate-change shocks by lowering Kenya's reliance on hydropower generation and oil imports.[1] In the event, the authorities' efforts proved successful despite additional challenges that required augmentation of access at the time of the second review.

B. Performance Under the Program

3. **Fiscal consolidation and the introduction of major reforms contributed to the program's success despite emerging challenges (Figure 1)**. However, a worse-than-envisaged development in international prices (especially higher food and oil prices) and a major drought that hit the Horn of Africa creating a humanitarian emergency in 2011, weighed on the external position. Moreover, because of the substantial increase in food and fuel prices, monetary policy could not continue accommodating a fast pace of domestic demand expansion. Thus, the program had to incorporate a new focus on demand management to rein in inflation, while the Fund provided augmented financial support under the ECF.

4. **The program successfully adapted to the new challenges:** Significant monetary tightening and a new framework for monetary operations helped to quickly curb inflation and stabilize the Shilling; an additional fiscal effort supported the external position; and, financial supervision was enhanced to anticipate emerging risks. In the event, the success of the program has contributed to an economic revival that is spreading its roots deeper.

[1] See Box 2 in IMF Country Report No. 11/48.

Box 1. Kenya: Rebuilding Policy Buffers Under the ECF Program

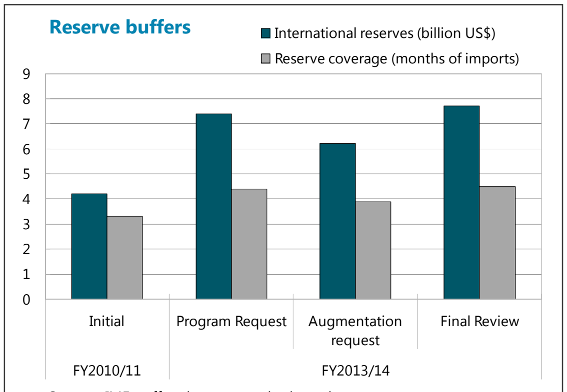
Kenya achieved the program's key macroeconomic objectives.

- **Kenya strengthened its external position substantially.** Reserve accumulation exceeded the program targets set both at the time of the initial request and at the time of the request, for augmentation. Kenya succeeded in building up international reserve buffers despite a large deterioration of the terms of trade.

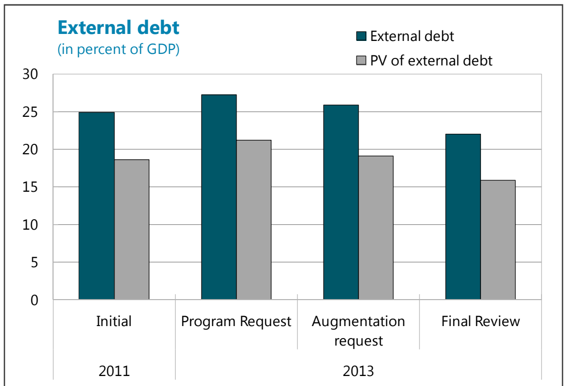
- **Kenya's public sector debt remained sustainable as measured by its present value.** Overall, fiscal policy remained in line with the medium-term profile envisaged at the beginning of the program, with a slightly higher debt-to-GDP ratio explained by the impact of external shocks on growth. The World Bank upgraded Kenya to "strong performer" in its 2012 Country Policy and Institutional Assessment index, which implies a higher indicative threshold for external debt sustainability.

- **Kenya's external debt remained slightly below original projections thanks to prudent borrowing on non-concessional terms.** Kenya's borrowing decisions remained in line with its debt management strategy. Government guarantees were limited to energy-related projects.

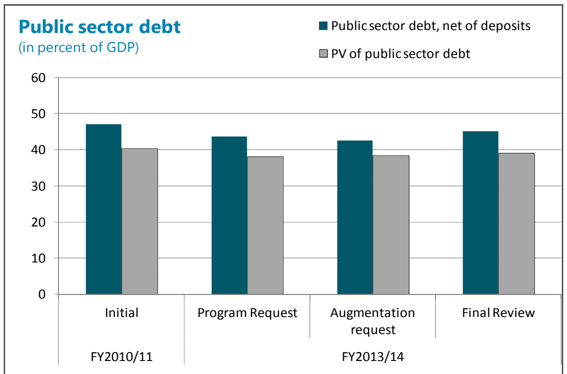
- **The program's objectives were achieved despite several adverse shocks:** (a) Kenya's terms of trade worsened by a cumulative 18 percent during the program period versus 10 percent envisaged at the start of the program; (b) a severe drought in the Horn of Africa in 2011 caused an inflationary shock and put pressure on the balance of payments; (c) tightly contested presidential elections added to political uncertainty during the transition to a devolved government, and; (d) the global growth slowdown was more protracted than originally anticipated.



Sources: IMF staff and country authority estimates.

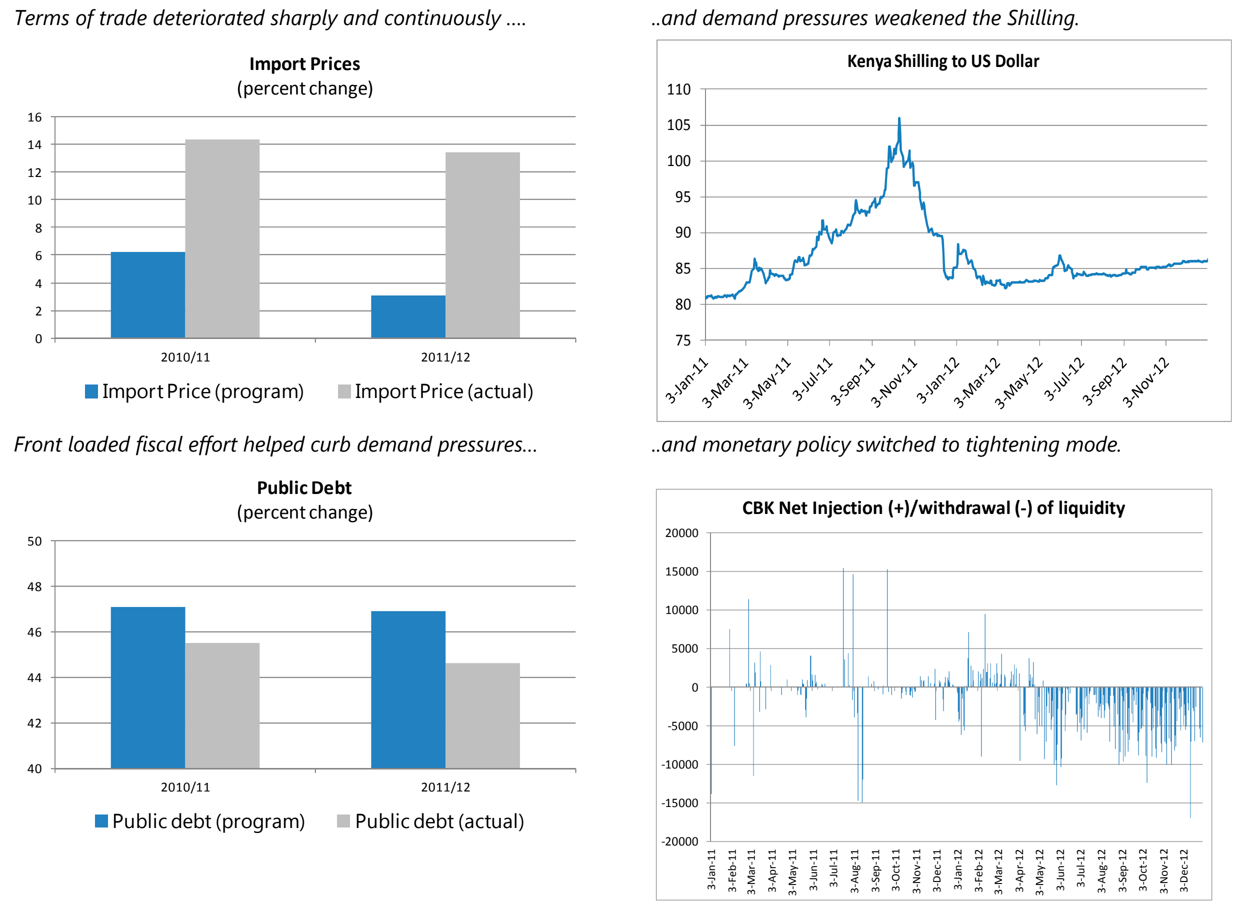


Sources: Country authorities and IMF staff estimates.



Sources: IMF staff and country authority estimates.

Figure 1. Kenya: Dealing With Adverse Shocks During 2011–12



5. All program targets for June 2013 were met. The CBK kept Net Domestic Assets (NDA) well below the program's ceiling and Net International Reserves (NIR) well above the program's floor. On the fiscal front the floor on the primary budget balance was met, and the ceiling on contracting of non-concessional debt by the central government was met with substantial head room. The structural benchmark on audits of 50 of the 100 largest VAT payers was also met, and there have been no external payments arrears by the central government. The central government's priority social expenditure was above the program floor.

6. Fiscal discipline was maintained despite spending pressures and revenue challenges in 2012/13. The fiscal outcome was within the program threshold for the primary balance of the central government. However a shortfall in VAT performance, UN delays in reimbursing the costs of the security operations under the African Union Mission in Somalia (AMISOM), and faster-than-expected execution of foreign finance projects at concessional terms boosted the primary deficit to about 3 percent of GDP raising slightly the debt to GDP ratio. Additional spending was mostly concessional and, as a result, the present value of debt is close to the program objective.

C. Macroeconomic Outlook

7. Macroeconomic conditions continue to strengthen (Figure 2). Thanks to significant reforms in recent years, economic activity has gained momentum supported by strong macroeconomic policies, growing investor confidence, and good weather conditions. Buoyant tax collections and accelerating credit growth to the private sector, particularly in the service and construction sectors, point to strong domestic activity with growth likely to get close to 6 percent in 2013/14.

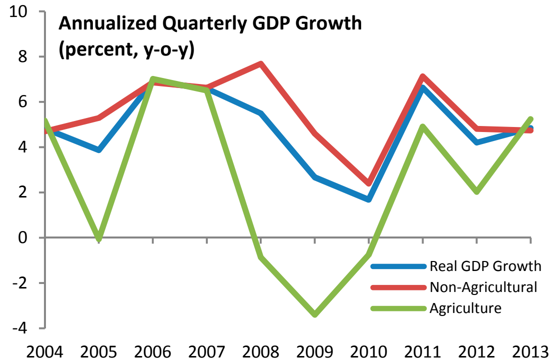
8. Monetary policy ensured that inflation remained within the Central Bank of Kenya's (CBK) target range (5±2½ percent) for one full year until end-August. Inflation rose to 8.3 percent in September reflecting the one-off impact of removing widespread VAT exemptions. This effect should taper off in the coming months and inflation should return within the CBK's target range by early 2014. The central bank has taken a cautious approach by keeping its policy rate constant at 8.5 percent since May. Moreover, the CBK has adopted a monetary tightening bias by leading the interbank rate close to the upper bound of its policy corridor around its policy rate (CBR).

9. Kenya's external position has strengthened with international reserves above US$6 billion (around 4 months of projected imports) (Figure 3). Thanks to tight policies, good weather, and improving exports of financial services, Kenya's current account deficit is projected to narrow to 8.3 percent of GDP in 2013/14 despite a substantial increase in capital-goods imports reflecting foreign direct investment in oil-exploration equipment. Moreover, updated information on service receipts suggests that the official external current account deficit has been significantly overstated (see Appendix). Accordingly, the authorities have agreed to revised current account projections. Capital inflows have intensified especially after the political uncertainties subsided in the aftermath of largely peaceful Presidential elections earlier in 2013.

