



Institute of  
Economic Affairs

# Kenya - IMF Synthesis Report

## No. 21/72

# **The Kenya - IMF Synthesis Report No. 21/72**

**Published by**



Institute of  
Economic Affairs

©Institute of Economic Affairs, 2021

All rights reserved

5th Floor ACK Garden House, 1st Ngong Avenue

P.O. Box 53989-00200 Nairobi, Kenya

Tel: 242-20-2721262, 2717402

Fax: 254-20-2716231

Cell: 0724-256510, 0733-272126

Email: [admin@ieakenya.or.ke](mailto:admin@ieakenya.or.ke)

Website: [www.ieakenya.or.ke](http://www.ieakenya.or.ke)



## Table of Contents

<b>1.0 Introduction</b>	<b>5</b>
1.1 Definition of key terms	6
<b>2.0 Structure of the IMF</b>	<b>9</b>
<b>3.0 IEA Appraisal</b>	<b>10</b>
<b>4.0 Context</b>	<b>12</b>
<b>5.0 Recent economic development</b>	<b>14</b>
<b>6.0 Economic outlook</b>	<b>17</b>
<b>7.0 Program policies</b>	<b>21</b>
A. Supporting the authorities' covid response while reducing medium-term debt vulnerabilities	21
B. Structural reforms	23
C. Strengthening the monetary policy framework and safeguarding financial stability	25
<b>8.0 Financing and program modalities</b>	<b>27</b>
<b>9.0 Staff appraisal</b>	<b>29</b>

# 1

## 1.0 Introduction

This document is a publication by the Institute of Economic Affairs (IEA-Kenya) that presents a synthesis of the IMF Country Report No. 21/72 that was published in April 2021. The report contained the information and analyses of the agreement to a 38-month program of financial and technical support based on a request presented to the IMF, analyzed by its staff and an approval obtained from the Executive Board of the IMF.

The purpose of this publication is to provide a navigation guide to understanding the content of the report, to present an analysis of the implications of the commitments made by the authorities (Government of Kenya) and the challenges and risks, highlight the benchmarks and assess the political economy risks to attainment of the specific declarations and commitments.

The report is arranged to mirror the contents of the IMF Country Report No. 21/72 sequentially highlighting the content of each of the five main sections and concluding with a matrix listing the commitments and benchmarks and a commentary on the possibilities and challenges for their attainment during the duration of the program. While this analysis assumes that any readers have basic knowledge of the institutional functions of the IMF and its relationship to its members, it presents a definition of the terms and a description of the decision-making organ of the IMF in respect of program plans.

## 1.1 Definition of Key Terms

1. **Rapid Financing Instrument (RFI)**- The Rapid Financing Instrument (RFI) provides rapid financial assistance, which is available to all member countries facing an urgent balance of payments need. The RFI was created as part of a broader reform to make the IMF's financial support more flexible to address the diverse needs of member countries. The RFI replaced the IMF's previous emergency assistance policy and can be used in a wide range of circumstances<sup>1</sup>.
2. **Rapid Credit Facility (RCF)**- The Rapid Credit Facility (RCF) provides rapid concessional financial assistance with limited conditionality to low-income countries (LICs) facing an urgent balance of payments need. The RCF was created under the Poverty Reduction and Growth Trust (PRGT) as part of a broader reform to make the Fund's financial support more flexible and better tailored to the diverse needs of LICs, including in times of crisis. The RCF places emphasis on the country's poverty reduction and growth objectives<sup>2</sup>.
3. **Extended Credit Facility (ECF)**- The Extended Credit Facility (ECF) provides financial assistance to countries with protracted balance of payments problems. The ECF was created under the Poverty Reduction and Growth Trust (PRGT) as part of a broader reform to make the Fund's financial support more flexible and better tailored to the diverse needs of low-income countries (LICs), including in times of crisis. The ECF is the Fund's main tool for providing medium-term support to LICs<sup>3</sup>.
4. **Standby Credit Facility**- The Standby Credit Facility (SCF) provides financial assistance to low-income countries (LICs) with short-term balance of payments needs. The SCF was created under the Poverty Reduction and Growth Trust (PRGT) as part of a broader reform to make the Fund's financial support more flexible and better tailored to the diverse needs of LICs, including in times of shocks or crisis<sup>4</sup>.

---

<sup>1</sup>"The IMF's Rapid Financing Instrument (RFI)." IMF, 23 Mar. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/02/19/55/Rapid-Financing-Instrument](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/19/55/Rapid-Financing-Instrument).

<sup>2</sup>"IMF Rapid Credit Facility (RCF)." IMF, 30 Mar. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/08/Rapid-Credit-Facility](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/08/Rapid-Credit-Facility).

<sup>3</sup>IMF. "IMF Extended Credit Facility (ECF)." IMF, 2 Apr. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/04/Extended-Credit-Facility](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/04/Extended-Credit-Facility).

<sup>4</sup>"IMF Standby Credit Facility (SCF)." IMF, 11 Feb. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/10/Standby-Credit-Facility](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/10/Standby-Credit-Facility).

5. **Extended Fund Facility** - The Extended Fund Facility was established to assist countries experiencing serious payment imbalances because of structural impediments or slow growth and an inherently weak balance-of-payments position. An EFF provides support for comprehensive programs including the policies needed to correct structural imbalances over an extended period <sup>5</sup>.
6. **IMF Standby Arrangement** - The SBA framework allows the IMF to respond flexibly to countries' external financing needs and to support their adjustment policies with short-term financing. All member countries facing actual or potential external financing needs are eligible for SBAs subject to IMF policies<sup>6</sup>.
7. **IMF Quota** -An individual member country's quota broadly reflects its relative position in the world economy and, are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The IMF is a quota-based institution and form building blocks of the IMF's financial and governance structure<sup>7</sup>.
8. **Special Drawing Rights (SDR)** - The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves and serves as the unit of account for the IMF. The value of the SDR is based on a basket of five currencies—the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling. The SDR is neither a currency nor a claim on the IMF but it is a potential claim on the freely usable currencies of IMF members. SDRs can be exchanged for these currencies<sup>8</sup>.
9. **IMF Technical Assistance (IMF TA)** - The IMF shares its expertise with member countries by providing technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration, and official statistics with the view of strengthening institutions involved in the Management of the Economy such central banks, Finance Ministries and Statistical Agencies . These capacity development efforts help countries achieve their growth and development objectives and contribute strongly to their progress toward their Sustainable Development Goals (SDGs). Capacity development is one of the three core functions of the IMF and accounts for around a third of its spending<sup>10</sup>.
10. **IMF Surveillance** - A core responsibility of the IMF is to oversee the international monetary system and monitor the economic and financial policies of its 190 member countries, an activity known as surveillance. This process takes place at the global, regional, and country levels, the IMF identifies potential risks to stability and recommends appropriate policy adjustments needed to sustain economic growth and promote financial and economic stability<sup>11</sup>.

