Executive Board Minutes 21/64-2

June 23, 2021–11:00 a.m.

Kenya—First Reviews of the Extended Arrangement Under the Extended Fund Facility and an Arrangement Under the Extended Credit Facility and Requests for Modifications of Performance Criteria and Structural Conditionality

Documents: EBS/21/52, and Sup.1

Staff: Goodman, AFR; Kaufman, SPR

Length: 42 minutes

ISSUED: November 22, 2022
APPROVAL: December 1, 2022

CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors welcomed Kenya's progress under the Extended Fund Facility and Extended Credit Facility arrangements, despite challenging circumstances. They emphasized that steadfast commitment to program objectives and maintaining momentum of structural reforms will be necessary for sustained and inclusive recovery. Directors recognized the significant challenges in the vaccination program, including global vaccine supply constraints, while noting that its successful implementation remains key to economic recovery.

Directors commended the authorities' strong measures to reduce debt vulnerabilities. They welcomed the improved primary balance targeted in the draft FY21/22 budget, which carries forward ongoing fiscal consolidation efforts while maintaining support to key economic sectors affected by the pandemic. They commended the authorities' commitment to meet their FY21/22 tax targets, including by bringing forward contingency tax measures if the legal challenge to the corporate minimum tax is sustained, or its yield substantially reduced. Looking ahead, Directors emphasized that reducing debt vulnerabilities and making room for needed social and development spending requires improving spending efficiency and undertaking further tax policy and revenue administration measures. They noted that the new proposed debt anchor would strengthen Kenya's legal framework on indebtedness and help reduce debt vulnerabilities.

Directors encouraged the authorities to push ahead with structural reforms. They welcomed the significant progress made in assessing the financial situation of SOEs and emphasized the need to build on this effort to identify least-cost approaches to reduce SOEs' liquidity gaps and budgetary financing needs, while delivering more effective oversight. Directors stressed the importance of strengthening fiscal governance, advancing anti-corruption work, and enhancing the AML/CFT framework to bolster accountability and confidence. They welcomed publication of comprehensive audits of COVID-19 expenditures and looked forward to planned disclosure of beneficial ownership information of companies awarded procurement contracts.

Directors commended the Central Bank of Kenya's (CBK) proactive policy response. They supported maintaining an accommodative monetary policy stance as long as inflation and inflation expectations remain well-anchored within the target band, while allowing the shilling to act as a shock absorber. They looked forward to the envisaged plans to enhance the monetary policy framework. Directors noted that the pandemic has exacerbated preexisting bank asset quality issues and called for maintaining close supervision of credit risks and provisioning.

EXECUTIVE BOARD DECISIONS

The Executive Board took the following decisions:

Kenya—First Review of the Extended Arrangement Under the Extended Fund Facility and Request for Modification of Performance Criteria and Structural Conditionality

1. Kenya has consulted with the Fund in accordance with paragraph 3(d) of the Extended Arrangement under the Extended Fund Facility for Kenya (EBS/21/29, 03/19/2021, the "Extended Arrangement") in order to review program implementation.

2. The letter dated June 10, 2021 from the Cabinet Secretary, National Treasury and Planning and the Governor of the Central Bank of Kenya (the "June 2021 Letter"), together with its attached Memorandum of Economic, Financial and Structural Reform Policies (the "June 2021 MEFP") and Technical Memorandum of Understandings (the "June 2021 TMU") shall be attached to the Extended Arrangement and the letter dated March 19, 2021, together with its attachments, shall be read as supplemented and modified by the June 2021 Letter and its attachments.

3. Accordingly, the Extended Arrangement shall be amended as follows:

a. The performance criteria referred to in paragraphs 3(a)(i)-(v) of the Extended Arrangement for end-June 2021 shall be as specified in Table 1 of the June 2021 MEFP, and as further specified in the June 2021 TMU.

b. The performance criteria referred to in paragraphs 3(b)(i)-(vi) of the Extended Arrangement for end-December 2021 and end-June 2022 shall be as specified in Table 1 of the June 2021 MEFP, and as further specified in the June 2021 TMU.

c. The reference in paragraph 3(c) of the Extended Arrangement to "Table 1 of the MEFP, and as further specified in the TMU" shall be replaced with a reference to "Table 1 of the June 2021 MEFP, and as further specified in the June 2021 TMU".