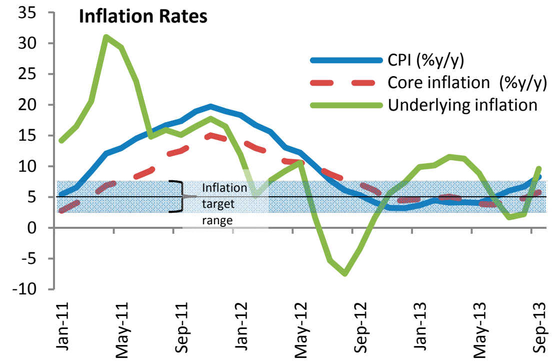
10. Fiscal policy has remained in line with the program despite significant spending needs, most recently from devolution (Figure 4). The 2013/14 revised budget targets a primary deficit lower than 2 percent of GDP that would allow to partially reverse the increase in the public debt to GDP ratio that took place in 2012/13. Devolution is under way in an orderly manner with counties taking over functions from the central government at a pace adapted to existing capacity. Spending at the national and county levels will take place in line with the procedures set by the Public Financial Management (PFM) law and within the Intergrated Financial Management Information System (IFMIS) that should limit the risk of overspending and emphasize lowering non-priority outlays.

Figure 2. Kenya: Macroeconomic Developments

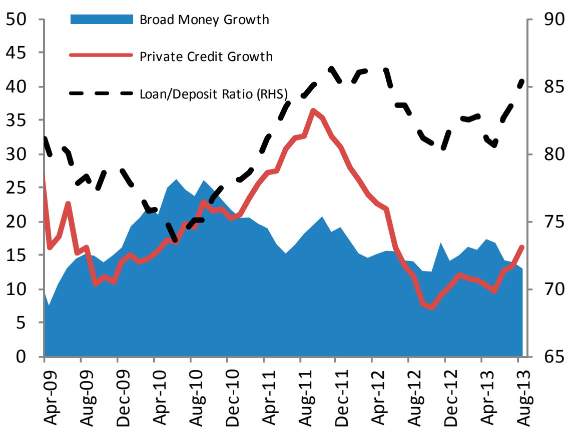
GDP growth has started to pick up helped by positive investors' sentiment and good weather…



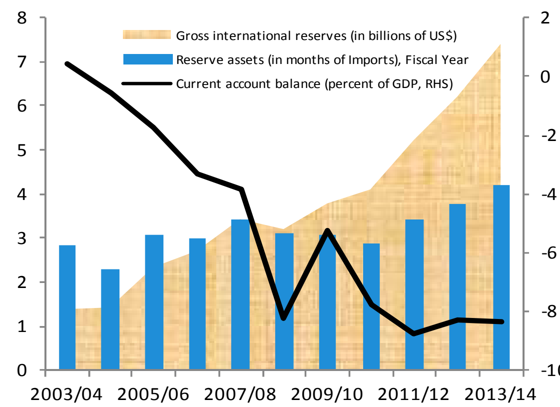
… and inflation has converged to the authorities' target.



Credit is growing in line with available financial resources fueling growth …



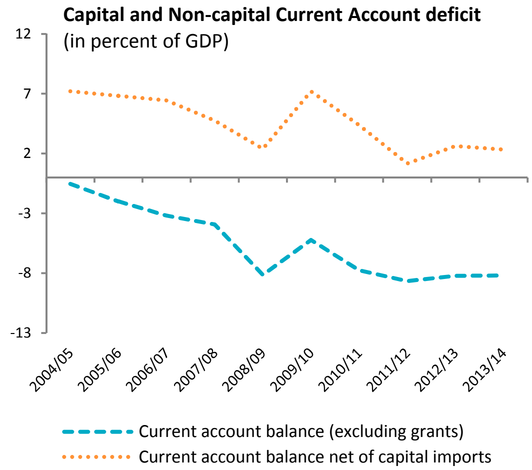
… and international reserve buffers are sizable.



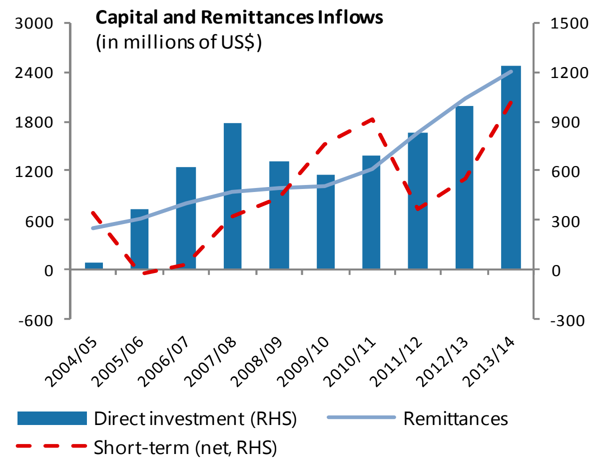
Sources: Kenyan authorities' data and IMF staff estimates.

Figure 3. Kenya: External Developments

External current account balance net of capital good imports shows improvement…[1]



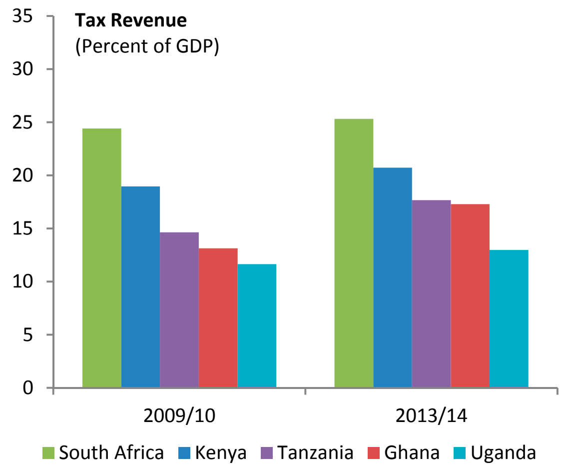
…and remittances and foreign direct investment are picking up.



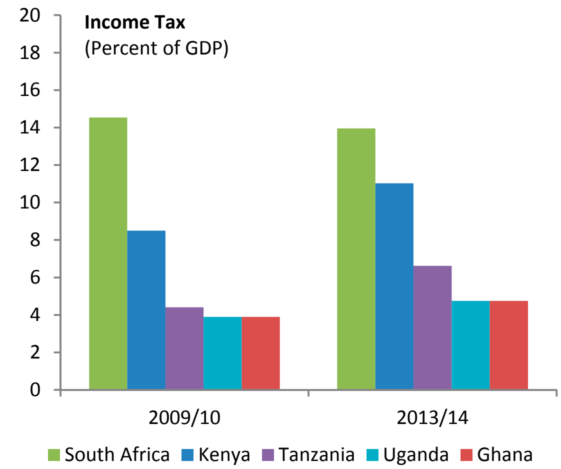
Sources: Kenyan authorities' data and IMF staff estimates.
[1] Total capital imports, including all types of energy, oil, machinery and equipment, and airplanes

Figure 4. Kenya: Fiscal Developments

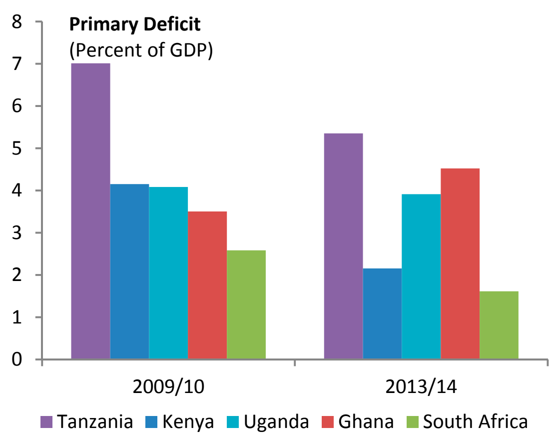
Tax revenue performance in Kenya shows improvement …



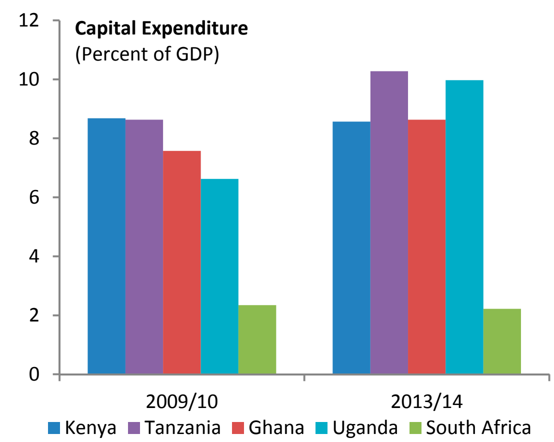
… with a significant contribution from income tax collection.



Primary deficit is lower, …



..with stable infrastructure spending.



Source: IMF staff estimates

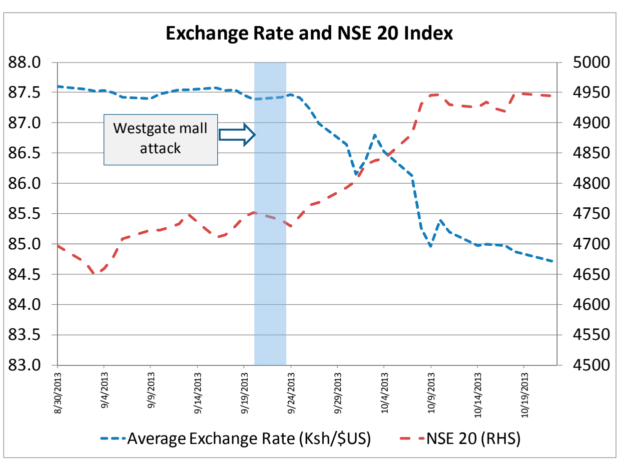
POLICY DISCUSSIONS AND RISKS

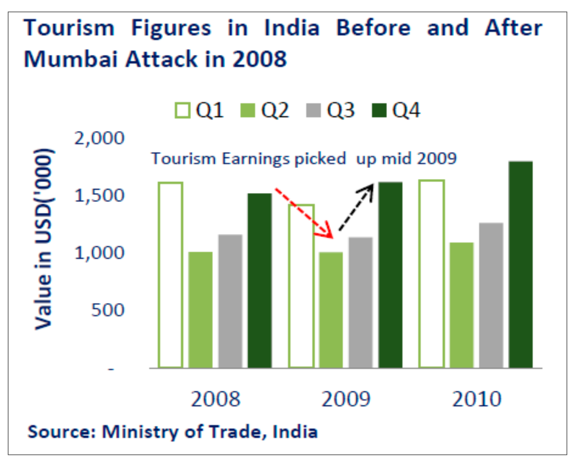
The program is coming to its end having fully achieved its objectives: Kenya's strong external position has increasingly supported the shilling; improved public debt sustainability has placed the government in a more comfortable position to access international capital markets; tax measures have raised the potential for revenue mobilization; public finance management reforms have supported the process of devolution to counties; the modernization of central bank monetary policy framework has helped keep inflation expectations in check despite adverse shocks; stronger supervisory powers for the central bank have contributed to consolidate financial stability; and opening capital markets to more competition has attracted capital inflows. Moreover, economic activity has picked up momentum, helped by the consolidation of Kenya as a regional hub, major strides in financial inclusion; a dynamic services sector with access to high-end technology, and higher investment from traditional and new partners, especially on oil and mining exploration.

A. Risks to the Outlook

11. Risks to the external outlook have risen somewhat, but Kenya's strong external position is providing welcome stability:

a. **The Westgate mall terrorist attack is expected to have an impact mostly on tourism, the insurance industry and large-scale supermarkets.** So far the foreign exchange market reaction has been muted. Stock prices declined only slightly to bounce back the following days. Capital inflows continued reflecting strong foreign investors' interest in Kenya's stock market and increased appetite for medium-term government securities. Tourism receipts were already subdued because of uncertainty surrounding the political transition and the protracted slowdown in Europe. Experts compare the attack with the one in Mumbai 2008, where tourism reversed after just three quarters.





b. A large deterioration in Kenya's terms of trade is expected this fiscal year. WEO projections, show a significant upward revision of oil price projections and a sharp downward revision of tea price projections. However, on the one hand, Kenya has a sound track record in macroeconomic management during periods of adverse terms of trade deterioration, and, on the other hand, external vulnerability may be less pressing than what the official balance of payments shows, in light of ongoing revisions to service receipts and foreign direct investment figures (See Appendix).

12. The main risks to Kenya's macroeconomic stability continue to be domestic. Renewed political uncertainty could hamper economic growth and deter investors and capital inflows. Moreover, higher-than-expected devolution costs and possible over-lapse of functions between the central and county levels of the government could reverse the recent gains in fiscal sustainability.

