International Monetary Fund

Kenya and the IMF

Press Release:
IMF Executive Board Completes First Review Under the Stand-By Arrangement and Standby Credit Facility Arrangement for Kenya
September 16, 2015

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Kenya: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

August 31, 2015

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.

Letter of Intent

Nairobi, Kenya
August 31, 2015

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

Dear Ms. Lagarde:

1. Kenya's macroeconomic performance remains strong in the face of headwinds, supported by significant infrastructure investments, mining, and lower energy prices. Growth remains robust, despite the adverse impact on tourism on account of the prevailing security challenges. Inflation is within our target band, thanks to the coming on stream of low-cost geothermal energy and lower oil prices, and despite the impact of higher food prices in early 2015. The Shilling has depreciated against the US dollar mostly in response to global market developments, and its volatility has increased reflecting lower net capital inflows to our domestic market, similar to those observed in other emerging/frontier economies. The current level of foreign exchange reserves, backstopped by the precautionary program with the IMF, continues to provide an adequate cushion against exogenous shocks.

2. Performance under our economic program supported by the Stand-By Arrangement (SBA) and the Standby Credit Facility (SCF) arrangement has been broadly in line with program targets. We met all quantitative performance criteria and indicative targets under the program through end-March 2015 (Table 1), with the exception of temporary delays in the repayment of some external obligations resulting in the nonobservance of the continuous performance criterion on external arrears. These obligations were fully settled, and we have taken corrective measures to avoid any recurrence of such delays. We are therefore requesting waivers under both arrangements for this temporary non-observance. Reflecting the tapering of capital flows that started in April, the end-June indicative target on NIR was missed, as was the indicative target on the net domestic assets of the CBK. All other end-June indicative targets were met. In addition we have made significant progress in structural reforms, and we plan to address implementation delays by adhering to time-bound action plans to streamline the government's payroll, strengthening the Debt Management Office, submitting the new CBK Bill to parliament, and by implementing the Treasury Single Account (Tables 2 and 3). Consistent with our program commitments, we are bolstering CBK's ability to conduct stress testing and continue to further strengthen its supervisory framework, with a view to safeguard financial stability.

3. Reflecting our continued prudent macroeconomic policies and structural reforms together with substantial public investment, we expect an acceleration of economic growth in 2015. Nevertheless, external developments and domestic events—especially the high volatility in global markets and

continued domestic security challenges—have put pressure on the foreign exchange market and public spending. In order to address these challenges, we maintained tight liquidity conditions in the money market by raising interest rates on longer-maturity instruments for Central Bank operations, and occasional sale of foreign exchange to smooth excessive exchange rate volatility. The Monetary Policy Committee raised the Central Bank Rate (CBR) by 150 basis points in June 2015, and by a further 150 basis points in July 2015.

4. As the impact of the above external and domestic shocks has proved persistent, a modest modification of the macroeconomic framework and quantitative targets under the program is warranted. We therefore request modification of the end-September 2015 performance criteria and of end-December 2015 indicative targets for net international reserves, net domestic assets, and the primary budget balance of the central government (Table 1).

5. Given our strong program implementation to date and the policy priorities outlined in the attached update of the Memorandum of Economic and Financial Policies (MEFP), we request completion of the first review under the SBA and SCF arrangements. In addition, given the continued low risk of external debt distress, we request the elimination of the performance criterion on contracting and guaranteeing of non-concessional external debt by the national government.

6. We intend to continue treating both arrangements as precautionary, and will only draw under these arrangements when an actual balance of payment need materializes. The second review under the SBA and the SCF arrangements will reassess the situation as well as program performance at the end-September 2015 test date. The second review is expected to be completed in January 2016.

7. The policies set out in the attached MEFP will enable us to achieve our program objectives, which remain unchanged. We will take any further measures that may become necessary for this purpose. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations. We will provide such information as the IMF may request in connection with progress in implementing our economic and financial policies. We authorize the publication of the staff report for the first review of the SBA/SCF-supported program, this letter of intent, and the attached MEFP and technical memorandum of understanding.

Sincerely yours,

/s/
Henry Rotich
Cabinet Secretary
The National Treasury

/s/
Patrick Njoroge
Governor
Central Bank of Kenya

Attachments:
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

I. DEVELOPMENTS UNDER THE PROGRAM

1. **Our economy has continued to perform well**. Real GDP grew by 5.3 percent in 2014, mainly driven by performance in mining and quarrying, electricity supply, construction, information and communication, finance and insurance and transport and storage sectors. The economy is estimated to expand at a robust pace in 2015, supported by strong private sector demand, and rising public investments, including a faster-than-expected execution of the Standard Gauge Railway (a major regional project). At the same time, the accommodation and food services sectors have been adversely affected by prevailing security threats that have discouraged tourist arrivals, while agricultural production has remained weak in the first quarter of 2015. Inflation has trended upward in recent months, reaching about 7 percent in June.

2. **The current account deficit widened to 10.4 percent of GDP in 2014, reflecting sizable imports of capital equipment and an acceleration of external services imports**. On the other hand the capital and financial flows recorded net inflows amounting to 12.5 percent of GDP in 2014, resulting in overall balance of payments surplus of about 2.2 percent of GDP, compared with 2.5 percent under the original program projections.

3. **That said, economic policy management and implementation of reforms under the program has been affected by the onset of external and domestic shocks.** Rising volatility in global markets in recent months, lower export prices, and the Garissa terrorist attack in April 2015 have adversely affected capital inflows and receipts from merchandise exports and tourism. These have contributed to a depreciation of the shilling and increased volatility in the foreign exchange market in recent months. To stabilize inflationary expectations and contain the second round effect of the weaker shilling on wages and prices, the CBK raised the Central Bank Rate (CBR) twice (in June and July 2015) by a cumulative 300 basis points to 11.5 percent and the interest rates on longer-maturity instruments for Central Bank liquidity operations by 250 basis points above CBR (see ¶15 below). Limited use of our international reserves buffer was aimed at smoothing exchange rate volatility. In addition, to effectively address the security threats, we have accelerated security-related spending, which has contributed to fiscal pressures in FY2014/15 (see ¶6 below).