d. The second paragraph 3(d) of the Extended Arrangement shall be renumbered as paragraph 3(e) and paragraph 3(e) of the Extended Arrangement shall be renumbered as paragraph 3(f).

e. The reference in paragraph 3(d) of the Extended Arrangement to "paragraph 62 of the attached MEFP" shall be replaced with a reference to "paragraph 60 of the June 2021 MEFP".

f. The reference in paragraph 3(f) of the Extended Arrangement to "Paragraph 23 of the TMU and Table 1 of the MEFP" shall be replaced with a reference to "Paragraph 23 of the June 2021 TMU and Table 1 of the June 2021 MEFP".

4. The Fund decides that the first review specified in paragraph 3(d) of the Extended Arrangement is completed, and that Kenya may make purchases under the Extended Arrangement.

5. This Decision shall become effective only upon the adoption of Decision No. 17066 by the Executive Board. (EBS/21/52, 06/10/21)

Decision No. 17065-(21/64), adopted
June 23, 2021

2. Kenya—First Review of the Arrangement Under the Extended Credit Facility and Request for Modification of Performance Criteria and Structural Conditionality

1. Kenya has consulted with the Fund in accordance with paragraph 4(c) of the arrangement for Kenya under the Extended Credit Facility (EBS/21/29, 03/19/2021, the "ECF Arrangement") to review program implementation and to reach understandings regarding the conditions for future disbursements.

2. The letter dated June 10, 2021 from the Cabinet Secretary, National Treasury and Planning and the Governor of the Central Bank of Kenya (the "June 2021 Letter"), together with its attached Memorandum of Economic, Financial and Structural Reform Policies (the "June 2021 MEFP") and Technical Memorandum of Understandings (the "June 2021 TMU") shall be attached to the ECF Arrangement and the letter dated March 19, 2021, together with its attachments , shall be read as supplemented and modified by the June 2021 Letter and its attachments.

3. Accordingly, the ECF Arrangement shall be amended as follows:

a. A new paragraph 2(e) shall be included in the ECF Arrangement to read as follows:

"(e) The fifth disbursement, in an amount equivalent to SDR 38 million, will be available on or after November 7, 2022, at the request of Kenya and subject to paragraphs 4 and 5 below."

b. Paragraph 4 of the ECF Arrangement shall be renumbered as paragraph 4.A.

c. In paragraph 4.A(a) of the ECF Arrangement, subparagraphs (vi)-(x) shall be renumbered: (i)-(v) and the reference to "Table 1 of the MEFP and further specified in the TMU" shall be replaced with a reference to "Table 1 of the June 2021 MEFP and further specified in the June 2021 TMU".

d. The reference in paragraph 4.A.(b) of the ECF Arrangement to "Table 1 of the MEFP and further specified in the TMU" shall be replaced with a reference to "Table 1 of the June 2021 MEFP and further specified in the June 2021 TMU".

e. The reference in paragraph 4.A.(c) of the ECF Arrangement to "paragraph 62 of the MEFP" shall be replaced with a reference to "paragraph 60 of the June 2021 MEFP".

f. A new paragraph 4.B shall be included in the ECF Arrangement to read as follows:

"Kenya will not request the fifth disbursement under this arrangement specified in paragraph 2(e) above:

(a) if the Managing Director of the Trustee finds that the data as of June 30, 2022 indicate that:

(i) the floor on the primary balance of the national government;

(ii) the floor on the stock of net official international reserves of the Central Bank of Kenya;

(iii) the ceiling on contracting or guaranteeing of new external non-concessional debt by the national government and the Central Bank of Kenya;

(iv) the ceiling on contracting or guaranteeing of new external concessional debt by the national government and the Central Bank of Kenya;

(v) the ceiling on new domestic guarantees granted by the national government;

(vi) the floor on tax revenue of the national government as set out in Table 1 of the June 2021 MEFP and further specified in the June 2021 TMU was not observed; or

(b) until the Trustee has determined that fourth program review referred to in paragraph 60 of the June 2021 MEFP has been completed."

g. The reference in paragraph 5(a) of the ECF Arrangement to "Table 1 of the MEFP and further specified in the TMU" shall be replaced with a reference to "Table 1 of the June 2021 MEFP and further specified in the June 2021 TMU".

h. The reference in paragraph 5(c) of the ECF Arrangement to "Paragraph 23 of the TMU and Table 1 of the MEFP" shall be replaced with a reference to "Paragraph 23 of the June 2021 TMU and Table 1 of the June 2021 MEFP".