---

<sup>5</sup>“IMF Extended Fund Facility (EFF).” IMF, 22 Feb. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/56/Extended-Fund-Facility](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/56/Extended-Fund-Facility)

<sup>6</sup>“IMF Stand-by Arrangement (SBA).” IMF, 11 Feb. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/33/Stand-By-Arrangement](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/33/Stand-By-Arrangement).

<sup>7</sup>“IMF Quotas.” IMF, 4 Mar. 2021, <https://www.imf.org/en/About/Factsheets/Sheets/2016/07/14/12/21/IMF-Quotas>

<sup>8</sup>“Special Drawing Right (SDR).” IMF, 18 Feb. 2021, [www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR](http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR).

<sup>9</sup>“IMF. “About the IMF: Work: Technical Assistance.” [www.imf.org](http://www.imf.org), 2021. [www.imf.org/external/about/techasst.htm#types](http://www.imf.org/external/about/techasst.htm#types).

11. **Balance of Payments (BOP)**- A country's balance of payments is the difference between all the money flowing into the country in a particular period and the outflow of money to the rest of the world.
12. **Debt Service Suspension Initiative (DSSI)**- This means that the bilateral official creditors are during a limited period, suspending debt service from the poorest countries (73 low- and-middle income countries) that request suspension.

---

<sup>10</sup>IMF. 2019. "IMF Capacity Development." IMF. 2019. <https://www.imf.org/en/About/Factsheets/imf-capacity-development>.

<sup>11</sup>IMF Surveillance." IMF, March 1, 2021. <https://www.imf.org/en/About/Factsheets/IMF-Surveillance>.



# 2

## 2.0 Structure of The IMF

The IMF was established in July 1944 at United Nations Bretton Woods Conference in the United States by 44 countries in attendance who sought international Economic Cooperation. Kenya joined the Fund on February 3, 1964<sup>12</sup>. At present, the International Monetary Fund has a membership of 190 countries.

The day-to-day work is overseen by an executive board of 24 executive directors representing Member countries and assisted by the IMF Staff. The Executive Board makes decisions through the casting of votes based on the quotas allocated to them. United States, Japan, China, France, United Kingdom, Germany, Saudi Arabia have a single executive director by the size of quotas while the rest of 183 economies have categorized into 16 different groups<sup>13</sup>.

The IMF has a total of \$1 trillion that it can lend to member countries. The IMF lends loans to low-income countries with 0% interest rates. IMF's interest rates on emergency financing are permanently set at zero. The primary source of IMF's financial resources is the Members quotas<sup>14</sup>.

The IMF is accountable to the Board of Governors who sit at the top of IMF's Organizational structure<sup>15</sup>. The board of Governors consists of one governor and an alternate governor from each member country. In practice, it is usually the top official from the Central Bank and Ministry of Finance.

---

<sup>12</sup>IMF -- Resident Representative Office in Kenya." IMF, 6 Apr. 2021, [www.imf.org/en/Countries/ResRep/KEN](http://www.imf.org/en/Countries/ResRep/KEN)

<sup>13</sup>IMF 2021. "IMF Executive Directors and Voting Power." Wwww.imf.org. April 20, 2021. <https://www.imf.org/external/np/sec/memdir/eds.aspx>.

<sup>14</sup>The IMF at a Glance." IMF. March 3, 2021. <https://www.imf.org/en/About/Factsheets/IMF-at-a-Glance>.

<sup>15</sup>"International Monetary Fund Organization Chart." www.imf.org, 26 Aug. 2020, [www.imf.org/external/np/obp/orgcht.htm](http://www.imf.org/external/np/obp/orgcht.htm).

# 3

## 3.0 IEA Appraisal

Kenyan authorities are far more optimistic about the prospects for recovery in the medium-term compared to the IMF. IMF seems to be more cautious. We lean on the IMF understanding anchored by the March - April lockdown whose effects will be felt in Q2. IMF's language choice is diplomatic, and the statements are made with circumspection but several readings through the sections of the report reveal a cautionary tone that Kenya's economic management during the duration of the program will require sound and careful stewardship. In our view, the narrative and data presented in the report are comprehensive for the decisions taken by the Executive Board of the IMF. A review of the report shows that the IMF Staff have an accurate view of Kenya's overall risk profile and broad reforms necessary to reduce the risk of default on debt.

**Public debt:** Both the ECF and RCF are based on the available quota of Kenya's Special Drawing Rights. At the announcement of the decision of the Executive Board of the IMF in April 2021, some Kenyan citizens expressed concern and disapproval in the belief that this program would commit the government to undertake unpopular reforms and raise public indebtedness. Our view however is that all factors considered, it appears that IMF's cushion is the best that is available to Kenya among a limited set of sub-optimal options. Indeed, the support provided under the ECF and RCF is indispensable to enable Kenya to find complimentary sources for other resources because they are provided as concessional loans. A detailed examination of Kenya's public finance position reveals that the government could not run if all borrowing were to cease immediately. The only option would be an immediate default on debt, a situation that should be avoided through prudent stewardship.

**Program Management Risks:** Apart from the economic risks that have been stated, this program does not only face economic risks but also risks from domestic politics. There is a real chance that the political costs of financial and governance reform of State-Owned Enterprises will be too costly for an executive approaching the end of its term to carry out. An equally large risk factor is regarding reforms related to access to information on corporate ownership and further disclosure of public procurement. These are areas in which both politicians in the legislature and the executive, together with the professionals in Kenya's bureaucracy may have a convergence of interest to preserve their influence and manipulation of state processes for direct economic gain and political patronage. A third risk factor for the completion of the program comes from the questionable effectiveness of Kenya's legislative arm of government, which has not demonstrated the ability to dispassionately assess

economic programs and restrain executive overreach. At the same time, while there is an impending election, the executive branch of government and the legislature have low public confidence. This means that the difficult but necessary political and economic tradeoffs that are required to reform public sector organizations and particularly the State-Owned Enterprises could be easily derailed by populist rhetoric against privatization or closure of firms that are a drain to the public purse.

