International Monetary Fund

Kenya and the IMF

Press Release:
IMF Executive Board Completes Sixth and Final Review Under the ECF Arrangement for Kenya and Approves US$110.2 Million Disbursement
December 2, 2013

Kenya: Letter of Intent

November 15, 2013

The following item is a Letter of Intent of the government of Kenya, which describes the policies that Kenya intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Kenya, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

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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:

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.

1. 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.

2. 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.

3. 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.

4. 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.

5. 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.

6. 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.

7. 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.

8. 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.

9. 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.

10. 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.

11. 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.
Macro criticality: The VAT reform will allow for higher mobilization of revenue which will reduce the fiscal imbalance.		
VAT Audits of the 50 largest taxpayers.		Completed.
Macro criticality: 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.
Macro criticality: 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.
Macro criticality: Single Treasury Account (STA) adoption will improve both liquidity management and expenditure control.		
Banking supervision	First Review	Completed.
Amend the Banking Act to reinforce prompt corrective action by the banking supervision authority.		
Macro criticality: Reinforcing the banking supervision authority is crucial to reducing the risk of macroeconomic instability.		
Capital markets	First Review	Completed.
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.		
Macro criticality: 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.		