4. The Fund decides that the first review specified in paragraph 4(c) of the ECF Arrangement is completed, and that Kenya may request the second disbursement referred to in paragraph 2(b) of the ECF Arrangement. (EBS/21/52, 06/10/21)

Decision No. 17066-(21/64), adopted
June 23, 2021

EXECUTIVE BOARD ATTENDANCE[2]

A. Sayeh, Acting Chair

Executive Directors	**Alternate Executive Directors**
I. Mannathoko (AE)	
A. Andrianarivelo (AF)	
	J. Corvalan (AG), Temporary
	C. White (AP)
	R. Velloso (BR), Temporary
	Z. Zhang (CC)
	J. Romero (CE)
L. Levonian (CO)	
	H. Azal (EC)
A. Buisse (FF)	
	K. Merk (GR)
	B. Singh (IN), Temporary
D. Fanizza (IT)	
	M. Kashima (JA)
	M. El Qorchi (MD)
	M. Merhi (MI), Temporary
	T. Manchev (NE), Temporary
	J. Sigurgeirsson (NO)
A. Mozhin (RU)	
	F. Rawah (SA), Temporary
	F. Mochtar (ST)
	M. Zhunusbekova (SZ), Temporary
	D. Ronicle (UK)
	Rachel Lyngaas (US), Temporary

G. Bauche, Acting Secretary
H. Malothra, Summing Up Officer
A. Lalor, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
African Department: V. Crispolti, A. Fedelino, M. Goodman, J. Jack, F. Nyankiye, G. Pula, T. Rasmussen, A. Selassie, S. Touray. Communications Department: A. Kanyegirire, W. Murray. Fiscal Affairs Department: L. Bounader. Finance Department: L. Chidawaya,

[2] For countries in each constituency, please see the Constituency Codes in the annex.

C. Kadama, M. Mohlala. Legal Department: P. Di Benedetta, J. Duasing, C. El Khoury, R. Snipeliski Nischli, J. Swanepoel. Monetary and Capital Markets Department: S. Gray. Office of Executive Directors: W. Keller, U. Nielsen. Strategy, Policy, and Review Department: P. Iossifov, M. Kaufman. World Bank Group: A. Dennis, X. Furtado, P. Schuler. Executive Director: S. Bhalla (IN), R. Lim (ST), M. Mahmoud (MI), P. Moreno (CE), M. Mouminah (SA), R. von Kleist (GR). Alternate Executive Director: B. Alhomaly (SA), A. Alhosani (MI), A. Guerra (CE), C. Just (EC), W. Nakunyada (AE), R. N'Sonde (AF), F. O'Brolchain (CO), O. Odonye (AE), L. Palei (RU), P. Rozan (FF), F. Sylla (AF). Senior Advisors to Executive Directors: W. Abdelati (MI), S. Ahmed (MD), H. Andrianometiana (AF), E. Cartagena (CE), M. Choueiri (MI), J. Damgaard (NO), J. Garang (AE), O. Hendrick (AG), M. Ismail (AE), B. Jappah (AE), B. Lischinsky (AG), M. Maidi (AE), Son T. Nghiem (ST), J. Rojas (CE), S. Senich (US), A. Tolstikov (RU), G. Vasishtha (CO). Advisors to Executive Directors: A. Abdullahi (AE), F. Al-Kohlany (MI), P. Al-Riffai (MI), A. Arevalo Arroyo (CE), M. Bangrim Kibassim (AF), B. Boostani (MD), K. Carvalho da Silveira (AF), L. Cerami (IT), D. Fadhel (MI), G. Khurelbaatar (AP), Y. Kikucji (JA), H. Koh (GR), R. Moral Betere (CE), K. Osei-Yeboah (MD), B. Piasecki (SZ), M. Pucnik (EC), Y. Yang (CC), F. Lopez (CE), D. Coelho (BR), A. Evangelou (UK).