# 4

## 4.0 Context

The IMF Country Report No. 21/72 starts by stating the context through which Kenya’s application and macroeconomic affairs should be assessed. It splits the contextual factors into three heads as enumerated below:

**Prior to the COVID-19 shock, Kenya’s economy was performing well, though with rising public debt vulnerabilities.**

According to the IMF country report no. 21/72, Kenya’s economy was performing well before the Covid-19 shock, despite some emerging challenges. Significant progress had been made in the last decade leading to notable reduction in poverty and inequality. Private credit growth increased in 2019 due to the removal of interest rate caps which in turn enhanced support towards private investment. The main challenges were reduced revenues as a percentage of GDP and increased dependence on non-concessional debt, which increased fiscal deficits and debt distress. Table 1 below is a summary of the growth picture that the IMF Country Report No. 21/72 is alluding to.

**Table 1: Macroeconomic & Fiscal Performance Pre-Covid**

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020-Q1</u>
<b>GDP growth rates (%)</b>	4.9	6.3	5.4	5.2
<b>Inflation rates(%)</b>	5	5.6	5.5	6.2
<b>% revenue to GDP</b>	–	18.2	17	–
<b>% Expenditure to GDP</b>	–	26	25.2	–
<b>% Budget deficit to GDP</b>	–	7.8	8.2	–
<b>% Public Debt to Debt Stock</b>	–	56.6	60.8	–
<b>Debt Servicing</b>	–	8	8.6	–

Source: National Treasury

Table 1 above shows the performance of the macroeconomic indicators before Covid-19 started, which highlights GDP growth as the main positive story with inflation at a moderately high level but still within the targeted range.

Table 1 illustrates fiscal performance before the covid-19 period. The % revenue to GDP reduced from 18.2% in 2018 to 17% in 2019, a decline of 1.2% of GDP. While this table shows a short period of time, it is noteworthy that the share of public. Spending to GDP remained above 7%, clearly above the acceptable upper limit of 2.5%-3% for a country of Kenya's income level and GDP size. Thus, the IMF's assessment that Kenya had good growth levels and emerging challenges are far too generous to Kenya's economic managers owing to the deterioration in the quality of debt management and the sustained deficit against a falling revenue collection ratio. Kenya had symptoms of debt distress and there was underlying vulnerability related to limited fiscal space to manage a serious shock such as the Covid-19 emergency presented.

### **The COVID-19 shock hit Kenya's economy very hard and exacerbated existing vulnerabilities.**

The note acknowledges expressly that debt problem and other existing challenges were aggravated by the COVID-19 pandemic., it caused reduced economic activities in various sectors because of the necessary containment measures adopted by the government. Increased economic pressures also contributed to a high risk of debt distress. In May 2020, Kenya relied on temporary financial assistance through Rapid Credit Facility Funds boosted by funding from the World Bank. Despite the temporary support from the Rapid Credit Facility Funds and the World Bank, a lack of a sensible fiscal adjustment would increase the debt ratio. Kenyan government set out Post-COVID Economic Recovery Strategy in December 2020 coupled with a Budget Policy Statement presented to Parliament in February 2021.

### **The authorities (meaning Government of Kenya) have requested a disbursement under the Extended Credit Facility (ECF) and Rapid Credit Facility (RCF) with total access of 100 % of quota (SDR 542.8 million, equivalent to US\$743.9 million)**

A 38-month arrangement requested by the Kenyan government under the Extended Credit Facility and Extended Fund Facility aimed at reducing the debt distress as well as carrying out the Post-COVID Economic Recovery Strategy. In addition to that, Kenya has undertaken to initiate structural adjustments according to the agreement. The Extended Credit Facility offers financial assistance through Balance of Payments and the Extended Fund Facility administered when a country faces medium-term Balance of Payment because of problems pertaining to structural reforms. In the 38-month arrangement, disbursement will occur in three phases. The International Monetary Fund proposes access at 1.655 billion Special Drawing Rights (SDR), or 305% of Kenya's quota to support budget needs and meet the balance of payment, accelerating capital market financing and other official lenders support.

# 5

## 5.0 Recent Economic Developments

### **The global pandemic worsened Kenya's macroeconomic challenges**

COVID-19 exacerbated vulnerabilities that Kenya's economy was already facing; the value of the shilling was falling against the dollar; tax revenues were decreasing as a share of GDP. The fiscal pressures pushed Kenya into high risk of debt distress. Kenya has so far still had low level of vaccinations and the rapid spread of the COVID-19 Pandemic coupled with the ensuing containment measures by the government in a bid to contain the spread is likely to slow economic activities thus undermining the 7% projected GDP growth for 2021.

### **The economy has staged a recovery**

The economy demonstrated signs of recovery in the third quarter of 2020 as it recorded contraction of 1.1%, of GDP. Still, this represented a slowdown compared to the growth of 5.8% in the comparable quarter in 2019. In the second quarter of 2020, the economy had contracted by 5.5% from a growth of 5.2% in a similar period in 2019. The rebound clearly indicates that the economic stimulus program by the government<sup>16</sup> in May 2020, amounting to a total of Ksh 53.7 Billion (0.4% of GDP) helped achieve the objective of stimulating the growth. However, it is notable that while the overall output in the industrial sector was positive, the manufacturing sub-sector remained restrained with growth of -3.9% and -3.2% in the second and third quarter of 2020 respectively.

### **The current account proved resilient against the backdrop of the shock**

Even though Kenya's current account balance is negative, it has demonstrated remarkable resilience in the wake of the COVID-19 pandemic. It recorded a deficit equivalent to 4.9% of GDP in December 2020 compared to a deficit of 5.8% of GDP in a similar period in 2019. The improvement in the current account balance was mainly due to the improvement in the merchandise account balance and the net primary income balance. In addition, the shilling acted as a shock absorber, depreciating against the US dollar from Ksh 102.9 in March 2020 to Ksh 110 in January 2021. The resilience of the current account is projected to reduce marginally to a deficit of 5.3 % of GDP in 2021 mainly on the account of projected increase in the imports.