B. Fiscal Discipline and Devolution

13. Fiscal policy continues to aim at gradual consolidation, while providing sufficient resources for much-needed infrastructure investment and for the successful rollout of fiscal devolution. The authorities plan to stick to their fiscal consolidation path implying a net public debt ratio of about 40 percent in 2017/18 and a deficit of 3 percent meeting the fiscal convergence criteria of the East African Community (EAC) monetary union much earlier than 2024. The 2013–14 budget targets a primary deficit that would allow Kenya to resume the path toward a declining debt-to-GDP ratio. Revenue mobilization should benefit from both the implementation of the new-VAT law, and measures to enforce tax collection from sectors showing lower compliance and amendments to the legislation to broaden the tax base.

14. The devolution process has already started as mandated by the 2010 Constitution. A number of committees have been put in place to guide the process by establishing guidelines indicating how counties should manage the devolved powers at different stages. At the same time, its implementation has remained flexible, with some functions remaining in the central government to allow for counties to adapt to the new framework. PFM regulations are expected to be submitted to the National Assembly in December, and should be fully in place shortly after to enhance expenditure control under the new decentralized system. The introduction of the Treasury Single Account (TSA) is a high priority for which the government is in the process of recruiting a resident advisor.

Box 2. Recent Tax-Revenue Enhancing Measures

Kenya has introduced a number of measures in the current fiscal year to strengthen tax collection:

- The new VAT law will contribute to improve administrative efficiency by simplifying procedures. It is expected to raise ¼ percent of GDP in additional revenue in FY 2013/14.

- The Kenya Revenue Authority (KRA) has intensified the auditing of large tax payers following the phasing out of the VAT withholding regime. The large taxpayers' office (LTO) has collected the equivalent of additional 2 percent of GDP in the first quarter of FY 2013/14.

- Broadening coverage of excise taxes to include financial transaction and mobile-phone transfers and streamlining customs services is expected to yield 1/3 percent of GDP in FY 2013/14;

- The user-friendly taxpayer interface (integrated tax management system, itax) has been implemented in October 2013, and will be complemented by remote transmission of Electronic Tax Register (ETR) data in December 2013, enhancing information management.

- The KRA has adopted a new strategy to enforce compliance in declaring real estate-related income, including rental income.

- A number of legislative amendments to make the Excise, VAT and Income Tax legislation consistent with the new Constitution will help tax administration, for example by streamlining the entire Income Tax Exemption management process, amending the Income Tax Act so as to empower the Commissioner to access books of accounts when tax evasion is proved in Court, and collecting corporate tax from officers of corporate bodies when they are convicted of tax fraud. In addition, the Income Tax Act will be amended to broaden its base to include capital gains and earnings from gambling.

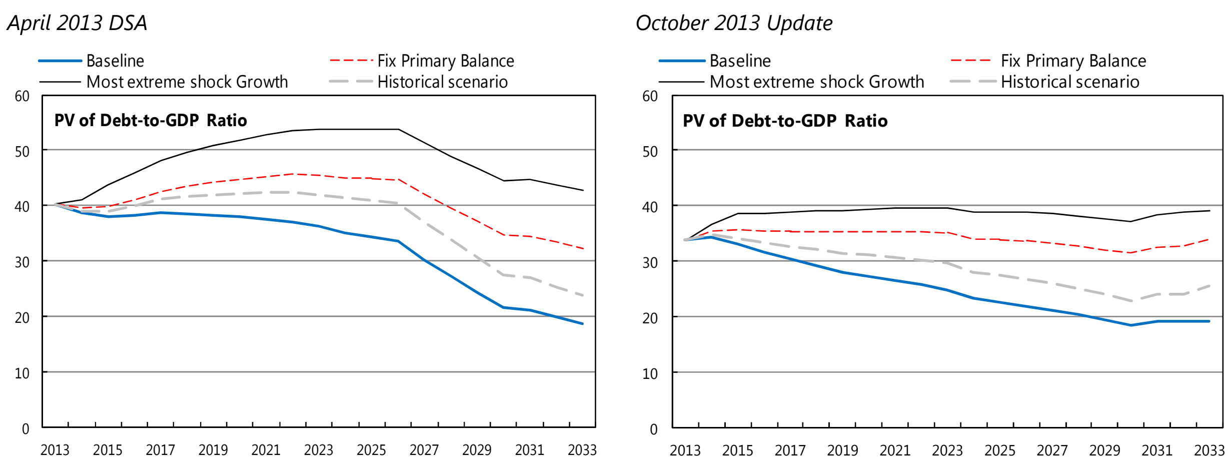
- A proposed Tax Appeals Tribunal Bill will establish a single tax appeals body. This measure will improve the dispute resolution framework, and instill professionalism and fast track conclusion of tax cases in compliance with the Constitution.

15. The Salaries and Remuneration Commission (SRC) is conducting a nationwide job evaluation to gradually move to a harmonized salary scales framework. The SRC's responsibilities are to set the salaries of elected and appointed civil servants (state officers), and to provide advice on civil servants' remunerations with the view to establish over time a harmonized salary scales framework both at the central and the county levels. The government is committed to be guided by the SRC's advice, and has set as a target ceiling of 7 percent of GDP for all general government wages in the medium term.[2]

[2] The current level of wage spending at the general government level is not known because an economic classification for general government level is not yet available.

16. The planned Eurobond issuance does not modify the favorable conclusions of the last Debt Sustainability Analysis (DSA) on Kenya's external and public debt position. A DSA update considering additional borrowing by US$500 million relative to the April 2013 DSA and the recent revision of the discount rate shows a more favorable debt profile.[3,4,5] Moreover, the World Bank recently has upgraded Kenya to "strong performer" in terms of quality of its policies and institutions (2012 CPIA) which increases the relative indicative threshold for external debt. The planned issuance amounts to US$ 1.5 billion, which would increase commercial lending by US$900 million as part of the proceeds would be used to repay maturing commercial obligations from a syndicated loan (US$600 million).

Figure 5. Kenya: Debt Profile Compared to Latest DSA



Sources: Kenyan authorities and IMF staff calculations.

C. Forward Looking Monetary and Financial Policies

17. The current monetary policy stance has helped to keep inflation expectations in check despite the short-term impact of higher VAT rates on consumer prices. Tight liquidity conditions have kept interbank interest rate above the CBR in recent weeks. The transition to a devolved government and to new organizational arrangements in line with the new constitution has also contributed to lower market liquidity at times, as government deposits at the CBK increased well above usual levels. These pressures are easing as the transfers of government functions to counties proceed, and counties adjust to the new institutional framework.

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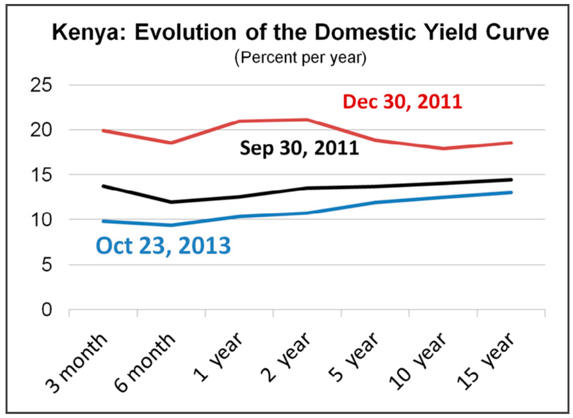
[3] A complete DSA update will be included in the next Article IV Report.

[4] The latest DSA assumed a US$ 1 billion Eurobond issue in FY2013/14.

[5] http://www.imf.org/external/np/sec/pr/2013/pr13408.htm

18. The CBK's forward-looking approach to monetary policy is paying off. Inflation expectations reflected in the yield curve remain consistent with the government's inflation target. The CBK and the Ministry of Finance are moving gradually to an inflation targeting framework. In that regard, the CBK has incorporated monetary policy analysis and forecasting among its key functions to support Monetary Policy Committee (MPC) decisions. Moreover, the prompt implementation of the Treasury Single Account will help reduce the reliance of Treasury on short-term central-bank financing, and it constitutes a further step towards inflation targeting.



19. The CBK intends to further accumulate international reserves. Capital inflows have continued as the participation of foreign investors in domestic bond markets has increased, attracted by high interest rates and a stable exchange rate. Currency risk hedging by large institutions prior to the elections has been unwinding in recent months, adding to the local foreign exchange supply. More active private equity investments and other long-term financing transactions also increase the supply of foreign exchange funds.

20. Banks are implementing CBK prudential guidelines in advance of the end-2014 deadlines. Systemically important banks are already moving to increase capital adequacy buffers in line with individual banks' risk profiles, and introducing contingency liquidity provisions into their planning. Banks are also increasing their provisioning in line with slightly higher non-performing loans that are expected to reverse as the economy recovery proceeds. However, progress with financial inclusion has continued with the creation of new instruments linking mobile-phone payments accounts with bank products. The CBK is introducing guidelines to facilitate consolidated supervision by specifying the features of cross-border non-operating holdings used by financial groups. Seven joint-inspections of financial groups are expected to take place by 2015 in coordination with other regional supervisors (forming "supervisory colleges"). On financial development, credit reference bureaus are now allowed to provide positive information of borrowers. The CBK is also introducing regulations specific to mobile-phone banking and other electronic financial transactions such as e-money, while enlarging CBK's oversight powers.

Box 3. Taking Steps Towards Inflation Targeting

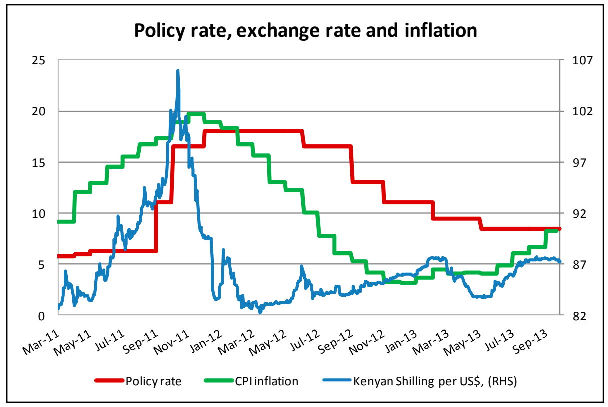
Over the last two years, the CBK has taken steps to a more forward-looking monetary framework moving gradually to an inflation targeting regime:

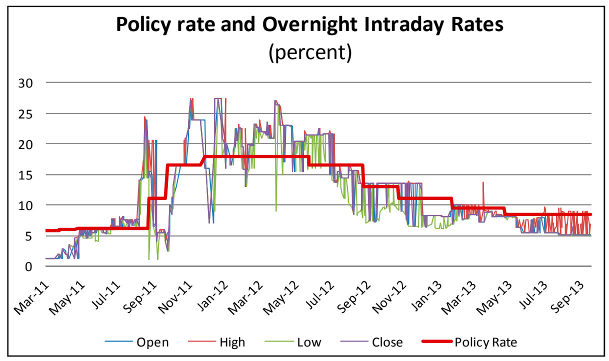
- In 2011, Kenya shifted its monetary policy framework at the outset of the ECF program from pure reserve money targeting to the use of an NDA ceilings and an NIR floors to support the accumulation of international reserves over the program period while maintaining monetary discipline.

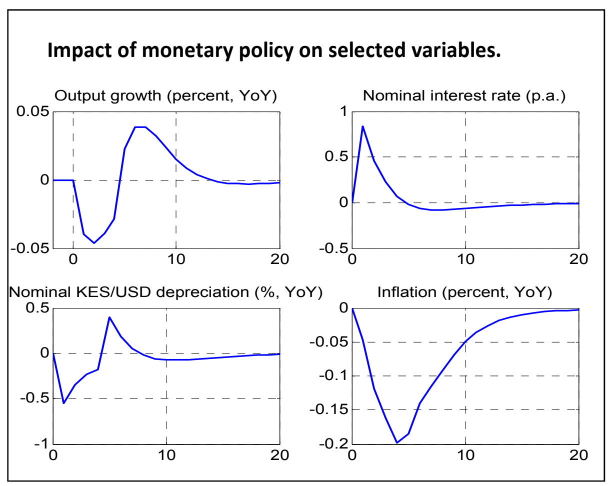
- In October 2011, the CBK introduced a new framework for monetary operations, centered on its policy rate (CBR) as a ceiling for repo and a floor for reverse repo operations.[1] At the same time, the CBK tightened monetary policy through consecutive increases in the CBR, successfully curbing inflation, exchange rate depreciation, and excessive credit growth.