II. PROGRAM POLICIES

A. Program Objectives

4. **Our main policy objectives continue to focus on maintaining macroeconomic stability, while at the same time sustaining infrastructure investments, deepening structural and governance reforms, improving security conditions and supporting devolution.** Progress in these areas would help strengthen the business environment, encouraging in turn innovation, investment, growth and expansion of economic and

employment opportunities in Kenya. The Fund-supported program continues to provide a policy anchor to implement our ambitious reform program, which has the following objectives:

- ***Fiscal policy***. Adhering to medium-term debt targets, while preserving room to implement an ambitious public investment program aimed at reducing social and infrastructure gaps, minimizing vulnerabilities to weather-related shocks, and supporting devolution.

- ***Public financial management***. Taking decisive steps to (i) increase the efficiency, effectiveness, transparency and accountability in the use of public resources, and (ii) contain fiscal risks arising especially from the fast-track devolution rollout and contingent liabilities.

- ***Monetary policy***. Achieving inflation rate within the target band of 5±2.5 percent, and further improving the monetary policy framework to facilitate the transition towards a fully-fledged inflation targeting framework.

- ***Financial stability***. Enhancing prudential oversight to address potential vulnerabilities including those arising from foreign currency exposure risks and cross-border expansion by Kenyan banks.

- ***Business environment.*** Creating a more favorable business environment, including by strengthening security, deepening structural and governance reforms to improve the cost of doing business, thus boosting investments and employment creation.

- ***Data provision***. Improving data quality to support economic policy making and facilitate transition to frontier/emerging market status.

B. Macroeconomic Framework

5. In light of the adverse impact that the above shocks are having on our economy, modest revisions to the macroeconomic framework for the program are warranted. For 2015, the proposed modifications include (i) somewhat lower GDP growth, reflecting the adverse impact of security challenges on the tourism sector; (ii) higher inflation, as a result of the pass-through to prices of the recent exchange rate depreciation and a slight pickup in global fuel prices; and (iii) a weaker balance of payments, in light of a modest deterioration in export prices, depressed tourism and weaker financial inflows from the ongoing volatility in global markets, resulting in lower international reserves. Risks to these projections remain on the downside, especially if global growth weakens further, and/or pressures in the foreign exchange market persist.

C. Fiscal Policy

6. Program policy objectives. Our fiscal anchor remains maintaining gross public debt below 45 percent of GDP in present value terms, and we are committed to gradually bringing the fiscal deficit over the medium term towards the EAMU's convergence criteria of 3 percent of GDP. This requires containing current spending and mobilizing additional revenues, with a view to preserving room for much-needed social and infrastructure spending aimed at supporting faster and more inclusive growth.

7. Fiscal performance in FY2014/15. We have faced several challenges implementing the 2014/15 budget. Revenue collection has been weaker than projected, reflecting mainly lower-than-expected income tax and VAT collection, and challenges in the full implementation of the capital gains tax. In addition, we have encountered pressures on other current spending, reflecting to a large extent the need for higher security-related outlays in response to recent security and terrorism events. On the positive side, the execution of the Standard Gauge Railway (SGR) has proceeded faster than expected, resulting in a front loading of development spending of about 0.8 percent of GDP. To contain the pressure on the fiscal deficit and financing from the aforementioned factors, we stopped new commitments by ministries and other agencies as of June 8, 2015. These measures allowed us to meet the indicative target on the primary fiscal deficit excluding SGR-related spending for end-June 2015 (Table 1).

8. The 2015/16 budget. The 2015/16 budget targets a primary fiscal deficit of 5.3 percent of GDP in 2015/16, striking an appropriate balance between the support for rapid and inclusive growth and fiscal discipline to maintain debt sustainability and remain consistent with financing constraints. We are confident that the policies outlined below are sufficient to achieve our fiscal objectives for 2015/16. Nevertheless, we are committed to take additional corrective measures if the fiscal outturn through end-2015 falls short of program targets.

- ***Revenue mobilization***. We have taken concrete steps to collect additional revenue, through a wide range of revenue yielding corrective measures as well as new policy initiatives expected to yield about Ksh 63.64 billion or 1.0 percent of GDP. This includes Ksh 28.44 billion from the modernized Excise duty Act 2015, adopted by Parliament in August that raises specific excises on cigarettes, alcoholic beverages, motor vehicles and motor cycles, and fuels; Ksh 5.0 billion from recent amendments to the Income Tax Act that replaced Capital Gains Tax with a withholding tax on the transaction value of the shares; Ksh 8.1 billion from higher VAT revenue reflecting expected improved compliance from identified non-filers via the new iTax; Ksh 3.0 billion from the expected improvement in compliance on customs revenues following the recent adoption of the Electronic Single Window declaration module; Ksh 4.1 billion from Real Estate from a simplified 12 percent tax on gross rental income of individuals; Ksh 10.0 billion from expected improvement in compliance from Pay-As-You-Earn (PAYE) ; and Ksh 5.0 billion from a newly introduced levy on identity verification queries to the Integrated Population Registration System (IPRS).

- ***Development spending***. This year's budget includes higher allocations to support critical infrastructure projects in roads, irrigation, the Standard Gauge Railway, ports, security, and energy. As a result, development spending as a share of total national government spending is set to increase to over 41 percent in 2015/16 compared to 29 percent in 2013/14, and an estimated 36 percent in 2014/15.