---

<sup>16</sup><https://www.president.go.ke/2020/05/23/the-seventh-presidential-address-on-the-coronavirus-pandemic-the-8-point-economic-stimulus-program-saturday-23rd-may-2020/>

## **A Rapid Credit Facility (RCF) disbursement in May helped weather the initial COVID-19 impact**

Rapid Credit Facility arrangement from the World Bank amounting to Ksh 78.3 billion (0.5% of GDP) was crucial in supporting budget shortfalls and thus bolstering the rebound in economic recovery in third quarter of 2020. Evidently, the fiscal deficit would have been worse had the facility been unavailable to support public spending. The fiscal deficit was 7.9% of GDP in 2019/20 compared to the projected value of 6.3% of GDP. However, it is underscored that due to the disruptions caused by the pandemic, the likelihood of the government missing on the target of the budget deficit of at least 3.0% GDP by 2023/24 is high. In other words, the IMF states here that government fiscal affairs are still at great risk of disruption and that extreme discipline will be required to attain the targets that are stated.

## **While the COVID-19 shock interrupted planned fiscal consolidation, the authorities have limited the fallout on the fiscal accounts**

Shifting of the targets on fiscal thresholds without regard to their impact on policy direction is among the recent developments that have featured government stands on fiscal policy thus signaling fiscal indiscipline. For instance, while the fiscal consolidation path over the medium term had been projected to a budget deficit of 3.0 % of GDP by 2024/25 it has since been revised in 2021's Budget Policy Statement to a budget deficit of 3.6 % of GDP. The sustained budget deficit has majorly been driven by sustained increase in the expenditure in the wake of the declining revenues, a phenomenon that is likely to continue being experienced given the current projection of an increase in the projected expenditure of 25.7 % of GDP in 2021 compared to 25.0 % of GDP in 2020 while the revenues are projected to decline to 17.0 % of GDP in 2021 compared to 17.2 % of GDP in 2020.

The public debt threshold has been a moving target too; from a threshold of 50% Net Present Value of GDP, this was varied to the current Ksh 9 Trillion in 2019. Increased spending and lackluster fiscal consolidation and reduction of waste and corruption at a time when revenues are underperforming, interest payments are rising and the economy's ability to incur more debt is narrowing, is highly likely to render the economy vulnerable to acute fiscal distress.

## **Pressures on borrowers' balance sheets have risen but financial sector vulnerabilities remain contained**

While the performance on regulatory ratios indicates that the financial vulnerabilities are contained, this may be dented by the rise in reported Non-Performing Loans (NPL) ratio from 12.7% in February to 14.1% in December 2020. The vulnerabilities may further be exacerbated by the decline in the forward-looking provisioning whereby the return on equity fell to 14 % in December from 20 % earlier in the year, representing a decline by 6 percentage points. Lifting of the tax relief measures in January 2021 in the wake of COVID-19 containment measures by the government is a likely catalyst for a surge in NPL ratio and thus increased financial vulnerability. The third wave shock in Covid-19 illness and mortality rates in Kenya is likely to affect firm performance with the possibility that firms may suffer further stress and affect their ability to service loans.

## **The external position of Kenya in 2020 was broadly in line with the level implied by fundamentals and desirable policies**

The combined Extended Credit Facility (ECF) and Extended Fund Facility (EFF) arrangements of US\$ 2.4 billion by IMF is a low-cost financing vital for sustain Kenya's investment and social programs over the next three years. With prudent financial management, the facility provides an opportunity for the achievement of durable and inclusive recovery. Given the high risk of debt distress that the country was facing even before the Covid-19 shock, the facility is also vital in cushioning against debt vulnerability that may emanate from external quarters such as a shock on the exchange rate. However, transparency and accountability through the anti-corruption framework ought to be enhanced to ensure that the spending is channeled to the areas where it is most needed. In addition, the allocation of the Extended Fund Facility (305 % of quota) should be an impetus to address necessary structural reforms to enhance economic growth and improve an inherently weak balance-of-payments position and address weaknesses in the governance including reforms of some State-Owned Enterprises (SOEs). In the view of the IEA-Kenya, this series of reforms represent the highest political economy risks for the completion of the entire program.



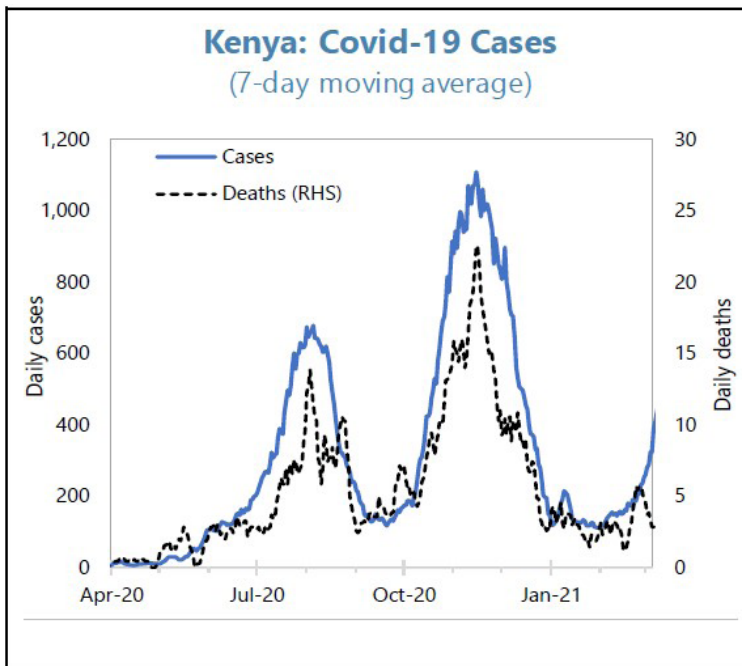
# 6

## 6.0 Outlook and Risks

### The economy is expected to rebound in 2021, though the outlook is subject to high uncertainty

The IMF Country Report No. 21/72 acknowledges that despite poor performance in the tourism sector because of Covid-19 travel restrictions, a slackening agricultural sector and base effects, GDP growth is expected to reach 7.6% in 2021. Two weeks after the publication of this IMF Country Report No. 21/72, this confidence in that growth rate must be moderated because the resumption of restrictions in Kenya and suspension of travel and other activities will affect the growth momentum. While 2020 saw oil prices at a record low for spot and futures markets, in 2021 oil prices are recovering which would influence inflation, but the Central Bank of Kenya remains confident that it is expected to remain contained within the target range by the generally moderate recovery in domestic demand. Increased capital imports coupled with the bullish market outlook for oil prices are expected to result in widening the current account deficit.