- The CBK continued to supply liquidity to the market mainly through the purchase of foreign exchange and used open market operations in response to temporary liquidity excesses. Volatility in the interbank market and dispersion in money market interest rates have declined substantially.

- Recently, the CBK has created a Monetary Policy Analysis Unit within the CBK's Research Department to provide MPC with projections and analysis using an in-house forecasting and policy analysis system (FPAS), designed with technical assistance from IMF RES. This framework has already been used in the September 2013 MPC meeting to assess the impact of the current monetary policy stance on main economic variables (see bottom chart).



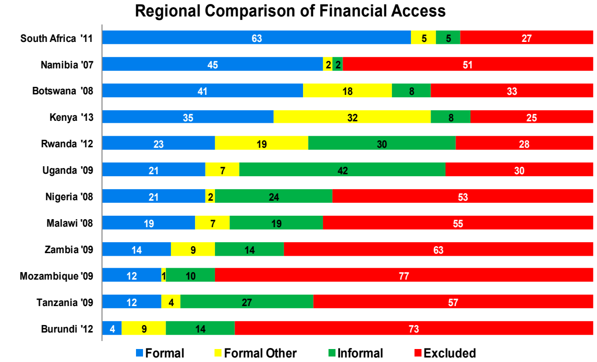




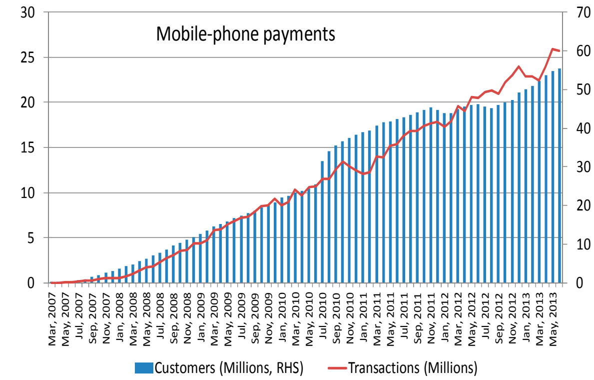
[1] Previously, the CBR was only used as a reference to set the interest rate on the CBK overnight lending facility.

Figure 6. Kenya: Financial Inclusion

Kenya shows the lowest share of population excluded from financial services…

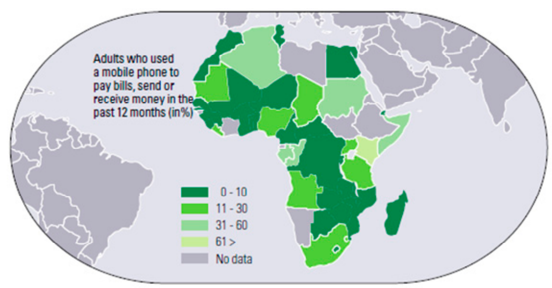


…to a large extent because of the success in making mobile-phone payments available to its population.



Kenya is a regional leader in use of mobile money use…

Map II.1: Mobile Money Users in Africa



Source: Demirgüç-Kunt and Klapper (2012).

..thanks to low transaction costs.

Table VII.1: Cost of a 200 USD Money Transfer (P2P)

Mobile payment		Cash to cash	
Provider	Cost (USD)	Provider	Cost (USD)
Celpaid (Cote d'Ivoire)	8	WARI (Senegal)	20
Airtel (Burkina Faso)	6	CMS (Senegal)	2
Inova (Burkina Faso)	6	ACEP (Senegal)	2
Societe Generale (Senegal)	10	Ecobank (Burkina Faso)	8
M-Pesa	1		
Orange Money (Senegal)	9		

Source: Central Bank of West African States (BCEAO).

PROGRAM ISSUES

21. The authorities expressed interest in a future program with the Fund. Discussions are expected to take place during the forthcoming Article IV consultation tentatively planned for March 2014.

22. A new Poverty Reduction Strategy Paper (PRSP) is circulated to the Executive Board. It updates Kenya's first Vision 2030 Medium-Term Plan 2008-2012. The Kenyan authorities have consented to the Fund's publication of this paper. A JSAN of the new PRSP would be issued to the Board in the coming months.

STAFF APPRAISAL

23. *Achievements*: Economic reforms have paid off. Kenya has now achieved the objectives set by its economic program supported by the ECF. The external and fiscal positions are stronger, inflation has been tamed, and the country's economic performance is less vulnerable to both external and domestic shocks. On the structural front, Kenya has made significant inroads with reforms of its: (a) expenditure and social protection systems; (b) tax system; (c) financial system; and (d) business regulatory framework. The country has laid the foundations to bring the economy to middle-income status within the next decade through sustained and more inclusive growth.

24. ***Challenges and risks*****:** Both domestic and external risks could pose hurdles to Kenya's quest toward emerging-market status. On the domestic front, an unsuccessful fiscal devolution could derail fiscal discipline and erode the recent success toward gradual consolidation leaving lower buffers to deal with adverse shocks. On the external front, while the global recovery has started, new vulnerabilities have surfaced in emerging markets that are now fast becoming key economic partners for Kenya. In this context, policies should, on the one hand, cement the improved macroeconomic conditions by preserving low-inflation, continuing to increase foreign reserves, and aiming at lowering gradually the public debt-to-GDP ratio, while raising infrastructure investment. On the other hand, the structural reform agenda should continue aiming at making Kenya's economy even more resilient by removing various remaining bottlenecks, from the regulatory framework to the functioning of ports and airports.

25. ***Fiscal Policy:*** The authorities have so far demonstrated a strong commitment to fiscal discipline, despite major spending pressures from both the transition to a new form of devolved government, and from high expectations of service delivery in the aftermath of the March elections. In particular, the new-VAT law has reduced the number of exemptions substantially, despite opposition from vested interests. Overall, the authorities' medium-term fiscal plans appear sufficiently ambitious, but still within reach, provided that devolution continues in an orderly manner without duplicating central government functions. It is encouraging that these plans do not incorporate the impact of revenue stemming from the recent discovery of commercially viable oil and mineral wealth. The improved quality of policies has placed Kenya in a good position to tap the international financial markets. Nevertheless the authorities should pay close attention to market conditions when issuing the planned Eurobond and make all possible efforts to provide timely and detailed information on economic conditions and policy plans.

26. ***Revenues:*** The efforts to close the tax-administration gaps that emerged in 2012/13 have already started to yield significant results, and need to continue. The now broader and much simplified VAT should not only further help tax administration, but also improve the business climate by facilitating tax refunds. It will be important to resist possible pressures to unduly broaden the, so far, short list of exemptions. Looking forward, the tax reform agenda should focus on customs and income taxes with the objective to remove distortions and facilitating private economic activity, while safeguarding revenue mobilization.

27. ***Expenditures:*** The improved public management system has allowed the authorities to identify and cut significant amount of non-priority spending. However, efforts should now focus on reining in the recent increases in the wage bill that could crowd out spending in much-needed infrastructure investment and social protection. To this purpose, it will be important that the authorities implement the recommendations of the SRC for harmonizing the pay scales within the existing resource envelope. The devolution process should lead to enhanced accountability, better delivery of services at the county level, and eventually bolster social cohesion and stability. To be successful, this process needs the prompt implementation of the PFM regulations and an operational TSA, both at the central and county levels of government. A fully-working TSA will not only help expenditure control, but also facilitate monetary policy that could be complicated by a proliferation of counties' accounts with commercial banks.

28. ***Monetary and exchange rate policies:*** Monetary policy has gained substantial credibility by delivering inflation within the authorities' target for twelve consecutive months. The CBK's cautious approach that tightened monetary conditions following the VAT-related rise in inflation in September should help maintain low inflation expectations. Looking forward, the CBK should not lower the CBR until inflation gets closer to the lower bound of its target range. The CBK has made significant strides in improving its analytical capacity to assess the impact of monetary policy on inflationary expectations, a key signpost in its plan to gradually move to a fully-fledged inflation targeting framework. The CBK should continue gradually accumulating foreign exchange reserves until they cover 4.5 months of projected imports, and thereafter intervene only occasionally to smooth out excessive exchange-rate volatility.

29. ***Statistical issues:*** As Kenya moves toward emerging-market status, investors are following more closely economic and financial policy developments to gauge how effective are government policies in establishing a consistent track record by addressing existing vulnerabilities. Reliable statistical information is essential for this purpose. There are two priorities areas. First, balance-of-payment statistics need to be reviewed to better reflect growing trade in services and record accurately capital flows, particularly those linked to the financing of direct investment. Second, government statistics should promptly shift to monitoring the position of the general government because devolution spending by counties constitutes a substantial component of fiscal policy.

30. ***Structural Policies:*** Strong policy ownership has allowed the authorities to respect all the structural benchmarks under the program. But, these reforms reflect only in part the wide structural agenda that is, by no means, exhausted. Looking forward, the review of the fiscal regime for the extractive and oil industry appears of particular importance given the new-found natural resource wealth. Moreover, the ongoing work to streamline the large number of existing parastatals and to better monitor their financial position would contribute to improving the fiscal position and to creating more scope for private economic activity.

31. ***Program performance:*** All June 2013 targets quantitative performance criteria were met. The structural benchmark and indicative targets for June 2013 were observed. The authorities' second PRSP has been circulated to the Executive Boards of the Fund and of the World Bank. Staff recommends completion of the sixth review of the ECF arrangement. The authorities have indicated interest in a successor program with the Fund.

Table 1. Kenya: Selected Economic Indicators, 2011/12–2016/17 [1]

	2011/12	2012/13		2013/14	2014/15	2015/16	2016/17
				Projections			
		5th Review	Estimate				
(Annual percentage change; unless otherwise indicated)							
National accounts and prices							
Nominal GDP (market prices, in billions of Kenya shillings)	3,244	3,728	3,661	4,167	4,774	5,434	6,130
Real GDP growth (market prices)	4.5	5.3	5.1	5.9	6.3	6.4	6.4
GDP deflator (average) [2]	10.9	8.9	7.4	7.5	7.8	7.0	6.0
Consumer price index (annual average) [2]	16.0	4.4	4.6	7.1	6.0	5.1	5.0
Consumer price index (end of period) [2]	10.0	5.0	4.9	6.8	5.5	5.0	5.0
Import volume growth, goods	11.7	9.5	10.5	5.1	9.1	8.6	9.0
Import value growth, goods	17.0	7.0	6.3	6.8	7.5	7.6	7.2
Export volume growth, goods	3.7	6.9	8.7	6.0	9.1	8.7	9.9
Export value growth, goods	7.1	5.3	3.2	-2.6	5.5	7.4	9.2
Terms of trade, goods, and services (Base year 2000)	-8.2	0.9	-3.4	-7.9	0.9	0.8	1.1
Ksh per US$ exchange rate (end of period)	82.9	…	85.8	4/			
Nominal effective exchange rate (- depreciation; end of period)	18.2	…	…	…	…	…	…
Real effective exchange rate (- depreciation; end of period)	12.4	…	…	…	…	…	…
Money and credit							
M3 (broad money and foreign currency deposits, end period)	15.5	16.8	14.2	17.0	…	…	…
Reserve money	16.7	14.9	11.7	17.5	…	…	…
(In percent of GDP; unless otherwise indicated)							
Investment and saving							
Investment	20.2	20.7	20.0	22.2	22.3	22.5	22.6
Central government	9.2	8.0	8.1	8.6	8.5	8.5	8.6
Other	11.0	12.7	11.9	13.6	13.8	14.0	14.1
Gross national saving	11.5	12.3	11.7	13.8	14.6	15.2	15.9
Central government	3.1	1.7	0.9	3.0	3.6	4.0	4.5
Other	8.3	10.6	10.8	10.9	11.0	11.2	11.3
Central government budget [3]							
Total revenue	23.1	24.5	23.1	24.7	24.7	24.8	24.9
Total expenditure and net lending	29.2	31.5	30.5	30.4	29.7	29.4	29.0
Overall balance (commitment basis) excluding grants	-6.2	-6.9	-7.4	-5.7	-5.0	-4.6	-4.1
Overall balance (commitment basis) including grants	-5.7	-4.9	-6.8	-4.8	-4.3	-3.9	-3.5
Primary budget balance	-2.2	-2.0	-3.0	-1.9	-1.6	-1.4	-1.1
Net domestic borrowing	2.0	4.4	4.6	1.6	3.3	2.6	2.2
Balance of payments							
Exports value, goods, and services	28.5	24.8	26.4	24.4	23.0	21.7	20.6
Imports value, goods, and services	44.9	41.5	42.5	40.2	37.8	35.9	34.3
Current external balance, including official transfers	-8.7	-8.4	-8.3	-8.4	-7.7	-7.3	-6.8
Current external balance, excluding official transfers	-8.7	-8.9	-8.4	-8.3	-7.7	-7.3	-6.7
Gross international reserve coverage							
In billions of U.S. dollars (end of period)	5.2	5.5	6.2	7.4	8.0	8.8	9.7
In months of next year imports (end of period)	3.4	3.4	3.8	4.2	4.2	4.3	4.4
Public debt							
Total public debt, net (percent of GDP)	44.6	43.7	45.9	45.1	43.7	42.3	41.7
Of which: external debt	23.4	20.8	22.4	22.9	21.0	19.8	19.6
Domestic debt, net of deposits	21.2	22.9	23.4	22.2	22.7	22.5	22.1

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year is from July 1st through June 30th.