- ***Recurrent spending***. We will continue to contain current spending, especially on wages, while maintaining high priority social spending. In particular, we will streamline the national government payroll following the identification of ghost workers and redundancies by a recent biometric personnel audit. We will also extend to 2015/16 the freeze on new recruitment (except for exceptional services such as security, health and education) that was introduced in FY2014/15. These actions would allow us to continue reducing wage spending to 5.1 percent of GDP in 2015/16 (compared to 5.6 percent in 2013/14). We also plan to conduct a biometric personnel audit for counties and semi-autonomous government agencies. At the same time, security-related recurrent spending will increase in 2015/16 to boost our counter-terrorism capabilities to effectively deal with heightened security threats.

9. **Devolution**. We are taking steps to strengthen accountability and fiscal discipline in the use of devolved resources, to achieve our constitutional objectives of improving service delivery and enhancing equitable economic development at the county level. This includes implementation starting in June 2015 of a framework establishing limits and guidelines for borrowing by county governments consistent with the PFM Act. The safeguards included in this framework will help contain fiscal risks and ensure public debt sustainability. We will complete an audit of outstanding county assets and liabilities by end-December 2015 (proposed resetting of the end-September 2015 **structural benchmark**). Further, we are implementing a strategy to enhance revenue management by counties to strengthen their revenue raising measures and correct duplication and distortions in local taxes and fees that hurt the business environment. Based on the positive experience in the introduction of the county borrowing framework, we are organizing a conference to discuss the international experience in these matters before October 2015. In addition, the national government continues to support capacity building at the county level, in particular on improving revenue collection, including by automating county revenue collection and leveraging the Kenya Revenue Authority's (KRA) infrastructure.

10. **Staff rationalization**. The Government approved in August a plan to continue implementation of the Capacity Assessment and Rationalization of the Public Service (CARPS) program (end-March 2015 **structural benchmark** under the program), aiming at a significant rationalization of the public service to ensure that government functions are properly structured and staffed to facilitate public service delivery at the national and county levels. The next phase of the program entails the start up of a process of rationalization and redeployment, which would entail the following key steps in the period July-December 2015:

- Continue with the hiring freeze except for exceptional cases approved by the Cabinet Secretary for Devolution and Planning and the Cabinet Secretary for the Treasury.
- Establish legal and pension frameworks that allow transfer of staff among counties and between ministries and counties.
- Renew contracts of staff only in cases clearly identified in the new government structure.
- Establish options and incentives for voluntary separation to address structural problems with capacity and performance of public service, with a clearly specified budget for accelerated benefits, early exit compensations, and other facilities.

- Establish a joint ministerial-county committee to oversee the rationalization and redeployment process.

11. Public finance management. To contain and manage fiscal risks from contingent liabilities beyond those associated with devolution, we reported in the 2015 Medium-Term Budget Policy Statement on all commitments and obligations under all existing PPPs and guarantees, meeting the end-March structural benchmark. We have also adopted a new risk and exposure assessment framework under the Public Private Partnership (PPP) program. We have established a link between the PPP unit and the Debt Management Office to exchange information on the treatment of contingent liabilities arising from the projects as they reach execution stage.

12. Debt Management. We will leverage on the Commonwealth Secretariat Debt Recording and Management System (CSDRMS) to derive loan repayment obligations as they fall due, without the need to wait for invoices from lenders and make the request for release of funds. The payment process will start 30 days before the due date to allow for internal approvals by National Treasury and Controller of Budget, and eventual payment by CBK well before the due date. As a reset **structural benchmark** for end-September, we will also introduce the following measures to strengthen Debt Management Office:

- Fill the position of Director General of the Directorate of Public Debt Management.
- Appoint Directors assigned full time to the DMO.
- To ensure timely repayment of external obligations, the DMO will (i) elevate to the cabinet secretary a quarterly report with all obligations coming due, (ii) use the Commonwealth Secretariat Debt Recording and Management System as the basis for auditing debt repayments instead of relying on the invoices, and (iii) start the automation of internal processes between different units involved in processing debt payments.
- Initiate the process of separating front, middle and back office functions, with technical assistance from the Fund. In particular, we will assign staff in the DMD middle office to manage risk and compliance issues; identify the number of staff needed for front, middle, and back office functions; and ensure deployment of necessary personnel to cover these functions.
- Incorporate cost/risk analysis of the borrowing operations, steered by targets established in the debt-management strategy. The analysis will also be extended to new contingent liabilities and PPP projects.
- Auction plans including dates and instruments will be published at least a month ahead. DMO representative at the auction would be responsible for implementing the monthly plans and will be empowered to decide on deviations of the plan in case market conditions change significantly.

- Include in the next Annual Public Debt Report an evaluation of how the government debt management activities have complied with the debt management strategy.

13. Treasury Single Account. We are making significant progress in improving the efficiency of the government cash management and payment processes and in extending the coverage of the IFMIS/Internet banking and financial reporting to include all key government entities with accounts at the CBK. This will lay the foundations for enhanced cash management practices in preparation for the full adoption of the Treasury Single Account (TSA). The full TSA implementation will entail the automation of cash planning and exchequer release process and consolidation of the government bank accounts balances at the CBK on a daily basis. The consolidation will provide the basis of calculating interest on the net government cash position, net of the overdraft balance. The assessment of the TSA system to be adopted in Kenya required a longer-than-anticipated initial phase of institutional coordination, requiring a resetting of the end-June 2015 structural benchmark under the program. We have now taken the decision to adopt a sub-account structure TSA model, which is in line with our PFM legal and institutional framework. In that regard, we commit, as a **reset structural benchmark** under the program, by end-September to: (i) complete the migration of the National Government voted MDAs to IFMIS and internet banking, with the exception of the security agencies. This will allow the National Treasury and the CBK access to information in real time about the availability of idle resources in spending units; (ii) capture exchequer transactions, debt payments and other Consolidated Fund Services transactions in IFMIS to be able to generate reports of revenues, payments and bank balances upon request; (iii) reach a Service Level Agreement between the National Treasury and the CBK that would govern the agency operations including overdraft and interest calculations, service fees and other charges arising from their financial relations in anticipation of the likely reduction in reliance on overdraft and interest paid thereon; and (iv) start automating the Exchequer release process, enabling timely transfers, payments and account reconciliations.