Figure 1: 7- Day Moving Average of Covid-19 Cases in Kenya



Source: IMF Country Report No. 21/72 p.6

As much as this outlook shows renewed optimism for an economic recovery in 2021, the nature of the Covid-19 pandemic in Kenya is such that each subsequent wave exhibits a characteristic of higher infections, morbidity, and mortality rates than the preceding wave as seen in the figure above. Even worse, is that in March 2021 Kenya reported the highest mortality rates from covid-19 in Africa and it often takes several weeks to reduce the three factors of infections, morbidity, and morbidity rates once a surge commences. Considering the phase of Covid-19 restrictions introduced on March 26th which include a tighter nighttime curfew and travel restrictions, the shock on the economy in March and April 2021 is most likely to be more pronounced and deflate the momentum of growth that started in January. Thus, there might be a need for moderation of the growth figures further, unless there is an even bigger rebound later in 2021.

### **Kenya's medium-term outlook is positive, but the pandemic's socio-economic impact will take time to reverse**

Covid-19 emergency managed to reverse 5 years' worth of Kenya's poverty reduction gains. A study by the World Bank shows that Kenya's poverty rate increased to 36% because of the pandemic, driving an additional 2M people below the poverty line. In 2020, 1 in every 3 Kenyan workers were employed in firms facing high risk of temporary closure and reduced revenues, highlighting the vulnerability of household incomes. Expanding the beneficiary base of existing social protection programs would aid in alleviating poverty, though the government of Kenya hardly has the fiscal space to support this policy. A Ksh. 50B targeted cash transfer program, equivalent to the cost of the 2020 VAT relief, would reach 20,000 Kenyan households which are approximately 2.5 M people. This would more than offset the increase in poverty brought about by Covid-19<sup>18</sup>.

Medium-term growth is estimated to reach 6% and is attributed to the reopening of schools, the planned fiscal consolidation and growth of total exports projected to reach 13.3% of GDP in 2025.

### **Risks to the outlook remain tilted to the downside**

While the document confirms that at the time of its drafting, the medium-term growth and debt outlook for Kenya is positive, it acknowledges that the foreseeable risks are "tilted towards the downside"<sup>19</sup>. The document considers that these risks may be driven not only by a rise in infections but also by the possibility that the Covid-19 emergency may be extended. The effect of a protracted pandemic status would undermine the situation of an ongoing recovery. Since the publication of this report, the drivers of this particular risk have come into play because of elevated infections and mortality in Kenya. The resumption of restrictions in March 2021 and the extension of the curfew hours will inevitably affect the performance of firms in urban areas generally and the five counties in which entry and exit have been banned. This confirms that the anticipation that while the prospects seem well in the medium term, there are headwinds to that forecast, and these may still pose unforeseen challenges to the agreement itself and the country's recovery.

---

<sup>18</sup> <https://www.worldbank.org/en/country/kenya/publication/kenya-economic-update-covid-19-erodes-progress-in-poverty-reduction-in-kenya-increases-number-of-poor-citizens>

<sup>19</sup> IMF Country Report No. 21/72. p. 9

That circumspection is also valid when examined against the admission that besides the risks imposed by external developments, Kenya faces risks to economic performance from the unpredictability of rainfall and intermittent locust invasions effects on agricultural output. Besides the overall risks to economic growth, the note identifies political risks coming from the referendum which might be held before the end of 2021 and which will be followed closely by the general elections in 2021. The third risk factor comes from the real possibility that contingent liabilities for State Owned Enterprises (SOEs) are likely to get worse if the first two risk factors obtain. This means that the public debt position would deteriorate and upset the agreed rationalization and fiscal consolidation plans.

Seeking to strike a balance, while maintaining that the risks to the downside are real, the report acknowledges that a reduction in global prices of crude petroleum would ease pressure on Kenya by improving the terms of trade<sup>20</sup>. This is significant because in the week after the publication of this note, the crude oil prices continued to rise and this created the possibility of higher nominal pump prices in Kenya, which the government avoided by tightening the margins of oil dealers with suggestions that it uses proceeds from a price stabilization fund that has not been fully brought to work. It is evident that both the price stabilization mechanism and the shrinkage of dealer margins are not sustainable means for the medium term either.

### **The authorities viewed the growth outlook somewhat more positively than staff.**

Having stated its overall view about the challenges that Kenya should anticipate in the quest to restore growth and a balance in the debt position, the IMF's note states that its counterparts in Kenya (the authorities) had a more positive growth outlook. This is evident in the forecasts that the Treasury has published in the Budget Policy Statement that guided budget formulation for the Financial year starting July 01, 2021. Government forecasts exhibit exuberance with the implication that the worst phase of Covid-19 morbidity and mortality may be over.

In addition, the authorities in Kenya remarked that disruption under the covid-19 emergency created uncertainties in data compilation which led to errors on the upside in reported figures for manufacturing and employment. The implication is that the representatives of the Government of Kenya are confident that the recovery is much stronger but obscured in part by the available data. This confidence on the part of the Kenyan authorities is further expressed in their undertaking for full implementation of the reform agenda and that this would produce at least 6.5% annual growth in GDP for the medium term. As noted already, the IMF, as the interlocutor to the government of Kenya, thinks that despite all these positive claims, the risks still mount in a way that may reduce the pace of Kenya's recovery during the term of this agreement.

This section concludes with Box 3 in which the IMF lays out a schematic summary of Kenya's vaccine deployment policy. While the note merely takes cognizance of the policy, it renders no other view on it. This is a curious finding for the IEA-Kenya because the ability to design and deploy an effective

---

<sup>20</sup>IMF Country Report 21/72. P.10

vaccination policy is critical to Kenya's recovery both in the short and the medium term. Indeed, the vaccination policy and its implementation in 2021 and beyond becomes another risk factor because in March 2021, the government had to reinstitute restrictions and curfew which affect operations that are critical for the medium-term economic performance.

# 7

## 7.0 Program Policies

This section of the IMF report 21/72 dissects the content of the specific reforms or program policies to which Kenya and the IMF are committed and for which specific milestones are agreed.