[2] The consumer price index series was revised in November 2009 based on a new methodology.

[3] Revenue plus program grants minus recurrent expenditure.

[4] June 30, 2013.

Table 2. Kenya: Central Government Financial Operations 2011/12–2016/17[1]

	2011/12	2012/13		2013/14	2014/15	2015/16	2016/17
		Fifth Review	Estimate	Projections			
(In billions of Kenyan shillings, unless otherwise indicated)							
Revenues and grants	**763.5**	**990.8**	**868.2**	**1,066.9**	**1,212.6**	**1,384.7**	**1,567.7**
Revenue	**748.2**	**914.4**	**847.2**	**1,031.1**	**1,179.9**	**1,347.7**	**1,528.0**
Tax revenue	626.5	739.9	701.2	863.7	988.8	1,130.7	1,283.7
Income tax [2]	312.5	370.6	373.4	459.7	533.9	612.7	700.1
Import duty (net)	51.7	61.5	57.7	69.0	76.0	83.6	91.8
Excise duty	78.9	91.8	85.5	113.2	125.8	138.7	151.1
Value-added tax	183.4	216.0	184.6	221.8	253.1	295.7	340.8
Nontax revenue	121.7	174.5	146.0	167.4	191.2	217.0	244.3
Investment income	14.1	19.1	15.3	17.7	20.3	23.1	26.0
Other	50.2	65.6	63.0	68.9	78.9	89.8	101.3
LATF	16.4	20.2	18.1	0.0	0.0	0.0	0.0
Ministerial and Departmental Fees (AIA) [3]	41.0	69.6	49.7	67.3	77.1	87.7	99.0
Railway Levy	0.0	0.0	0.0	13.5	14.9	16.4	18.0
Grants	**15.3**	**76.4**	**21.0**	**35.8**	**32.7**	**37.0**	**39.7**
Project grants	15.3	56.5	15.1	25.0	22.0	25.0	27.3
Program grants	0.0	19.9	5.8	0.5	0.0	0.0	0.0
AMISON	0.0	0.0	0.0	10.3	10.7	12.0	12.4
Expenditure and net lending	**947.9**	**1,172.9**	**1,117.7**	**1,267.1**	**1,418.0**	**1,599.2**	**1,779.3**
Recurrent expenditure	**642.3**	**854.4**	**809.0**	**897.8**	**1,008.5**	**1,120.2**	**1,249.6**
Current transfer to counties	0.0	0.0	0.0	125.0	143.2	163.0	183.9
Interest payments	91.2	105.8	121.2	121.4	130.5	137.0	143.6
Domestic interest	82.3	94.5	110.2	110.2	113.2	115.9	118.4
Foreign interest due	8.9	11.3	11.1	11.2	17.3	21.1	25.2
Wages and benefits (civil service)	224.6	292.2	274.4	272.0	303.6	335.4	370.5
Civil service reform	0.0		0.0	0.0	0.0	0.0	0.0
Pensions, etc.	26.1	41.0	27.0	41.7	48.5	56.0	64.1
Other [3]	221.7	325.7	295.1	253.0	286.4	319.1	360.0
Defense and NSIS	78.7	89.7	91.2	84.7	96.4	109.7	127.6
Development and net lending	**300.7**	**300.7**	**298.9**	**359.3**	**409.5**	**468.6**	**529.7**
Capital transfer to counties	0.0	0.0	0.0	68.4	83.1	96.8	111.8
Domestically financed	211.9	207.2	201.8	171.0	211.6	246.5	284.4
Foreign financed	86.0	93.5	94.7	117.5	111.9	120.1	128.2
Net lending	2.8	2.5	2.4	2.4	3.0	5.2	5.2
Equalization Fund (grants to marginalized areas)	0.0	3.0	0.0	3.5	0.0	0.0	0.0
Contingencies	0.0	5.0	0.0	5.0	0.0	10.4	0.0
Drought expenditures	4.9	0.0	0.0	0.0	0.0	0.0	0.0
Constitutional Reform [4]	0.0	9.8	9.8	1.5	0.0	0.0	0.0
Balance (commitment basis, excluding grants)	**-199.7**	**-258.5**	**-270.5**	**-236.0**	**-238.0**	**-251.4**	**-251.3**
Balance (commitment basis, including grants)	**-184.4**	**-182.1**	**-249.6**	**-200.2**	**-205.3**	**-214.4**	**-211.6**
Adjustments to cash basis	**22.4**	**0.0**	**16.8**	**0.0**	**0.0**	**0.0**	**0.0**
Balance (cash basis, including grants)	**-162.0**	**-182.1**	**-232.8**	**-200.2**	**-205.3**	**-214.4**	**-211.6**
Financing	**162.0**	**182.1**	**232.5**	**200.2**	**205.3**	**214.4**	**211.6**
Net foreign financing	98.5	17.9	62.7	131.9	49.4	75.2	79.5
Disbursements	122.0	43.6	86.2	220.0	92.0	97.5	103.4
Project loans	70.7	37.0	79.6	92.5	92.0	97.5	103.4
Program loans	0.0		0.0	0.0	0.0	0.0	0.0
Commercial borrowing [5]	51.3	6.6	6.6	127.5	0.0	0.0	0.0
Repayments due	-25.4	-26.2	-24.0	-88.6	-43.1	-22.3	-23.8
Change in arrears	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling / debt swap	0.5	0.5	0.5	0.5	0.5	0.0	0.0
Net domestic financing	63.5	164.2	169.8	68.3	155.9	139.2	132.0
Memorandum items:							
Nominal GDP	3,244.5	3,728.3	3,661.4	4,167.4	4,774.1	5,433.7	6,129.9
Primary budget balance including grants	-70.8	-76.3	-111.5	-78.8	-74.9	-77.4	-68.0
Stock of domestic debt, net (end of period)	688.7	852.9	858.5	926.8	1,082.7	1,222.0	1,354.0
Total public debt, net of deposits	1,447.9	1,630.0	1,680.3	1,880.5	2,085.9	2,300.3	2,557.5

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

[2] Includes LATF from 2013/14.

[3] Coverage increased in FY 2010/11 to incorporate tuitions and fees to universities and hospitals, and associated expenditure.

[4] Includes estimated expenditures associated with the implementation of the new constitution.

[5] Includes planned sovereign bonds and proceeds from syndicated loan.

Table 2. Kenya: Central Government Financial Operations 2011/12–2016/17[1] (concluded)

	2011/12	2012/13		2013/14	2014/15	2015/16	2016/17
	Preliminary	5th Review	Estimate	Projections			
	(In percent of GDP)						
Revenues and grants	**23.5**	**26.6**	**23.7**	**25.6**	**25.4**	**25.5**	**25.6**
Revenue	**23.1**	**24.5**	**23.1**	**24.7**	**24.7**	**24.8**	**24.9**
Tax revenue	**19.3**	**19.8**	**19.2**	**20.7**	**20.7**	**20.8**	**20.9**
Income tax [2]	9.6	9.9	10.2	11.0	11.2	11.3	11.4
Import duty (net)	1.6	1.6	1.6	1.7	1.6	1.5	1.5
Excise duty	2.4	2.5	2.3	2.7	2.6	2.6	2.5
Value-added tax	5.7	5.8	5.0	5.3	5.3	5.4	5.6
Nontax revenue	**3.8**	**4.7**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**
Investment income	0.4	0.5	0.4	0.4	0.4	0.4	0.4
Other	1.5	1.8	1.7	1.7	1.7	1.7	1.7
LATF	0.5	0.5	0.5	0.0	0.0	0.0	0.0
Ministerial and Departmental Fees (AIA) [3]	1.3	1.9	1.4	1.6	1.6	1.6	1.6
Railway Levy	0.0	0.0	0.0	0.3	0.3	0.3	0.3
Grants	**0.5**	**2.0**	**0.6**	**0.9**	**0.7**	**0.7**	**0.6**
Project grants	0.5	1.5	0.4	0.6	0.5	0.5	0.4
Program grants	0.0	0.5	0.2	0.0	0.0	0.0	0.0
AMISON	0.0	0.0	0.0	0.2	0.2	0.2	0.2
Expenditure and net lending	**29.2**	**31.5**	**30.5**	**30.4**	**29.7**	**29.4**	**29.0**
Recurrent expenditure	**19.8**	**22.9**	**22.1**	**21.5**	**21.1**	**20.6**	**20.4**
Current transfer to counties	0.0	0.0	0.0	3.0	3.0	3.0	3.0
Interest payments	2.8	2.8	3.3	2.9	2.7	2.5	2.3
Domestic interest	2.5	2.5	3.0	2.6	2.4	2.1	1.9
Foreign interest due	0.3	0.3	0.3	0.3	0.4	0.4	0.4
Wages and benefits (civil service)	6.9	7.8	7.5	6.5	6.4	6.2	6.0
Civil service reform	0.0		0.0	0.0	0.0	0.0	0.0
Pensions, etc.	0.8	1.1	0.7	1.0	1.0	1.0	1.0
Other [3]	6.8	8.7	8.1	6.1	6.0	5.9	5.9
Defense and NSIS	2.4	2.4	2.5	2.0	2.0	2.0	2.1
Development and net lending	**9.3**	**8.1**	**8.2**	**8.6**	**8.6**	**8.6**	**8.6**
Capital transfer to counties	0.0	0.0	0.0	1.6	1.7	1.8	1.8
Domestically financed	6.5	5.6	5.5	4.1	4.4	4.5	4.6
Foreign financed	2.7	2.5	2.6	2.8	2.3	2.2	2.1
Net lending	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Equalization Fund (grants to marginalized areas)	**0.0**	**0.1**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**
Contingencies	**0.0**	**0.1**	**0.0**	**0.1**	**0.0**	**0.2**	**0.0**
Drought expenditures	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Constitutional Reform [4]	**0.0**	**0.3**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**
Balance (commitment basis, excluding grants)	**-6.2**	**-6.9**	**-7.4**	**-5.7**	**-5.0**	**-4.6**	**-4.1**
Balance (commitment basis, including grants)	**-5.7**	**-4.9**	**-6.8**	**-4.8**	**-4.3**	**-3.9**	**-3.5**
Adjustments to cash basis	**0.7**	**0.0**	**0.5**	**0.0**	**0.0**	**0.0**	**0.0**
Balance (cash basis, including grants)	**-5.0**	**-4.9**	**-6.4**	**-4.8**	**-4.3**	**-3.9**	**-3.5**
Financing	**5.0**	**4.9**	**6.3**	**4.8**	**4.3**	**3.9**	**3.5**
Net foreign financing	3.0	0.5	1.7	3.2	1.0	1.4	1.3
Disbursements	3.8	1.2	2.4	5.3	1.9	1.8	1.7
Project loans	2.2	1.0	2.2	2.2	1.9	1.8	1.7
Program loans	0.0		0.0	0.0	0.0	0.0	0.0
Commercial borrowing [5]	1.6	0.2	0.2	3.1	0.0	0.0	0.0
Repayments due	-0.8	-0.7	-0.7	-2.1	-0.9	-0.4	-0.4
Change in arrears	0.0		0.0	0.0	0.0	0.0	0.0
Rescheduling / debt swap	0.0		0.0	0.0	0.0	0.0	0.0
Net domestic financing	2.0	4.4	4.6	1.6	3.3	2.6	2.2
Memorandum items:							
Nominal GDP	3,244.5	3,728.3	3,661.4	4,167.4	4,774.1	5,433.7	6,129.9
Primary budget balance	-2.2	-2.0	-3.0	-1.9	-1.6	-1.4	-1.1
Stock of domestic debt, net (end of period)	21.2	22.9	23.4	22.2	22.7	22.5	22.1
Total public debt, net of deposits	44.6	43.7	45.9	45.1	43.7	42.3	41.7

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

[2] Includes LATF from 2013/14.