DISCUSSION RECORD[3]

The Acting Chair (Ms. Sayeh):

We now meet to consider the first review of Kenya's arrangement under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF). Bank staff is attending this meeting, and we welcome them. All Directors issued gray statements.

The authorities have continued to demonstrate strong commitment to their economic program. This, we think is evidence in the important progress made in carrying forward their fiscal consolidation efforts and in advancing the structural reform agenda despite some temporary delays. The recent publication of comprehensive audits of COVID-19-related expenditures also sets a good example of fiscal transparency. Kenya's engagement with the Fund has continued to catalyze financing from Kenya's development partners and capital markets, including through a successful Eurobond issuance this past week, a World Bank development policy operation the week before, and support from G-20 through the Debt Service Suspension Initiative (DSSI).

Ms. Mannathoko:

I will just say a few words on behalf of the Kenyan authorities, just to thank Executive Directors for their comments and their support towards completion of this review, and their very constructive observations in gray statements and the valuable advice will be conveyed to the authorities. In line with their advice, maybe just to say a few words on vaccination. The authorities are committed to containing the virus and accelerating COVID-19 vaccination while mitigating impacts on the ground. They are mobilizing additional resources and seeking to diversify vaccine sourcing. As staff indicate, we hope to expand the coverage to 60 percent of the population by the middle of 2023. Beyond this, maybe just to say that the authorities in terms of the program, they intend to sustain just targeted fiscal support over the near term alongside fiscal consolidation efforts that are aimed at supporting debt sustainability. We will share that advice on close attention to the state-owned enterprise (SOE) sector looking at this and working to strengthen the fiscal governance.

On the monetary front, they want to maintain an accommodative stance. They understand that this is appropriate, and for the financial sector

[3] Edited for clarity.

they will continue to monitor financial sector developments to mitigate against any risks to financial stability. I will keep it brief, and I can elaborate in my closing comments if necessary after I hear what Executive Directors say.

The staff representative from the African Department (Ms. Goodman):

Thanks to Directors for the questions and comments in the gray statements. Before we begin, I would like to provide some very brief updates on recent developments.

First, on the COVID-19 situation, following the third wave, which peaked in mid-April, cases have again over the past few weeks started rising. Kenya has now been recording about 500 new cases each day, up from around 300 per day in early June. The increase has been seen mainly in the Western part of the country where case numbers have been rising, as they also have been in neighboring Uganda and Rwanda. In response, 13 counties in Western Kenya were declared a hot spot zone, and a series of containment measures have been put in place in that region, effective June 18. These include an expanded nighttime curfew, a ban on public gatherings and restriction of non-essential movement in and out of the zone. This mirrors what was done in the Nairobi area during the earlier third wave.

A few points on the Eurobond issuance mentioned by the Deputy Managing Director. On program financing, the favorable terms that Kenya secured on the $1 billion Eurobond issuance on June 17 included that it was a 12-year bond, and it was priced at 6.3 percent. The bond has a split maturity with equal installments maturing in 2033 and 2034 and with a slightly lower interest rate than the 6.5 percent, which is assumed in staff's last Debt Sustainability Analysis (DSA). It also is favorable for the debt profile. The authorities' plan debt management operations in the coming fiscal year and the favorable investor appetite on this issue is a positive sign.

Finally, staff had also issued a staff supplement last week on the end-March outturn on social spending.

Mr. Rozan:

We issued a gray statement with Mr. Ronicle where we expressed our support to the review and the associated decision, so I will just underline very quick points on program design consideration and debt management.

First, we agree with staff that major term risks are tilted to the downside, so as the program remains ambitious, with frequent reviews early on and short-term challenges, as well as high-risk on fiscal components, continuous flexibility in the implementation will be needed. The fact that early on in the program implementation indicative targets (ITs) were missed and sound structural benchmarks were delayed bears to underline the importance of contingency planning, of course, and work on the authorities' implementation capacity, in particular through technical support.

Second, we note that the risk of debt distress continues to be assessed as high with a sizable impact of debt service on the fiscal accounts. In this regard, it is unfortunate that the DSSI impact was halved in the first semester of 2021. We also note at the program approval that Kenya's debt is susceptible to exports and exchange rate shocks, so we support debt management that is proactive and forward leaning to moderate the weight on public expenditure and weather any additional shock. We very much support the authorities' willingness to modify and modernize their debt management law towards international standards, including with reporting to Parliament on the strategy for the medium- to long-term.