14. Parastatal reform. We continue to upgrade the regulatory framework governing our parastatal sector. To that effect, a Code of Governance was approved in January 2015 by Presidential Executive Order. This Code has introduced a framework guiding appointments, and improving accountability in state-owned corporations. The Government Owned Entities Bill has been submitted to the Cabinet, and the Sovereign Wealth Fund Bill is being reviewed by the Attorney General before submission for final cabinet discussion. We also initiated the process of merger of parastatal entities, starting from the agricultural sector, bringing down the research and regulatory parastatals in the sector from 12 to 2.

D. Monetary Policy

15. Program policy objectives. We reaffirm the key objective of keeping headline inflation in the medium term at the midpoint of our target range (5±2.5 percent), in the context of a floating exchange rate regime. We will continue to monitor developments in the foreign exchange market and intervene only to mitigate excess volatility, while maintaining adequate reserve buffers to protect the economy in the event of further exogenous shocks.

16. Monetary policy stance. The CBK remains vigilant against inflationary pressures. Consistent with a forward looking monetary policy framework, and to support a tightening bias in monetary conditions, the CBK raised in May 2015 the ceiling on CBK liquidity operations for longer-maturity term auction deposit rates from 0 to 250 basis points above the CBR. During the meeting of June 9, 2015, the MPC raised the Central Bank Rate (CBR) by 150 basis points. This measure is intended to anchor inflation expectations in the presence of continued high food prices, shilling depreciation in the recent months and the partial reversal of oil prices. To mitigate the potential impact of global developments and emerging risks on inflationary expectations, at its meeting on July 7, the MPC raised the CBR further by 150 basis points to 11.5 percent, and also introduced a 3-day repo to further expand the menu of instruments for liquidity management. We are confident that these actions will help contain inflation expectations and moderate second round inflationary effects. We stand ready to take further actions as needed, to keep inflation anchored around the middle of our target band.

17. Monetary policy framework. Consistent with commitments under the program, we have taken a number of steps to further strengthen our monetary policy framework. These include (i) submission to parliament in September of a Central Bank Act/draft Central Bank Bill, which enshrines in legislation the CBK's current policy of prioritizing price stability and strengthens further CBK's operational independence (reset structural benchmark for end-September 2015, Table 3); and (ii) establishment in March 2015 of an inflation modeling and forecasting unit at the CBK, which is providing scenario analysis and other inputs to inform monetary policy decisions. In addition, we plan to increase the frequency of submission by the National Treasury to the CBK of Government cash flow plans to quarterly (rather than annually) starting in July.

E. Financial Sector

18. Program policy objectives. We will continue to safeguard financial stability by further strengthening the financial sector oversight framework, continuing to enforce prudential rules, and by managing risks associated with rising cross-border operations, expansion of banks activities into holding group structures, and increased volatility in the foreign exchange market.

19. Prudential oversight. We have taken a number of steps to further strengthen our banking sector prudential framework and maintain financial stability:

- ***Enhanced bank monitoring and enforcement of prudential rules***. As part of our prudential toolkit, we have recently completed surveying and analyzing banks' loan restructuring activity and their exposure to mortgages, as well as strictly enforcing prudential rules on loan loss provisioning. We will continue to monitor developments in these areas on a regular basis and take appropriate remedial measures as needed. To manage the risks associated with increased volatility in the foreign exchange market, we will analyze the balance sheet risks associated with assets and liabilities denominated in foreign currency by September 2015.

- In order to ensure strong and well capitalized financial institutions, we plan to, among other measures, review the minimum capital requirements. We will also strengthen supervisory and regulatory measures to align institutions capital to their risk profiles.

- ***Stress tests***. With a view to enhance CBK's ability to conduct top-down stress testing of the banking system, we are developing a micro and macro-financial model within a relatively simple, but robust stress-testing methodology that captures the main risks faced by banks operating in Kenya. CBK has undertaken an Organizational Development Review (ODR) to provide an appropriate institutional arrangement for conducting banks' stress testing and developing other macro-prudential tools. With support of Fund TA, we plan to roll out the first set of stress-test results by end-June 2016.

- ***Cross-border and consolidated supervision***. As part of our effort to strengthen consolidated supervision, we currently have operational supervisory colleges for 6 of the largest Kenyan banks operating in the region. With support from AFRITAC East, we have also successfully concluded the host supervision assessment for Uganda and expect to finalize such assessments for all the remaining host countries by end-June 2017.

F. Ease of Doing Business and Data Quality

20. Program policy objectives. Improve the business environment, including by deepening structural and governance reforms, with a view to ease cost of doing business and thus boost investments and employment creation. To facilitate transition towards emerging market status will require, among other things, improving the quality, coverage and timeliness of Kenya's macroeconomic statistics.

21. Improving the business environment and regulatory reforms. We have taken a number of steps that are reducing the cost of doing business in Kenya, including the adoption of (i) streamlined procedures through a new online portal for company and property registration; (ii) online approvals and lower charges for construction permits in Nairobi; (iii) steps that have nearly halved the number of days to obtain electricity (to 78 from 155 days with the goal to reduce further to 30days; (iv) significantly simplified procedures for trading across border; and (v) an alternative simplified contract dispute mechanism in Nairobi.

- Currently, business name search and reservation is being done online through e-Citizen portal and the mobile USSD code. For about 40 percent of the companies registered, it takes only 2 days and for the remaining 60 percent about 12 days compared to 30 days as indicated in the World Bank Doing Business. At the same time, the procedures for registering property have been reduced from 9 to 6.

- The company and Insolvency Bills have been redrafted to take into account comments from Parliament and have been published and resubmitted to Parliament. Once the Company Act is passed, it will be possible to have processes for starting a business from one point. The Registration of Business Service Bill has also been submitted to Parliament.