[3] Coverage increased in FY 2010/11 to incorporate tuitions and fees to universities and hospitals, and associated expenditure.

[4] Includes estimated expenditures associated with the implementation of the new constitution.

[5] Includes planned sovereign bonds and proceeds from syndicated loan.

Table 3. Kenya: Monetary Survey 2011–2014

	Jun-11	Dec-11	Jun-12	Dec-12	Jun-13	Dec-13	Jun-14
(In billions of Kenyan shillings, unless otherwise indicated)							
Central Bank of Kenya (CBK)							
Net foreign assets	282.8	258.7	330.5	364.1	402.1	425.8	485.1
(in millions of US dollars) [1]	3,147	3,041	3,923	4,234	4,854	5,136	5,852
Net domestic assets	-62.3	-3.7	-73.2	-70.5	-114.7	-81.8	-147.5
Net domestic credit	17.7	54.8	-24.7	-13.4	-62.5	-29.6	-95.3
Government (net)	-7.1	54.8	10.7	10.9	-20.9	10.0	-50.0
Commercial banks (net)	19.9	0.0	-35.4	-24.2	-41.7	-39.6	-47.8
Other items (net)	-80.0	-58.4	-48.5	-57.2	-52.2	-52.2	-52.2
Reserve money	220.4	255.0	257.3	293.6	287.4	344.0	337.6
Currency outside banks	119.0	137.0	126.9	147.8	148.0	168.2	163.6
Bank reserves	101.5	118.0	130.3	145.9	139.5	175.8	174.1
Banks							
Net foreign assets	-0.8	36.5	-8.7	-38.2	-40.9	-29.8	-29.8
(in millions of US dollars)	-9.3	429.3	-103.4	-443.6	-493.9	-360.0	-360.0
Reserves	101.5	118.0	130.3	145.9	139.5	175.8	174.1
Credit to CBK	-19.9	0.0	35.4	24.2	41.7	39.6	47.8
Net domestic assets	1,170.2	1,209.3	1,293.1	1,433.2	1,512.5	1,664.7	1,742.2
Net domestic credit	1,346.4	1,444.7	1,539.6	1,689.4	1,800.0	1,952.2	2,029.6
Government (net)	284.9	256.8	287.3	358.0	400.4	412.6	342.0
Other public sector	21.7	30.8	41.2	49.8	36.2	49.2	50.4
Private sector	1,039.7	1,157.1	1,211.1	1,281.6	1,363.4	1,490.4	1,637.3
Other items (net)	-176.2	-235.4	-246.4	-256.2	-287.5	-287.5	-287.5
Total deposits	1,251.0	1,363.8	1,450.1	1,565.1	1,652.7	1,850.3	1,934.2
Monetary survey							
Net foreign assets	281.9	295.2	321.8	326.0	361.2	395.9	455.3
(in millions of US dollars)	3,137.3	3,470.2	3,820.1	3,790.6	4,360.0	4,776.0	5,491.7
Net domestic assets	1,098.8	1,218.9	1,272.9	1,401.3	1,459.4	1,642.3	1,675.4
Net domestic credit	1,344.2	1,505.1	1,552.4	1,702.5	1,781.6	1,964.7	1,982.1
Government (net)	277.8	311.6	297.9	368.8	379.5	422.6	292.0
Other public sector	21.7	30.8	41.2	49.8	36.2	49.2	50.4
Private	1,044.7	1,162.7	1,213.2	1,283.9	1,365.9	1,492.9	1,639.8
Other items (net)	-245.4	-286.2	-279.5	-301.2	-322.2	-322.4	-306.7
M1	620.1	622.7	623.7	710.7	753.8	843.9	882.2
Money and quasi-money (M2)	1,183.9	1,254.0	1,339.1	1,469.0	1,547.6	1,732.6	1,811.2
M2 plus resident foreign currency deposits (M3)	1,380.7	1,514.2	1,594.7	1,727.3	1,820.6	2,038.2	2,130.7
M3 plus nonbank holdings of government debt (L)	1,720.6	1,876.1	1,970.1	2,129.5	2,277.4	2,549.6	2,665.2
Memorandum items (Annual percent change unless otherwise specified)							
M1	21.2	7.9	0.6	14.1	20.9	18.7	17.0
M2	14.5	14.1	13.1	17.2	15.6	17.9	17.0
M3	15.2	19.1	15.5	14.1	14.2	18.0	17.0
Deposits	15.1	20.0	15.9	14.8	14.0	18.2	17.0
Reserve money	4.8	14.5	16.7	15.1	11.7	17.1	17.5
Currency outside banks	17.4	11.4	6.7	7.9	16.6	13.8	10.5
Net domestic credit	23.7	26.7	15.5	13.1	14.8	15.4	11.3
Government (net)	0.0	12.2	7.2	18.4	27.4	14.6	-23.1
Private	30.7	30.9	16.1	10.4	12.6	16.3	20.0
Net domestic assets of the banking sector	19.6	21.7	15.8	15.0	14.7	17.2	14.8
NDA growth (as percent of the base period M3)	12.5	13.8	10.1	9.7	9.5	11.3	9.5
Multiplier (Average M3/RM)	6.1	6.2	6.1	6.1	6.2	6.2	6.2
Velocity (GDP/M2)	2.5	2.5	2.5	2.5	2.5	2.4	2.4

Sources: Kenyan authorities and IMF staff estimates and projections

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

Table 4. Kenya: Balance of Payments 2011/12–2016/17

	2011/12	2012/13		2013/14	2014/15	2015/16	2016/17
					Projections		
		5th Review	Estimate				
	(In millions of US dollars, unless otherwise indicated)						
Current account	**-3,343.2**	**-3,696.5**	**-3,568.0**	**-4,101.7**	**-4,336.2**	**-4,675.4**	**-4,871.2**
Excluding official transfers	-3,320.5	-3,906.5	-3,611.0	-4,082.5	-4,311.1	-4,650.3	-4,846.1
Exports, f.o.b.	5,960.9	6,251.1	6,152.8	5,994.7	6,322.3	6,788.6	7,415.2
Coffee	263.0	277.2	217.6	225.2	225.5	251.1	278.2
Tea	1,138.2	1,347.2	1,291.0	1,049.3	1,012.9	1,054.4	1,157.1
Horticulture	647.9	725.5	731.8	755.7	795.4	838.5	909.8
Imports, f.o.b	-14,903.0	-15,833.0	-15,840.9	-16,913.3	-18,180.5	-19,554.3	-20,952.5
Oil	-4,192.3	-4,126.9	-3,954.4	-4,362.0	-4,531.2	-4,591.4	-4,619.3
Other Private	-10,398.5	-11,515.1	-11,770.4	-12,212.3	-13,291.4	-14,592.4	-15,926.7
of which: Capital Imports[1]	-3,116.8	-4,209.4	-3,679.7	-4,398.1	-4,910.7	-5,526.7	-6,255.9
Balance on goods	-8,942.2	-9,581.9	-9,688.1	-10,918.5	-11,858.3	-12,765.7	-13,537.3
Balance on services [2]	2,651.4	2,246.7	2,782.1	3,174.4	3,512.2	3,656.1	3,683.4
of which: foreign travel credit[3]	970.7	832.8	860.9	909.5	1,064.0	1,139.1	1,220.2
Balance on goods and services	-6,290.8	-7,335.2	-6,906.1	-7,744.1	-8,346.1	-9,109.6	-9,853.9
Income (net)	-144.9	-258.4	-212.8	-214.0	-178.4	-103.4	144.2
Current transfers (net)	3,092.5	3,897.2	3,550.8	3,856.4	4,188.2	4,537.6	4,838.5
Private (net)	3,115.1	3,687.1	3,507.9	3,875.7	4,213.3	4,562.7	4,863.6
of which: remittances	1,658.1	2,130.8	2,086.0	2,409.5	2,656.6	2,910.8	3,118.2
Capital and financial account	4,150.4	3,788.6	4,339.6	5,246.7	5,006.7	5,570.3	5,911.8
Capital account (incl. capital transfers)	173.4	654.0	176.0	291.1	255.8	285.8	311.5
Financial account [4]	3,977.0	3,134.7	4,163.6	4,955.6	4,750.9	5,284.6	5,600.3
Net FDI	830.0	1,382.6	993.9	1,233.6	1,424.2	1,641.9	1,868.0
In Kenya	855.7	1,422.3	1,046.7	1,272.8	1,459.7	1,680.4	1,905.7
Abroad	-25.7	-39.8	-52.8	-39.2	-35.5	-38.4	-37.7
Net other investment	2,186.4	1,756.2	2,707.8	3,726.2	3,328.0	3,642.8	3,730.8
Official, medium and long term	1,128.8	204.3	725.0	1,525.9	765.3	746.6	800.7
Inflows	1,416.9	508.5	1,004.5	2,545.4	1,180.2	1,094.7	1,172.2
Project loans	807.0	431.8	927.3	1,077.0	996.2	923.6	965.6
Commercial loans [5]	609.8	76.7	77.1	1,468.4	80.1	168.3	189.5
Outflows	-288.1	-304.2	-279.5	-1,019.5	-414.9	-348.1	-371.5
Private, medium and long term	690.7	72.7	1,426.3	1,179.5	1,313.3	1,340.2	1,238.0
Energy financing	60.0	70.4	87.9	111.6	121.0	131.2	144.4
Kenya Airways	17.8	97.3	97.3	214.9	296.7	268.6	106.2
Other	612.9	-95.0	1,241.1	853.0	895.7	940.5	987.5
Short-term capital	366.9	1,479.2	556.5	1,020.8	1,249.4	1,556.0	1,692.1
of which: public net (includes trade credit)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
private net	366.9	1,479.2	556.5	1,020.8	1,249.4	1,556.0	1,692.1
of which: commercial banks	94.1	-55.6	368.5	-128.7	398.2	528.4	-3.8
Errors and omissions	974.2	0.0	469.3	0.0	0.0	0.0	0.0
Overall balance	807.2	92.2	771.6	1,145.0	670.5	894.9	1,040.7
Financing items	-807.2	-92.2	-771.6	-1,145.0	-670.5	-894.9	-1,040.7
Reserve assets (gross)	-1,120.9	-280.6	-980.6	-1,200.0	-600.0	-800.0	-900.0
Use of Fund credit and loans to the Fund (net)	307.8	182.6	203.1	49.1	-76.4	-94.9	-140.7
Disbursements	319.7	225.3	225.3	111.4	0.0	0.0	0.0
Repayments	-11.9	-42.7	-22.1	-62.3	-76.4	-94.9	-140.7
Rescheduling /debt swap	5.9	5.9	5.9	5.9	5.9	0.0	0.0
Memorandum items:							
Gross official reserves (end of period)	5,241.4	5,522.0	6,222.0	7,422.0	8,022.0	8,822.0	9,722.0
(in months of following year's imports of goods and services)	3.4	3.4	3.8	4.2	4.2	4.3	4.4
(excluding capital imports)	4.3	4.5	4.9	5.5	5.5	5.7	6.0
Current account balance (excluding official transfers, percent of GDP)	-8.7	-8.9	-8.4	-8.3	-7.7	-7.3	-6.7
(excluding all capital imports, i.e. energy, airplane related one-	1.2	2.7	2.7	2.4	2.9	3.0	3.4
Import volume growth, goods and services (percent)	10.0	9.0	10.8	6.1	9.7	9.1	9.4
Import value growth, goods and services (percent)	16.2	6.6	6.5	7.6	7.9	8.0	7.6
Export volume growth, goods and services (percent)	8.4	4.6	9.3	12.0	11.7	8.6	8.1
Export value growth, goods and services (percent)	12.9	3.2	4.6	4.9	8.0	7.3	7.3
Change in the terms of trade (goods and services, percent) [6]	-8.2	0.9	-3.4	-7.9	0.9	0.8	1.1

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Excludes power generation related machinary and airplanes but includes oil-exploration related machinery and equipment.