To realize the reform agenda under this arrangement, the authorities seek to address the more pressing concerns arising from the shocks realized from the COVID-19 pandemic to support medium-term growth. These policies are classified into three parts:

- A. Staff support to COVID-19 responses, while reducing debt vulnerabilities
- B. Structural reform and governance agenda; and
- C. Strengthening of the monetary policy framework

### A. Supporting The Authorities' Covid Response While Reducing Medium-Term Debt Vulnerabilities

#### Support to COVID-19 shock response initiatives

This section of the arrangement aims to prioritize policy actions that will cushion vulnerable groups against the adverse impact of the Covid-19 pandemic. This has necessitated the reinstatement of taxes that were suspended from April 2020 including corporate tax, private tax, personal relief, and VAT. Notably, the tax cuts were a welcome relief to taxpayers (both individuals and firms) and helped to stabilize private sector businesses while ensuring some disposable income to individuals. This is expected to result to a higher tax collection that will help in supporting various government projects. “The program aims to protect health and social expenditures, while gradually unwinding emergency expenditures in other non-priority areas”<sup>21</sup>. This arrangement defines priority social spending of the national government as the sum of the following:

- a) Cash transfers; to orphans and vulnerable children, elderly persons, persons with severe disabilities,
- b) Free primary and secondary education expenditures
- c) School food and sanitary programs,

---

<sup>21</sup>Ibid., P.11

- d) Free maternal healthcare, universal health coverage, health insurance subsidy for vulnerable groups (orphans, vulnerable children, people with disabilities, the elderly), and
- e) Vaccination and immunization programs.

Program policies aimed at supporting Kenya's Covid-19 response while at the same time reducing medium term vulnerabilities seek to ensure adherence to tax policies that have been rolled back in the medium term, while also putting in place systems that will seal loopholes in terms of collection and spending. The focus of available funds will be on high priority projects which include free primary and secondary education, cash transfer programs, and support to immunization and vaccination programs among others. Limited support will also be provided to the singled-out State Owned Enterprises that were adversely affected by the pandemic. This will ensure prudent use and allocation of resources, thereby yielding effectiveness in government spending in tandem with the recommendations of this instrument.

Most importantly, the spending and revenue generation plans are expected to maintain the fiscal deficit at 8.7% of GDP and total debt at 70.4% of GDP in the financial year ending in June 2021. IMF staff cut some slack for the government of Kenya by stating that a far more aggressive fiscal adjustment in the form of reduction of expenditures to moderate the fiscal deficit would undermine the nascent recovery.

## B. Structural Reforms

Over the years, one of the main budget-related risks in Kenya is the financial demands of struggling State-Owned Enterprises (SOEs) parastatals largely because of the declining profitability and large losses. For the Financial year ending in June 2020, the profit of public entities declined by a third to Ksh. 62.5 billion which is approximately 0.6% GDP. Deteriorating income positions of the SOEs, indicates reduced contribution to the budget and with the repayment of debt on-lent due, there is anticipated fiscal pressure to government.

For two financial years starting in 2019/20, Covid-19 shock exacerbated the already underlying financial weakness as shown in the persistent losses. For instance, Kenya Airways recorded major losses due to the global travel restrictions and has received cash infusions to maintain operations. Kenya Railways which had been recording rising revenues, experienced a worsening profitability in the FY2019/20 as it started to service the on-lent loans contracted for the construction of the Standard Gauge Railway. The structural reforms are cast in two components i.e. (i) the financial challenges facing SOEs and (ii) the governance of the SOEs.

Under the first component of improving the financial state in the SOEs, the Kenyan government has undertaken to do the following:

- **Component 1:** A financial evaluation will be carried out on 9 SOEs that bear the largest financial risks for the financial year ending in June 2021. This evaluation should have been completed by March 2021, preceding the publication of the IMF country report 21/72. The evaluation will serve as a basis for extraordinary SOE support for the FY20/21 which should be limited to “exigent needs” which a provision is made for under the supplementary budget for the outgoing year.

The 9 SOEs are: Kenya Airways, Kenya Airports Authority, Kenya Railways Corporation, Kenya Power, Kenya Electricity Generating Company, Kenya Ports Authority and the three largest public universities.

- **Component 2:** National treasury should prepare “an in-depth forward looking financial evaluation of the top 15-20 SOEs with the largest fiscal risk”, by end of May 2021. The evaluation should include a strategy for addressing the financial pressures in SOEs that should include a framework for deciding on interventions and reforms while considering the limited fiscal space and the programs’ fiscal targets.

2. Regarding reforms on the governance part of SOEs, Clause 26 speaks to having reforms to improve the oversight, monitoring and governance aimed at enhancing their resilience. To achieve this, government of Kenya will have to

- draft a blueprint that will identify necessary legal reforms and review institutional structures that would (might this include privatization?), enhance governance. This should be done by July 2021 with the IMF Technical Assistance.

3. Transparency of fiscal risk reporting will be improved with Kenya committing to undertake a fiscal risk analysis that quantifies contingent liabilities from high risk SOEs, and Public Private Partnerships being included in the annual Budget Review and Outlook Paper. Fiscal transparency is essential in overall management of fiscal risks and provides government and citizens with the information needed to support efficient financial decisions and to hold SOEs to account for their fiscal performance and use of public resources.

Separate from the governance of the SOEs, the program reflects agreed priorities to strengthen the anti-corruption framework in Kenya. The highest corruption risks, as noted in the IMF report, lie in public contracting, conflicts of interest, marketing, privatization processes, theft of assets and money laundering.

**The reform agenda in response to these risks requires:**

1) promotion of fiscal transparency by publishing procurement information. Government undertakes to implement provisions of the 2015 Public Procurement and Asset Disposal Act and the regulations of 2020, that allow for implementation of electronic procurements by all public entities.

2) Operationalizing the Access to Information Act.

3) Review of the current legal framework for asset declaration of senior public officials and conflict of interest rules should be done as a matter of high priority. Transparent asset declaration acts as a tool to prevent and combat corruption. The ongoing review will aim at establishing a uniform disclosure regime, strengthening sanctions on misreporting, and improving accessibility of the asset declarations

4) An effective implementation of the Anti-Money Laundering laws and others aimed at Combating Financing of Terrorism measures. Kenya has ongoing initiatives through the National Risk Assessment (NRA) process and in preparation for the Mutual Evaluation (ME) exercise by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) expected this year. By June 2021, the authorities will formulate the National AML/CFT Strategy and Action Plan to address any deficiencies identified in the NRA.