- The declaration module of the Electronic Single Window is now operational and beginning July 1st 2015, all importers and exporters and other service providers will be required to process their transactions through the system. This will enhance transparency, accountability, and remarkably ease the cost of doing business while at the same time strengthening revenue collection.

- In addition, the online iTax system is now operational and beginning April 2015, tax payers can only file their income tax and VAT returns and online. The iTax will: simplify tax processes and make it easy for Taxpayers to comply; shorten time taken to extract data & information on revenue; reduce time taken by Taxpayers when dealing with KRA; re-engineer business processes for effectiveness & efficiency; and enhance the ability/accuracy of KRA/Taxpayers to account for taxes thereby increasing revenues.

22. Data quality and timeliness. We are making progress on our commitment to improve macroeconomic statistics with a view to subscribing to the Fund's Special Data Dissemination Standard by 2022. To that end, in its 2015 Economic Survey publication, the Kenya National Bureau of Statistics (KNBS) published a BPM6-compliant balance of payments statement and Kenya's first consolidated GFS 2014 estimates for the public corporations, general government sector and its subsectors. In addition, the KNBS recently released the 2012/13 Kenya National Housing Survey results, including a first-ever official unemployment estimate for Kenya (8.1 percent). Moreover, the field work on the Foreign Investor Survey (FIS) for 2015 is currently underway as scheduled, and the results of the survey will be published by September 2015. The FIS data for 2015 and earlier years are expected to be used to publish a BPM6-compliant balance of payments fully integrated with an International Investment Position statement in the 2016 Economic Survey. Finally, the KNBS will commence with the Household Budget Survey in July 2015 with a view of publishing the results by end-2016.

Table 1. Kenya: Quantitative Performance Criteria and Indicative Targets

(in billion of Kenyan Shilling, unless otherwise indicated)

	2014		2015										
			Performance Criteria (PC)/Indicative targets (IT)										
	End-Dec.		End-Mar (PC)				End-June (IT)			End-Sep (PC)		End-Dec (IT)	
	Prog.	Prel.	Prog.	Adj. Prog.	Prel.	Met/Not Met	Prog.	Prel. Est.	Met/Not Met	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Quantitative performance criteria [1]													
Fiscal targets													
Primary budget balance of the national government (-=deficit, floor) [2, 3]	-104.1	-92.3	-171.9	-174.2	-140.3	Met	-209.9	-200.6	Met	-52.9	-78.0	-98.8	-119.6
Monetary targets [4, 5]													
Stock of central bank net international reserves (floor, in millions of US$) [6, 7]	5,909	6,746	5,956	5,956	6,498	Met	6,115	5,920	Not met	6,173	5,308	6,132	5,987
Public debt targets													
Contracting and guaranteeing of all medium and long term nonconcessional external debt by the national government (ceiling, millions of US$) [8, 9]	1,100	1,100	1,100	1,100	873	Met	1,600	873	Met	1,600	Proposed to be eliminated	2,100	Proposed to be eliminated
National government external payment arrears (ceiling, millions of US$) [10]	0	35	0	0	69	Not met	0	69	Not met	0	0	0	0
Monetary policy consultation clause													
Upper band	...	...	7.5	7.5	...	...	7.5	...		7.5	7.5	7.5	7.5
Center inflation target [11]	...	...	5.0	5.0	5.8	Met	5.0	7.0	Met	5.0	5.0	5.0	5.0
Lower band	...	...	2.5	2.5	...	...	2.5	...		2.5	2.5	2.5	2.5
Indicative targets													
Stock of net domestic assets of the central bank (ceiling) [5]	-230	-234	-206	-206	-230	Met	-186	-160	Not met	-177	-111	-192	-124
Priority social expenditures of the national government (floor) [3]	24	24	40	40	42	Met	52	53	Met	14	12	25	25
Stock of all guarantees issued by the national government (ceiling) [3]	45	45	50	50	0	Met	50	0.0	Met	50	...	50	...
Memorandum items:													
Maximum upward adjustment of the primary deficit ceiling owing to excess in concessional loans relative to program projections [3]	...	...	59.5	...	...	...	79.3	...	...	16.8	16.8	42.0	42.0
Programmed concessional loans [3]	...	...	85.6	...	...	...	119.0	...	...	23.7	23.7	69.5	69.5
Budgeted concessional loans [3]	...	...	145.1	...	...	...	198.3	...	...	24.8	24.8	111.4	111.4
Programmed external commercial debt (millions of US$) [3]	...	...	750	750	750	...	750	750	...	750	750	1,250	1,500
Program grants [3]	...	...	3.8	3.8	3.5	...	6.1	3.8	...	0.5	1.3	2.5	2.9

[1] Performance criteria for end-March 2015 and end-September 2015, and indicative target for end-June 2015 and end-December 2015.

[2] The primary budget balance of the national government is defined as overall balance including grants, plus interest payments, excluding SGR-related expenditure. Targets will be adjusted upwards by the excess in concessional loans relative to the programmed amounts, up to the budgeted amounts, and downwards by the shortfall in concessional loans relative to the programmed amounts.

[3] Targets for end-March 2015 and end-June 2015 are cumulative flows from July 1, 2014 (beginning of the 2014/15 fiscal year). Targets for end-September 2015 and end-December 2015 are cumulative flows from July 1, 2015.

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

[5] The NIR floor will be adjusted upward by half of the excess , and downward fully by the shortfall in external budgetary support (program grants) and external commercial debt relative to the programmed amounts. The NDA ceiling will be adjusted downward by half of the excess and upward fully for the shortfall of external budgetary support (program grants) and external commercial debt relative to the programmed amounts.

[6] Excludes encumbered reserves.

[7] Using exchange rates as at end-October 2014 (see TMU ¶9).

[8] Cumulative flow of contracted debt, from July 1, 2014.

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

[10] Continuous. Cumulative flow in gross terms from July 1, 2014 for the period through end-June 2015, and from July 1, 2015 thereafter.