[2] Service receipts were revised retroactively upwards in September 2013 to account for 90 percent of classified receipts as reported by commercial banks.

[3] The foreign travel credit comprise two components, recorded tourism inflows and an estimate of additional under-reported tourism receipts.

[4] Historical figures include errors and omissions.

[5] 2012 includes the $600 million syndicated loan.

[6] Base year: 2000.

Table 5. Kenya: Financial Soundness Indicators of the Banking Sector 2010–2013

	Dec-10	Jun-11	Dec-11	Jun-12	Dec-12	Jun-13
	(Percent)					
Capital adequacy						
Regulatory capital to risk-weighted assets	20.8	19.0	19.4	20.3	21.9	23.3
Regulatory tier 1 capital to risk-weighted assets	18.7	16.9	17.3	17.7	18.9	20.5
Total capital to total assets	13.2	12.8	13.2	15.3	16.3	17.1
Asset quality						
Non performing loans to total gross loans	6.2	5.4	4.4	4.5	4.5	5.3
Non performing loans net of provisions to capital	6.4	5.8	3.5	3.6	3.5	6.2
Earning assets to total assets	88.8	89.5	87.8	87.7	87.4	88.7
Earning and profitability						
Return on assets (ROA)	3.7	3.3	3.3	3.8	3.8	3.9
Return on equity (ROE)	30.7	30.8	32.2	33.7	34.2	31.2
Interest margin to gross income	34.7	40.9	38.6	31.5	32.7	36.6
Non interest expenses to gross income	48.2	48.2	44.6	36.2	37.8	40.7
Liquidity						
Liquid assets to total assets	38.4	34.9	33.3	34.2	35.2	35.3
Liquid assets to short-term liabilities	44.5	38.9	37.0	38.1	41.9	42.7
Liquid assets to total deposits	51.0	46.3	43.8	45.0	46.8	47.5
Total loans to total deposits	72.5	76.6	77.4	77.2	76.9	77.8
Sensitivity to market risk						
Net open position in foreign exchange to capital	4.3	4.6	3.3	3.4	2.6	2.7
Interest bearing assets to interest bearing liabilities	117.8	117.9	115.4	115.3	116.2	119.3
FX currency denominated assets to total assets	10.6	12.4	11.8	12.8	13.2	12.1
FX currency denominated liabilities to total liabilities	17.1	18.2	21.5	22.3	20.9	21.3
Spread between lending and deposit rate	9.3	8.8	8.4	9.9	10.3	9.4

Source: Central Bank of Kenya.

Table 6. Kenya: Performance Criteria for the Sixth Review under the 2011/14 ECF Arrangement
(In billions of Kenyan shillings; unless otherwise indicated)

	2012			2013					
	Performance Criteria			Indicative Targets			Performance Criteria		
	End-Dec.			End-March			End-June		
	Program	Actual	met/not met	Program	Actual	met/not met	Program	Actual	met/not met
Quantitative performance criteria									
Fiscal targets									
Primary budget balance of the central government (-=deficit, floor) [1,2]	-64.0	-60.7	met	-62.0	-39.3	met	-40.0	-31.9	met
Monetary targets [3,4]									
Stock of central bank net international reserves (floor, in millions of US$) [5,6]	4,460	4,530	met	4150	4238	met	4,250	4,919	met
Stock of net domestic assets of the central bank (ceiling)	-50	-81	met	-40	-46.6	met	-35	-79.3	met
Public debt targets									
Contracting or guaranteeing of medium- and long-term nonconcessional by the central government (ceiling; millions of US$) [7,8]	1,500	1,130	met	1,500	1,200	met	2,500	1,170	met
New central government and central government guaranteed external payment arrears (ceiling, millions of US$) [9]	0	2.47	not met	0	0	met	0	0	met
Indicative targets									
Priority Social Expenditures of the central government(floor) [2]	15.0	11.9	not met	21.0	26.8	met	28.3	33.8	met

[1] The primary budget balance of the central government is defined as overall balance including grants, minus concessional project loans, plus interest payments.
[2] Targets for end-September 2012,end-December 2012, end-March 2013, and end-June 2013 are cumulative flow from July 1, 2012 (beginning of the 2012/13 fiscal year).
[3] For program monitoring, the daily average for the month when testing dates are due.
[4] The NIR floor will be adjusted upward (downward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative to the programmed amounts. The NDA ceiling will be adjusted downward (upward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative to the programmed amounts.
[5] Excludes encumbered reserves.
[6] First review targets at September 1, 2010 exchange rates. Second review targets at April 29, 2011 exchange rate.
[7] Cumulative flow of contracted debt, from January 1, 2011.
[8] The targets on the ceiling of non-concessional external debt combine nonconcessional project loans, syndicated loan and sovereign bond.
[9] Continuous.

Table 7. Kenya: Structural Benchmarks for the ECF Arrangement

Item	Measure	Time Frame	Status
Tax measures			
	Submit Value Added Tax (VAT) legislation to help improve administration and compliance. *<u>Macro criticality</u>: The VAT reform will allow for higher mobilization of revenue which will reduce the fiscal imbalance.*	Second Review	Completed.
	VAT Audits of the 50 largest taxpayers. *<u>Macro criticality</u>: Restore compliance with VAT by large taxpayers following the phasing out of withholding requirements.*	Sixth Review	Completed.
Expenditure control			
	Submit Public Finance Management legislation to the Commission of Implementation of the Constitution, to help accelerate reforms in public financial management. *<u>Macro criticality</u>: PFM management legislation is crucial for increasing both spending efficiency and improving the fiscal management.*	Third Review	Completed.
	Adopt a Single Treasury Account to strengthen cash management and improve resource management. *<u>Macro criticality</u>: Single Treasury Account (STA) adoption will improve both liquidity management and expenditure control.*	Fourth Review	Completed.
Banking supervision			
	Amend the Banking Act to reinforce prompt corrective action by the banking supervision authority. *<u>Macro criticality</u>: Reinforcing the banking supervision authority is crucial to reducing the risk of macroeconomic instability.*	First Review	Completed.
Capital markets			
	Introduce legislation to allow the demutualization of the Nairobi Stock Exchange, to remove the conflict of interest from the governing body of the exchange and to strengthen capital markets. *<u>Macro criticality</u>: Demutualization of the Nairobi Stock Exchange is essential for the both development of deeper financial markets that will enhance financial stability, and attracting capital inflows to reduce the balance of payments financing need.*	First Review	Completed.

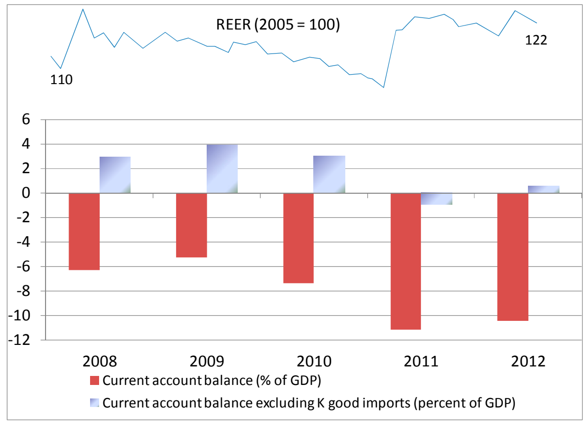
Table 8. Kenya: Timing of Disbursements and Reviews Under the 2011–14 ECF Arrangement

		Original ECF disbursement		ECF augmentation		Total disbursement	
Date of Availability	Conditions for Fund Disbursement	Millions of SDRs	Percent of quota [1]	Millions of SDRs	Percent of quota	Millions of SDRs	Percent of quota
January 31, 2011	Board approval of the arrangement	65.136	24.00	-	-	65.14	24.00
June 29, 2011	Observance of the end-March 2011 performance criteria and structural benchmarks, and completion of first review	43.424	16.00	-	-	43.42	16.00
December 9, 2011	Observance of the end-June 2011 performance criteria and structural benchmarks, and completion of second review	43.424	16.00	48.852	18.00	92.276	34.00
April 17, 2012	Observance of the end-December 2011 performance criteria and structural benchmarks, and completion of third review	43.424	16.00	28.497	10.50	71.921	26.50
October 24, 2012	Observance of the end-June 2012 performance criteria and structural benchmarks, and completion of fourth review	43.424	16.00	28.497	10.50	71.921	26.50
April 16, 2013	Observance of the end-December 2012 performance criteria and structural benchmarks, and completion of fifth review	43.424	16.00	28.497	10.50	71.921	26.50
December xx, 2013	Observance of the end-June 2013 performance criteria and structural benchmark, and completion of the sixth review	43.424	16.00	28.497	10.50	71.921	26.50
Total		**325.680**	**120.00**	**162.840**	**60.00**	**488.520**	**180.00**

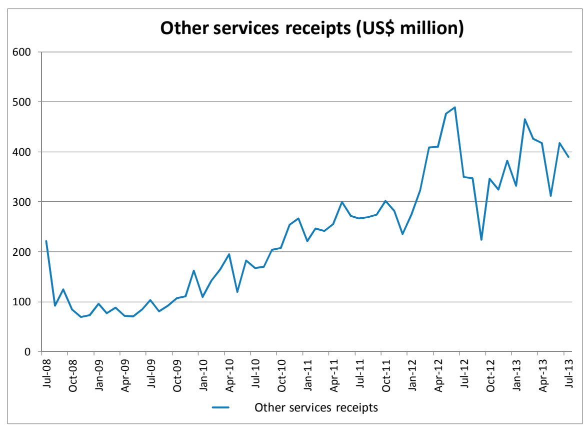
[1] Kenya's quota is SDR 271.4 million.

Appendix I. Kenya's Exchange Rate-Current Account Puzzle

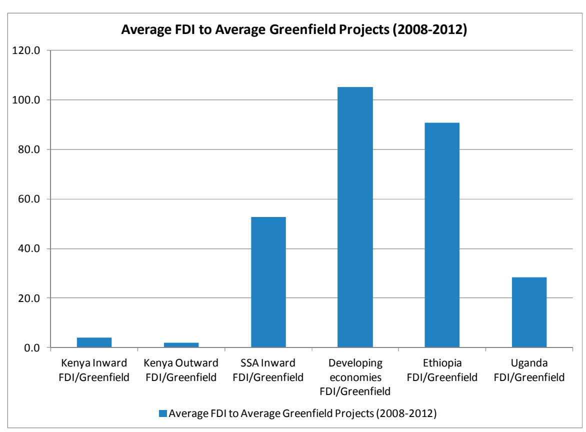
- **Kenya's current account deficit, at more than 10 percent of GDP in the last two years, seems at odds with observed 5-10 percent REER appreciation.** The rise of capital-good imports associated with higher investment is part of the explanation. In fact, the external current account excluding capital-good imports would be in surplus. However, ongoing upgrades in Balance-of-Payments statistics by the Kenya Bureau of National Statistics (KNBS) suggest that other factors may overstate the current account deficit and understate the share of long-term inflows in its financing.



- **Part of "unclassified" services reported by commercial banks are excluded from current account receipts because of possible inappropriate classification by commercial banks**. These "Unclassified" services quadrupled in the last four years, and at least to some extent includes new service categories that are not classified in the current framework. Part of this figure may reflect unreported remittances, but remaining "unclassified" items are still substantial and should not be treated as short-term capital inflows.