## C. Strengthening The Monetary Policy Framework and Safeguarding Financial Stability

### **The staff report assesses that CBK's accommodative Monetary policy stance and concludes that it remains appropriate**

The IMF report declares that the CBK's monetary policy stance is appropriate given the circumstances. But proposes a Monetary Policy Consultation Clause (MPCC) with a 5% (+/-2.5%) band to monitor inflation performance providing for a consultation with the Executive Board if inflation falls out the band. This is outlined in the Technical Memorandum of Understanding Paragraph 23. In keeping with the Monetary policy consultation clause, the CBK will continue to ensure the functioning of domestic capital markets. Equally important is the recognition that the change rate has been allowed to function as a shock absorber with "interventions" aimed at minimizing excessive liquidity.

**Moving ahead with the Workplan to strengthening the Monetary policy frame work** - As part of the structural benchmark, the CBK plans will publish a White Paper by end of June 2021 outlining planned reforms to improve the monetary policy framework drawing on inputs from many sources.

### **Preemptive Loans Restructurings to ease Liquidity for Many Borrowers Ending and Performance of these loans is being Monitored closely**

The restructuring of loans for household and corporate borrowers accounted for a reported 54% of banking system loans by value. 90% of the restructurings were carried out by large banks that are well-capitalized and follow IFRS-9 guidelines for expected loan provisioning. The supervisory and regulatory processes aim to ensure prudent Banking Circular No. 11 of 2020 asset classification and provisioning practices. The Central Bank of Kenya has instructed banks to undertake Internal Capital Adequacy Assessment Process (ICAAP) to assess the resilience of their portfolios to pandemic shock and curtail dividend payments<sup>23</sup>.

For the IEA-Kenya, it is unclear whether the regulator has the legal authority in determining dividend distribution policy and even if it is considered desirable for system stability, it rests on shaky constitutional and legal ground. The CBK expects the new credit guarantee scheme to play an important role in supporting new credit to SME's. The credit scheme guarantee was expected to have Ksh 5 billion in 2020/21 and a similar amount in 2021/22 and eventually to rise to Ksh 100 billion<sup>24</sup>.

---

<sup>23</sup>CBK. 2020. "Banking Circular No. 11 of 2020." [https://www.centralbank.go.ke/uploads/banking\\_circulars/1925129366\\_Banking%20Circular%20No.%2011%20of%202020%20-%20Internal%20Capital%20Adequacy%20Assessment%20Process%20\(ICAAP\)%20-%20Aug%2014%20%202020.pdf](https://www.centralbank.go.ke/uploads/banking_circulars/1925129366_Banking%20Circular%20No.%2011%20of%202020%20-%20Internal%20Capital%20Adequacy%20Assessment%20Process%20(ICAAP)%20-%20Aug%2014%20%202020.pdf)

<sup>24</sup>Staff, Reuters. 2020. "Kenya to Set up Credit Guarantee Scheme for Small Businesses Hit by COVID-19." Reuters, September 10, 2020. <https://www.reuters.com/article/health-coronavirus-kenya-economy-idAFL8N2G74R9>.

## **CBK implemented from September 2019 Safeguards Assessment**

The assessment by the IMF found that CBK Board and Audit Committee have maintained strong oversight of operations, and the external audit and financial reporting practices continue to be aligned with international standards. Priority recommendations to strengthen internal audit function and enhance management of foreign reserves have been implemented.

They noted that close monitoring of the post-shock economic and financial market situation, including loss provisioning and the impact on banks' earnings and capital buffers of restructured loans, would continue. In this context, loan classification and provisioning rules will continue to be fully applied as arrangements roll off, ensuring that any potential losses are recognized as accurately as possible.

---

<sup>25</sup>IMF Country Report No. 21/72 Clause 39, page 19

# 8

## 8.0 Financing and Program Modalities

The Executive Board of the IMF approved a 38-month SDR 1.655 billion (about US\$2.34 billion) arrangements for Kenya under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) aimed at support Kenya's COVID-19 response and address the urgent need to reduce debt vulnerabilities while safeguarding resources to protect vulnerable groups.

Based on the above facts about the facility, the following issues are worth consideration to ensure the funds are used for the intended purpose:

The IMF report indicates that Kenya's Public debt remains sustainable, but that debt service as a share of export and revenue has worsened due to shocks occasioned by the pandemic. Due to COVID-19, Kenya's risk of debt distress has moved to high from moderate with sharp decline in export and economic growth. The report suggests that fiscal adjustment under the program will reduce the debt-related risks and place debt as a share of GDP on a declining path while return of more normal global market conditions will allow access to Eurobond market at reasonable prices.

Kenya faces fiscal and financing gaps on balance of payments through the program period and the report affirms that these gaps will be "particularly large" during the first two years of the 38-month program period. This shows that the success of this program is dependent on economic growth, the ability to meet the revenue targets and the reforms to reduce the rising contingent liabilities from the SOEs. . To fill the financing gaps, Kenya is expected to receive additional sources of funding from the World Bank and specifically DSSI relief equivalent to 0.6% of GDP expected in the second half of 2021. The IMF has also approved the Extended Fund Facility and Extended Credit Facility and is estimated to contribute 0.5% of GDP in financial years 2021/22 and 2022/23.

Despite the substantial resources available to Kenya through the SDRs, Kenya will need to seek further loans and seek grants and additional concessional lending from the African Development Bank or other International Financial Institutions. The implication here is that the legislature and the executive will need to keep citizens abreast of the loan facilities that are certain to be agreed to during the tenure of this program.

The IMF staff propose the following monitoring modalities<sup>25</sup>, especially for the first two reviews where a level of increased uncertainty is expected.

- Quarterly monitoring.
- IT on tax collections.
- Structural benchmarks.
- Adjustor on COVID-19 vaccine-related spending.
- Adjustor on net international reserves.
- Adjustor on extraordinary SOE support.

The report mentions that limits will be set on new borrowing reflecting Kenya's elevated debt risks. This will ensure compliance with the requirement for any borrowed funds and lowered debt vulnerability.

Despite the expected peak in Kenya's amount of outstanding credit to IMF throughout the program period, the IMF indicates that Kenya's Capacity to repay the fund is adequate. However, with the emergence of downside risks such as slow growth or pullback of international investors from frontier markets in the medium term could place stress on Kenya's capacity to repay the IMF.