[11] Compliance will be evaluated based on the 12-month inflation average of the latest three months.

Table 2. Kenya: Performance Against End-March and end-June 2015 Structural Benchmarks

Measure	Target Date	Status
Complete an action plan aimed at strengthening the staffing of the Public Debt Management Office at the National Treasury (IMF Country Report No. 15/31, MEFP ¶13).	End-March 2015	**Not met.** Proposed to be reset for end-September 2015 (see Table 3).
Report in the Budget Policy Statement: (i) all existing PPPs, with their key features, including all commitments and obligations in PPP projects; and (ii) all government guarantees including those to counties (IMF Country Report No. 15/31, MEFP ¶13).	End-March 2015	**Met.** List and key features of existing PPPs included in the Budget Policy Statement approved by Parliament in February 2015.
Complete report on personnel audits for the national and county governments including a time-bound action plan aimed at rationalizing personnel to avoid overlapping of positions (IMF Country Report No. 15/31, MEFP ¶11).	End-March 2015	**Not met**. The staff rationalization plan was approved in August 2015 (see ¶9).
Adopt a framework for county borrowing with guidelines consistent with PFM Law, and incorporate future county borrowing in the government's medium-term debt strategy (IMF Country Report No. 15/31, MEFP ¶12).	End-March 2015	**Met.** The cabinet adopted the framework for county borrowing guidelines and sent it to the parliament for approval.
Submit to Parliament a new Central Bank of Kenya Bill that sets price stability as primary CBK objective (IMF Country Report No. 15/31, MEFP ¶17).	End-March 2015	**Not met**. The draft Bill has been reviewed by the Attorney General and is with the Commission on Implementation of the Constitution. It will thereafter be shared with Cabinet for Approval before submitting the draft Bill to Parliament. Proposed to be reset for end September.
Fully integrate payroll payments to core civil service through the GHRIS in IFMIS (IMF Country Report No. 15/31, MEFP ¶11).	End-June 2015	**Not met**. Proposed to be reset for end-September 2015 (see Table 3).
Complete the full Phase I core TSA to fully integrate the TSA with IFMIS (IMF Country Report No. 15/31, MEFP ¶13).	End-June 2015	**Not met**. Proposed to be reset for end-September 2015 (see Table 3). Significant progress made (see ¶12).

Table 3. Kenya: Existing and Proposed Structural Benchmarks, September 2015

Measure	Target Date	Macro Criticality
Take measures to strengthen the staffing of the Public Debt Management Office at the National Treasury (¶12). Proposed.	End-September 2015	Improve public debt management and reduce fiscal risks. Reset from end-March 2015.
Submit to Parliament a new Central Bank of Kenya Bill that sets price stability as primary CBK objective. Proposed.	End-September 2015	Strengthen CBK's independence and clarify policy objectives. Original target was end-March 2015 (see Table 2).
Complete the audit of assets and liabilities of all counties including those inherited at the onset of devolution (IMF Country Report No. 15/31, MEFP ¶12).	End-December 2015	Limit fiscal risks. Proposed to be reset from end-September 2015.
Produce GFS-compliant consolidated fiscal accounts for the national government and parastatals (IMF Country Report No. 15/31, MEFP ¶13).	End-September 2015	Limit fiscal risks.
Publish Foreign Investment Survey covering years 2012-13 (IMF Country Report No. 15/31, MEFP ¶22).	End-September 2015	Improve BOP data quality, assessment of private debt vulnerabilities, and information for macro policy making.
Complete the migration of all National Government MDAs to IFMIS/ Internet Banking (with the exception of security agencies); capture exchequer, debt payments and other Consolidated Fund Services transactions in IFMIS; reach a Service Level Agreement between the National Treasury and the CBK on agency operations; and start automating of Exchequer release process (¶13). Proposed.	End-September 2015	Improve liquidity management and facilitate monetary policy implementation.

Attachment II. Technical Memorandum of Understanding

1. This memorandum sets out the understandings between the Kenyan authorities and the IMF regarding the definitions of quantitative performance criteria and indicative targets, their adjusters and data reporting requirements for the 12-month Stand-By Arrangement and Standby Credit Facility.

2. For the purposes of the program, the National Government of Kenya corresponds to the budgetary central government encompassing the activities of the national executive, legislative and judicial powers covered by the National Budget. Specifically, it includes the parliament, presidential office, national judiciary, Ministries, Departments, Agencies, and Constitutional Commissions and Independent Offices.

II. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

3. Quantitative performance criteria were established for March 31, 2015, and September 30, 2015 with respect to:

- the primary balance of the national government including grants, and excluding spending related to the Standard Gauge Railway project, cash basis (**floor**);
- the net official international reserves (NIR) of the Central Bank of Kenya (CBK) (**floor**);
- nonconcessional medium- and long-term external debt contracted or guaranteed by the national government (**ceiling**)- proposed to be eliminated after the first review; and
- national government medium- and long-term external public debt arrears (**continuous ceiling**);
- monetary policy consultation clause (**band**).

4. The program sets indicative targets for June 30, 2015 with respect to:

- the net domestic assets (NDA) of the CBK (**ceiling**);
- priority social spending of the national government (**floor**); and
- stock of guarantees issued by the national government (**ceiling**).

III. PERFORMANCE CRITERION ON THE PRIMARY BALANCE OF THE NATIONAL GOVERNMENT

5. The national government primary balance on cash basis is defined as national government revenues and grants minus expenditures and net lending, plus due interest payments, and spending related to the Standard Gauge Railway project, adjusted for cash basis.

6. For program purposes, the **national government primary balance** on cash basis will be measured from the financing side as the sum of the following: (a) the negative of net domestic financing of the national government, excluding securitization of VAT refund arrears; (b) the negative of net external financing of the national government, excluding the executed amount of disbursements related to the Standard Gauge Railway project; and (c) domestic and external interest payments of the national government. For the March 31, 2015 and June 30, 2015 test dates, the national government primary balance will be measured cumulatively from July 1, 2014, and for the September 30, 2015 test date cumulatively from July 1, 2015.