- **Also, foreign direct investment (FDI) appears to have been substantially underreported.** A survey conducted by the KNBS in 2010 found that FDI underreporting was higher than 50 percent. This is confirmed by UNCTAD information: The ratio of official FDI to Greenfield projects does not even reach 5 percent in Kenya, compared to 55 percent for SSA countries to 100 percent for all developing economies.



- **Re-estimating the main balance of payments' components, by applying a conservative adjustment to service receipts and FDI, results in a significantly lower current account deficit and a larger share of its long-term financing (see chart below).** To keep this illustrative re-estimation balanced, we also introduce corrections to other items that are clearly understated, such as Kenya's investment abroad and portfolio inflows, and to remittances (deducting its adjustment from the adjustment in service receipts). This exercise shows that the external current account net of long-term financing may be close to balance, and that the share of BoP long-term financing is quite significant.

Kenya Actual and Adjusted BoP

Sources: KNBS, CBK, and IMF staff calculations.

Appendix II. Letter of Intent

Nairobi, Kenya

November 15 , 2013

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

Dear Ms. Lagarde:

1. Our performance under the program supported under the Extended Credit Facility (ECF) has remained strong. We met all the end-June 2013 performance criteria and indicative targets (Table 1) and structural benchmarks (Table 2). This letter details the achievements under the government's economic program, and provides an update on our economic policies looking forward.

2. The ECF-supported program has played an important role in ensuring macroeconomic stability following external and domestic shocks, such as the severe drought in the horn of Africa in combination with high international food and oil prices in 2011, and stagnating demand in our traditional export markets. Relatively robust growth mainly driven by domestic demand during the program has helped to restore fiscal and external sustainability and facilitated structural reforms. After staying within the target range for 12 consecutive months, inflation picked up recently reflecting the one-off impact of removing VAT exemptions in September. We remain committed to low and stable prices and we expect inflation to fall back within target range by early 2014.

3. We will continue to maintain fiscal discipline while pursuing our long-term development strategy as outlined in the Second Medium-Term Plan of Vision 2030. The 2013–14 budget targets a lower primary deficit that would allow a decline in the government debt-to-GDP ratio, further enhancing debt sustainability. We recognize that the recent revenue shortfalls resulting from gaps in VAT administration for large tax payers have placed constraints on pro-poor and pro-growth spending. The recently enacted new VAT law will contribute to administrative efficiency and revenue mobilization for priority outlays. In addition, we have intensified the auditing of large tax payers, broadened coverage of excise taxes and streamlined customs services. In fact there are already signs that point to stronger collections so far in 2013/14. A user-friendly taxpayer interface (integrated tax management system, *itax*) will be fully rolled out and the project to implement remote transmission of Electronic Tax Register (ETR) data will commence by year end. Amendments to the Income Tax Act to broaden its base to capital gains and intensify efforts to collect rental income tax should translate into better revenue mobilization.

4. Recent discoveries of oil and other mineral resources, if well-managed in a transparent manner, should significantly enhance the country's long-term growth prospects. We are revamping our fiscal regime framework to bring it in line with best international practice and maximize potential benefits from natural resource wealth, based on the technical assistance received from the IMF.

5. We have started devolving government functions to the newly established 47 counties. We are on track in implementing the regulations of the new PFM law that will ensure strict expenditure management and control. In addition, we have started broadening the coverage of IFMIS to the county level. This, together with the adoption of program based budgeting, should support our efforts to lower non-priority spending. To ensure an orderly transition to devolved government, we are prioritizing the implementation of the Treasury Single Account at both national and county levels that would benefit from our development partners' technical assistance.

6. The Salaries and Remuneration Commission (SRC) is already working to contain pressures on the wage bill while ensuring transparency and fairness for public service employees. Following the determination of wages and benefits for State Officers as mandated by our Constitution, the SRC plans to finalize its recommendations for the civil service as a whole by June 2014. The SRC work will help rationalize the salary scheme for all levels of government in line with the PFM law and limit the scope for ad hoc wage increases.

7. Our borrowing plans will remain anchored in our medium term debt management strategy which is built on ensuring public debt sustainability. We will shortly issue a sovereign bond to benchmark Kenya on the International Capital Markets, repay the syndicated loan we contracted in May 2012, and, reduce reliance on domestic financing.

8. Our monetary policy has succeeded in stabilizing expectations of inflation at targeted levels. The Central Bank (CBK) has been using its monetary operations framework to keep money market rates consistent with its policy rate. We recognize the importance of CBK—National Treasury coordination in facilitating the transmission of policy rate decisions to money market rates. This is consistent with our ongoing gradual move towards a fully-fledged inflation targeting framework. We will continue to gradually increase our international reserves coverage—in line with our import coverage target—and intervene only to smooth excessive volatility in the foreign exchange market.

9. Kenya's financial sector maintains its dynamism helped by growing market confidence and financial inclusion. Banking supervision will however remain vigilant of changes in the quality of loan portfolio to the extent that they could become a source of systemic risk. In addition, the new prudential guidelines introduced in 2012 are helping improve risk-management practices by financial institutions. Commercial banks are expanding their presence in the continent. To limit cross-border risks from systemically important financial groups, the CBK plans to further develop joint supervision with the relevant regulators in the region. We are enacting new regulations expanding the scope of Credit Reference Bureaus to include deposit-taking micro-finance institutions and share positive information on borrowers with the aim of enhancing financial access.

The introduction of the Real Estate Investment Trusts (REITs) in 2013 will help deepen financial markets.

10. The ECF-supported program has achieved its objectives. Therefore, we request completion of the sixth review and the disbursement of its last tranche, based on overall performance and the government's policy intentions going forward. We consent to the publication, including on the IMF website, of this letter of intent and the accompanying staff report.

11. Kenya has significantly reduced its vulnerabilities, but it remains exposed to major external shocks. The government intends to continue implementing its reform agenda with the support of the IMF to ensure orderly devolution and fiscal sustainability, support financial sector development, and promote inclusive growth. Looking forward, we wish to start discussions on a possible successor arrangement in the coming months.

12. We will continue to consult with the IMF on the implementation of the program. The government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the policies and achieving the objectives of the program.

Sincerely yours

/s/	/s/
Henry Rotich	Njuguna Ndung'u
Cabinet Secretary	Governor
The National Treasury	Central Bank of Kenya

Attachments:

Table 1. Kenya: Performance Criteria for the Sixth Review under the 2011/14 ECF Arrangement.

Table 2. Kenya: Structural Benchmarks for the ECF Arrangement.

Table 1. Kenya: Performance Criteria for the Sixth Review under the 2011/14 ECF Arrangement

(In billions of Kenyan shillings; unless otherwise indicated)

	2012			2013					
	Performance Criteria			Indicative Targets			Performance Criteria		
	End-Dec.			End-March			End-June		
	Program	Actual	met/not met	Program	Actual	met/not met	Program	Actual	met/not met
Quantitative performance criteria									
Fiscal targets									
Primary budget balance of the central government (-=deficit, floor) [1,2]	-64.0	-60.7	met	-62.0	-39.3	met	-40.0	-31.9	met
Monetary targets [3,4]									
Stock of central bank net international reserves (floor, in millions of US$) [5,6]	4,460	4,530	met	4150	4238	met	4,250	4,919	met
Stock of net domestic assets of the central bank (ceiling)	-50	-81	met	-40	-46.6	met	-35	-79.3	met
Public debt targets									
Contracting or guaranteeing of medium- and long-term nonconcessional by the central government (ceiling; millions of US$) [7,8]	1,500	1,130	met	1,500	1,200	met	2,500	1,170	met
New central government and central government guaranteed external payment arrears (ceiling, millions of US$) [9]	0	2.47	not met	0	0	met	0	0	met
Indicative targets									
Priority Social Expenditures of the central government(floor) [2]	15.0	11.9	not met	21.0	n.a.	n.a.	28.3	33.8	met

[1] The primary budget balance of the central government is defined as overall balance including grants, minus concessional project loans, plus interest payments.

[2] Targets for end-September 2012,end-December 2012, end-March 2013, and end-June 2013 are cumulative flow from July 1, 2012 (beginning of the 2012/13 fiscal year).

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

[4] The NIR floor will be adjusted upward (downward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative to the programmed amounts. The NDA ceiling will be adjusted downward (upward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative to the programmed amounts.

[5] Excludes encumbered reserves.

[6] First review targets at September 1, 2010 exchange rates. Second review targets at April 29, 2011 exchange rate.

[7] Cumulative flow of contracted debt, from January 1, 2011.

[8] The targets on the ceiling of non-concessional external debt combine nonconcessional project loans, syndicated loan and sovereign bond.

[9] Continuous.

Table 2. Kenya: Structural Benchmarks for the ECF Arrangement

Item Measure	Time Frame	Status
Tax measures		
Submit Value Added Tax (VAT) legislation to help improve administration and compliance.	Second Review	Completed.
<u>Macro criticality</u>: The VAT reform will allow for higher mobilization of revenue which will reduce the fiscal imbalance.		
VAT Audits of the 50 largest taxpayers.		Completed.
<u>Macro criticality</u>: Restore compliance with VAT by large taxpayers following the phasing out of withholding requirements.	Sixth Review	
Expenditure control		
Submit Public Finance Management legislation to the Commission of Implementation of the Constitution, to help accelerate reforms in public financial management.	Third Review	Completed.
<u>Macro criticality</u>: PFM management legislation is crucial for increasing both spending efficiency and improving the fiscal management.		
Adopt a Single Treasury Account to strengthen cash management and improve resource management.	Fourth Review	Completed.
<u>Macro criticality</u>: Single Treasury Account (STA) adoption will improve both liquidity management and expenditure control.		
Banking supervision		
Amend the Banking Act to reinforce prompt corrective action by the banking supervision authority.	First Review	Completed.
<u>Macro criticality</u>: Reinforcing the banking supervision authority is crucial to reducing the risk of macroeconomic instability.		
Capital markets		
Introduce legislation to allow the demutualization of the Nairobi Stock Exchange, to remove the conflict of interest from the governing body of the exchange and to strengthen capital markets.	First Review	Completed.
<u>Macro criticality</u>: Demutualization of the Nairobi Stock Exchange is essential for the both development of deeper financial markets that will enhance financial stability, and attracting capital inflows to reduce the balance of payments financing need.		

INTERNATIONAL MONETARY FUND

COM COMMUNICATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
December 2, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth and Final Review Under the ECF Arrangement for Kenya and Approves US$110.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Kenya's economic program supported by a three-year arrangement under the Extended Credit Facility (ECF). The completion of the review enables the immediate disbursement of an amount equivalent to SDR 71.921 million (about US$110.2 million), which will bring total disbursements to the full arrangement amount of SDR 488.52 million (about US$748.4 million). .

The Executive Board approved the Extended Credit Facility program for Kenya on January 31, 2011 (See Press release No. 11/22), which was augmented on December 9, 2011, for a total of SDR 488.52 million (180 percent of quota).

At the conclusion of the discussion on Kenya, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair issued the following statement:

"Kenya's macroeconomic conditions have continued to improve in the wake of far-reaching reforms supported by the Fund's Extended Credit Facility. The external and fiscal positions are now stronger, high inflation has been tamed, and the economy's resilience to shocks has been boosted. Improved policies have placed Kenya in a good position to tap the international financial markets. Strong domestic activity is expected in 2013/14.

"The authorities have demonstrated a strong commitment to fiscal discipline. Provided that devolution proceeds in an orderly manner, their medium-term fiscal plans give assurance that prudent policymaking will continue in the period ahead.

"The Central Bank of Kenya has gained credibility by maintaining inflation within its target for twelve consecutive months. A tighter monetary stance following the VAT-related spike in headline inflation in September has been key to keeping inflation expectations at low levels.

"Strong policy ownership has allowed the authorities to respect all the structural benchmarks under the program. Kenya has made significant inroads with reforms of its expenditure and tax systems, as well as of business and financial regulatory frameworks. Recent legislation on value added taxes will help mobilize revenue and strengthen the business climate.

"Although Kenya's economic outlook is favorable, both external and domestic risks persist. Continued engagement with the Fund could help the authorities manage these risks."