# 9

## 9.0 Staff Appraisal

IMF Staff acknowledges the damage from external shocks but states categorically that Covid-19 exacerbated existing vulnerabilities. The Shock created fiscal and external financial gaps that will last for the medium term. IMF's financial assistance to support the government of Kenya in pandemic response measures. It identifies the need to enhance tax revenue to GDP. The staff recognizes fiscal weaknesses associated with State Owned Enterprises and development strategies addressing State Owned Enterprises' challenges. It acknowledges the monetary policy stunts and advises government to monitor the risks. The staff also recommends the commencement of a 38-month arrangement under the Extended Credit Facility and Extended Fund Facility program.

On the other hand, the Government of Kenya has committed to undertake the following fiscal and structural adjustments:

- Tax broadening measures supported by improvements in revenue administration management and governance arrangement.
- Evaluation of fiscal risks associated with State Owned Enterprises (SOEs) and development of strategies that address SOE's challenges that are consistent with the limited fiscal space.
- Efficiency in government expenditure controls and better prioritization of domestically financed projects
- Increasing fiscal transparency and improvements on anti-corruption framework. This includes following up on irregularities highlighted by the Auditor General; publishing procurement information including beneficial ownership data of companies awarded contracts; operationalizing the Access to Information Act; review of current legal framework for asset declarations of senior public officials and conflict of interest rules; and strengthening the Anti-Money Laundering (AML) and Combating the Financing of Terrorism.
- Strengthen the monetary policy framework and support financial stability by refining policy operations to keep short-term interest rates stable and close to the policy rate.

Apart from the financial assistance, the IMF will offer technical assistance to the National Treasury and build its capacity especially in monitoring fiscal risks and embedding effective reporting into the annual budget process. In conclusion, the staff supports the extension of the credit facility to Kenya as the government has demonstrated strong commitment to fiscal and governance reforms. Additionally, the staff concluded that Kenya's debt remains sustainable, and its debt dynamics will be bolstered by the fiscal consolidation envisaged under the IMF financial assistance. However, the risk of the debt distress continues to be assessed as high.

**Table 2: Program Goals or Deliverables Matrix**

	Program Goals or Deliverables	Policy Fitness/ Priority (Yes or No)	Political Economy Risk (Low, Medium, High)	IEA Comment (Why we think the risk is high or not)
1.	Restore Kenya's tax-to-GDP ratio to 15.6% in FY 23/24	Yes	Medium	This policy move is necessary to close the deficit. But comes with tax changes that both businesses and individual taxpayers might oppose
2.	Reduce recurrent spending by 2.1 pp of GDP (from 20.0% FY20/21)	Yes	High	High because State Corporation and bureaucracy in the public sector are generally opposed to spending reductions. Ensuring that this 2.1% change happens would require the closure of some SOEs
3.	Submit to Parliament the FY21/22 budget consistent with program targets by end-April 2021	Yes	Low	This factor is embedded in the PFM Act and the Constitution. It is a routine driven by the PFM cycle.
4.	Risk evaluation of 9 SOEs by end-March 2021	Yes	Medium	The administration of SOEs might be reluctant to reveal in detail their risk profiles to the public. There is a high likelihood of the delay in the completion or full disclosure of the findings.
5.	Risk evaluation of the top 15-20 SOEs with the largest fiscal risk by end-May 2021	Yes	Medium	
6.	Completion of a draft blueprint identifying actions and legal reforms to enhance governance of SOEs by July 2021	Yes	Low	Ongoing
7.	Develop an integrated monitoring and reporting system by September 2021	Yes	Low	
8.	Include fiscal risk analysis quantifying contingent liabilities from high risk SOEs and PPPs in the BROP by end-September 2021	Yes	High	Most of Kenya's contingent liabilities in SOEs are hidden or protected by secret contracts whose disclosure would generate economic and political fallout.
9.	State Procurement Portal to be completed by end-April 2021	Yes	Medium	The portal has always existed, but it lacks clarity on the level of compliance expected of every state entity.
10.	Full implementation of the Access to Information Act	Yes	Low	Ongoing
11.	Review and strengthen the preventive anti-corruption framework	Yes	High	The political parties are divided and there is fear that anti-corruption policies will be targeted at the political opposition or political rivals of the president.  In addition to this, there is very low trust in EACC, and both their credibility and impartiality is questionable

12.	Formulate the National AML/CFT Strategy and Action Plan by June 2021	Yes	Low	AML policies are undermined by poor enforcement as mentioned in 11 above.
13.	A White Paper published by CBK outlining planned reforms to improve the monetary policy framework drawing on inputs from many sources by end-June 2021	Yes	Low	Ongoing.
14.	Program quarterly monitoring	Yes	Low	Treasury and the CBK have prior experience with this.
15.	In the event of a tax shortfall, identify expenditure offsets and potentially introduce additional tax measures	Yes	High	The requirement to introduce additional tax measures will be resisted by taxpayers and parliament might not pass it.
16.	Providing structural benchmarks as additional means of measuring policy implementation.	Yes	Low	A good mechanism for measuring program progress.
17.	Adjustor on Performance Criteria to fast-track COVID-19 vaccination program.	Yes	Medium	Makes the vaccination program a priority.
18.	Adjustor on net international reserves (NIR)	Yes	Medium	The CBK might have to adjust its FX policy in the event of a shock.
19.	Absorb half of the extraordinary support to SOEs up to 1percentage point of GDP in such support.	Yes	Low	This is an incentive for GoK to undertake deep structural reforms of the SOEs because the IMF is committed to providing a facility to offset half of the cost with an upward limit of up to 1% of GDP.

**Analysis by:**

1. Kwame Owino
2. Annah-Grace Kemunto
3. Maureen Barasa
4. Darmi Jattani
5. Leo Kemboi
6. Stephen Jairo
7. Melody Njeru
8. Winnie Ogejo
9. Noah Wamalwa
10. Raphael Muya





Institute of  
Economic Affairs

**Institute of Economic Affairs**

5th Floor, ACK Garden House | P.O. Box 53989 - 00200 Nairobi, Kenya.

Tel: +254-20-2721262, +254-20-2717402 | Fax: +254-20-2716231

Email: [admin@ieakenya.or.ke](mailto:admin@ieakenya.or.ke) | Website: [www.ieakenya.or.ke](http://www.ieakenya.or.ke)