The above items are defined as follows:

- **Net domestic financing** of the national government is defined as the sum of:
  - net domestic bank financing;
  - net domestic nonbank financing;
  - change in the stock of domestic arrears as reported by the National Treasury; and
  - proceeds from privatization.

- **Net external financing** is defined as the sum of:
  - disbursements of **external nonconcessional project loans**, including securitization and excluding executed amounts of disbursements related to the Standard Gauge Railway project;
  - disbursements of **budget support loans;**
  - the negative of principal repayments on all **external loans;**
  - net proceeds from issuance of external debt;
  - any exceptional financing (including rescheduled principal and interest);
  - net changes in the stock of short-term external debt; and
  - any change in external arrears including interest payments.

- **Domestic and external interest payments** of the national government are defined as the due interest charges on domestic and external national government debt.

7. Adjustors. The national government primary balance will be: (i) adjusted downward by the amount of the shortfall in program grants, which are expected as refunds for Kenya's participation in African Union Mission in Somalia (AMISOM), as specified in TMU Table 1 below; and (ii) adjusted upwards by the excess in concessional loans relative to the programmed amounts, up to the budgeted amounts in line with Kenyan law.

TMU Table 1. Kenya: African Mission in Somalia (AMISOM) Grant Schedule

(Billions of Kenyan Shillings)

	2015			
	Mar.	Jun.	Sep.	Dec.
Program Amount [1]	3.8	6.1	0.5	2.5

Source: Authorities' data.

[1] For FY2014/15 cumulative from July 1, 2014, and for FY2015/16 cumulative from July 1, 2015.

IV. PERFORMANCE CRITERION ON THE NET INTERNATIONAL RESERVES OF THE CENTRAL BANK OF KENYA

8. **The net official international reserves** (NIR) (stock) of the CBK will be calculated as the difference between total gross official international reserves and official reserve liabilities.

- **Gross official international reserves** are defined as the sum of:
  - the CBK's holdings of monetary gold (excluding amounts pledged as collateral);
  - holdings of Special Drawing Rights (SDRs),;
  - CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments).
- **Gross official international reserves** exclude:
  - the reserve tranche position in the IMF;
  - pledged, swapped, or any encumbered reserve assets, including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities;
  - deposits with Crown agents; and
  - precious metals other than gold, assets in nonconvertible currencies and illiquid foreign assets.
- **Gross official reserve liabilities** are defined as:
  - the total outstanding liabilities of the CBK to the IMF except those arising from the August 28, 2009 SDR general allocation and the September 9, 2009 SDR special allocation;
  - convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year;
  - commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

- The following **adjustors** will apply to the target for NIR:
  - ➢ If budgetary external program grants and external commercial debt exceed the programmed amounts set out in TMU Table 2 below, the target for NIR will be adjusted upward by half of the difference.
  - ➢ If budgetary external program grants and external commercial debt fall short of the programmed amounts set out in TMU Table 2 below, the target for NIR will be adjusted downward by the difference.

TMU Table 2. Projected Budgetary External Grants and Loans

(US$ millions)

	2015			
	Mar.	Jun.	Sep.	Dec.
Program grants [1]	40	52	14	25
External commercial debt [2]	750	750	750	1,500

Source: Kenyan authorities.

[1] For FY2014/15 cumulative from July 1, 2014, and for FY2015/16 cumulative from July 1, 2015.

[2] Cumulative from July 1, 2014.

9. NIR are monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar equivalent values, using the exchange rates as specified in TMU Table 3 below, and net international reserves will be computed as the daily average for the month when the testing date is due.

TMU Table 3. Kenya: Program Exchange Rates

(Rates as of October 31, 2014)

Currency	Kenyan Shillings per currency unit	US Dollars per currency unit
US Dollar	89.35	1.0000
STG Pound	142.74	1.5975
Japanese Yen	0.81	0.0091
Canadian Dollars	79.76	0.8926
Euro	112.34	1.2573
Swiss Franc	93.29	1.0444
Swedish Kronor	12.14	0.1359
Danish Kronor	15.09	0.1689
Chinese Yuan	14.62	6.1111
Australian Dollars	78.57	1.1373
SDR	132.09	1.4783

Source: Central Bank of Kenya.

V. CONTINUOUS PERFORMANCE CRITERION ON THE NATIONAL GOVERNMENT EXTERNAL PAYMENT ARREARS

10. National government external payment arrears to official and private creditors are defined as overdue payments (principal or interest), which were not made by their contract due date nor during the applicable grace period thereafter, on debt contracted by the national government. National government guaranteed external debt payment arrears (principal or interest) to official and private creditors are defined as overdue payments beyond 30 days after the original contract due date in order to allow the national government sufficient time to process the due repayment after the original debtor has notified of its inability to pay. The definition excludes arrears relating to debt subject to renegotiation (dispute) or rescheduling.

11. The performance criterion on the national government external payment arrears is defined as a cumulative flow in gross terms from July 1, 2015 and applies on a continuous basis.

VI. MONETARY POLICY CONSULTATION CLAUSE

12. The quarterly consultation bands around the projected 12-month rate of inflation in consumer prices (as measured by the headline consumer price index (CPI) published by the Kenya National Bureau of Statistics), are specified in the TMU Table 4 below. If the observed average for the latest three months of the 12-months rate of CPI inflation falls outside the lower or upper bands specified in the TMU Table 4 below for end-March 2015 and end-September 2015 test dates, the authorities will complete a consultation with the Executive IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) on proposed remedial actions if deemed necessary. When the consultation is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed.

TMU Table 4. Inflation Consultation Band

	2014				2015			
	Mar. Actual	Jun. Actual	Sep. Actual	Dec. Actual	Mar. Actual	Jun. Actual	Sep. Target	Dec. Indicat.
Upper band							7.5	7.5
Actual/*Center point*	6.3	7.4	6.6	6.0	6.3	7.0	*5.0*	*5.0*
Lower band							2.5	2.5

VII. INDICATIVE TARGET ON THE NET DOMESTIC ASSETS OF THE CENTRAL BANK OF KENYA

13. Net domestic assets (NDA) are defined as reserve money minus NIR converted in shillings at the accounting exchange rate specified in TMU Table 3, plus medium- and long-term liabilities (i.e., liabilities with a maturity of one year or more) of the CBK, including those arising from the August 28, 2009 SDR General allocation and the September 9, 2009 SDR Special allocation; minus the value in shillings of encumbered reserves converted at the accounting exchange rate specified in TMU Table 3.

- NDA is composed of:
  - net CBK credit to the national government;
  - outstanding net credit to domestic banks by the CBK (including overdrafts); and
  - other items net.
- Reserve money is defined as the sum of:
  - currency in circulation; and
  - required and excess reserves.
- The following **adjustors** will apply to the target for NDA:
  - If budgetary support (external grants and loans) and external commercial debt exceed the programmed amounts, the target for NDA will be adjusted downward by half of the difference.
  - If budgetary support (external grants and loans) and external commercial debt fall short of the programmed amounts, the target for NDA will be adjusted upward by the difference.

14. NDA are monitored in shillings, and will be computed as the daily average for the month when the testing date is due.

VIII. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

15. For the purposes of the program, priority social spending of the national government is defined as the sum of:

- cash transfers to orphans and vulnerable children;
- cash transfers to elderly;
- free primary education expenditure; and
- free secondary education expenditure**.**

IX. INDICATIVE TARGET ON GUARANTEES ISSUED BY THE NATIONAL GOVERNMENT

16. The guarantees issued by the national government include all guarantees extended by the national government to counties, public enterprises and all parastatal entities. Indicative targets for end-March 2015 and end-June 2015 are cumulative flows from July 1, 2014, and the indicative target for end-September 2015 and end-December 2015 are cumulative from July 1, 2015.

X. STRUCTURAL BENCHMARK ON PREPARATION OF GFS-COMPLIANT CONSOLIDATED FISCAL ACCOUNTS

17. The institutions to be covered under the end-September 2015 structural benchmark on the production of GFS-Compliant consolidated fiscal accounts includes (i) the budgetary central government; and (ii) all extrabudgetary units and entities.

XI. DATA REPORTING

18. To monitor program performance, the National Treasury and the CBK will provide to the IMF the information at the frequency and within the reporting deadlines specified in TMU Table 5 below.

TMU Table 5. Kenya: Summary of Data to Be Reported

Information	Frequency	Reporting Deadline	Responsible Entity
1. Primary balance of the national government			
Net domestic bank financing (including net commercial bank credit to the national government and net CBK credit to the national government)	Monthly	Within 15 days after the end of the month.	CBK
Net nonbank financing of the national government	Monthly	Within 15 days after the end of the month.	CBK
National government arrears accumulation to domestic private parties and public enterprises outstanding for 90 days or longer.	Monthly	Within 15 days after the end of the month.	National Treasury (NT)
Proceeds from privatization	Monthly	Within 15 days after the end of the month.	NT
Interest paid on domestic debt	Monthly	Within 15 days after the end of the month.	CBK
Interest paid on external debt	Quarterly	Within 4 weeks after the end of the quarter.	CBK
Disbursements of external nonconcessional project loans, including securitization	Quarterly	Within 45 days after the end of the quarter.	NT
Disbursements of budget support loans	Quarterly	Within 45 days after the end of the quarter.	NT
Principal repayments on all external loans	Quarterly	Within 15 days after the end of the month.	CBK
Net proceeds from issuance of external debt	Monthly	Within 15 days after the end of the month.	CBK
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 15 days after the end of the month.	NT
Net changes in the stock of short-term external debt	Quarterly	Within 45 days after the end of the quarter.	NT
Net change in external arrears, including interest	Monthly	Within 45 days after the end of the quarter.	NT
2. Gross official international reserves			
CBK's holding of monetary gold (excluding amounts pledged as collateral)	Monthly	Within 15 days after the end of the month.	CBK
Holdings of SDRs	Monthly	Within 15 days after the end of the month.	CBK
CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments)	Monthly	Within 15 days after the end of the month.	CBK

TMU Table 5. Summary of Data to Be Reported (continued)

3. Official reserve liabilities			
Total outstanding liabilities of the CBK to the IMF except those arising from the August 28,2009 SDR general allocation and the September 9, 2009 SDR special allocation;	Monthly	Within 15 days after the end of the month.	CBK
Convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year	Monthly	Within 15 days after the end of the month.	CBK
Commitments to sell foreign exchange arising from derivatives.	Monthly	Within 15 days after the end of the month.	CBK
4. Net domestic assets			
Net CBK credit to the national government	Monthly	Within 15 days after the end of the month.	CBK
Outstanding net CBK credit to domestic banks (including overdrafts)	Monthly	Within 15 days after the end of the month.	CBK
5. Other indicators			
Currency in circulation	Monthly	Within 15 days after the end of the month.	CBK
Required and excess reserves	Monthly	Within 15 days after the end of the month.	CBK
Nonconcessional medium- and long-term external debt contracted or guaranteed by the national government	Quarterly	Within 45 days after the end of the quarter.	NT
Accumulation of national government external payment arrears.	Monthly	Within 45 days after the end of the quarter.	NT
Social priority spending of the national government	Quarterly	Within 45 days after the end of the quarter.	NT
Guarantees issued by the national government to counties, public enterprises and all parastatal entities.	Monthly	Within 45 days after the end of the quarter.	NT
Inflows/outflows related to the SGR project	Quarterly	Within 45 days after the end of the quarter.	NT
12-month CPI inflation	Monthly	Within 15 days after the end of the month.	KNBS