With this, let me again underline our support to the authorities in this very uncertain time, and we think the program provides a very useful anchor to their efforts.

Mr. Merk:

We welcome the authorities' budget planning that balances continued essential support to the economy in the ongoing crisis with an early gradual rebuilding of buffers, thereby also helping to mitigate the need for more abrupt tightening at a later stage.

Strengthening public financial management, transparency, and good governance across the public sector is key, as well as containing fiscal risks in the SOE sector. We welcome the anticorruption safeguards. We note with concern the recently published report by the auditor general, as elaborated on in our gray. We emphasize that ensuring a transparent and efficient use of Fund resources should continue to receive highest attention.

Mr. Andrianarivelo:

We welcome Kenya's performance under the program and support the completion of the first reviews under the ECF-EFF arrangement. We also commend the authorities for conducting comprehensive audits on COVID expenditures for FY2020 and the submission of the result to Parliament by the auditor. In this regard, we encourage them to follow up on the recommendations. We acknowledge the efforts deployed by the authorities to mitigate the impact of COVID-19 and of a third wave.

While there are positive signs of commitment for the international community to allow more access to vaccines, we share the views highlighted by Mr. Romero and Mr. Cartagena, including international nongovernmental organizations (NGOs) for increasing the availability of resources needed for vaccines production and distribution. In the case of Kenya, it is clear that any delay in vaccination will result in a more challenging outlook.

Fiscal policies should find an appropriate balance between continuation of containment measures aimed at fighting the pandemic and supporting the recovery. In addition, efforts to achieve fiscal consolidation and reduce debt vulnerabilities must continue, and we thank Ms. Mannathoko for her remarks in this area earlier. In this context, we welcome the reforms undertaken to strengthen the debt management framework and modernize tax administration.

Finally, the commitments and advances made by authorities on the structural front, including in assessing the financial position of SOEs and fiscal governance, are positive steps. The authorities should also continue the efforts to strengthen the AML/CFT and anti-corruption frameworks.

Ms. Lyngaas:

We have issued a gray statement noting our support for the authorities' first review under this ECF and EFF and support their request for modifications. I will make only a few additional points for emphasis here.

First, I will note that the report indicates that DSSI relief for Kenya was lower than previously anticipated and contributed to the need for the authorities to request a modification of the end-June target on net international reserves. There were also a little bit more elaboration from staff on this in their responses to technical comments. We would just note that we very much look forward to staff including data by creditor in program documents, as will be implemented under the staff guidance note for the new revised debt limits program. We think that could have been very useful to inform Directors in this case, and we call on all creditors to fully implement the DSSI.

Second, we wanted to highlight and applaud this instance of very high-quality coordination between Fund staff and the World Bank whose budget support we understand is playing an important role alongside Fund financing to support Kenya's economic reforms.

Finally, this report mentions several areas where the Fund is providing technical assistance. We welcome staff's comments on whether there are areas where more technical assistance either from the Fund or other TA providers might be needed to support the authorities' reform priorities moving forward. With that, we strongly support this program and look forward to further updates on the authorities' reform agenda.

Mr. Velloso:

We issued a comprehensive gray statement supporting the conclusion of the first EFF-ECF review; therefore, I will briefly highlight a couple of points.

First, we share staff's assessment that program performance has so far been satisfactory, and we commend the authorities' commitment to the program's objectives. However, we are concerned with some risks to the outlook, such as heightened debt vulnerabilities, and the potential pickup in political tension in the context of the upcoming general elections. In this latter regard, we take positive note of staff's assurances that the program commands broad support among the main stakeholders in Kenya. This is very good news.

Second, the structural reform agenda is a critical part of the program and encompasses multiple sectors and initiatives. Of special notice, improving governance and efficiency of SOEs in mitigating risks stemming from SOEs will be key for continued program success. We, therefore, urge the authorities and staff to remain vigilant and be prepared to take additional measures as necessary to contain such risks.

Mr. Zhang:

The Kenyan authorities' response to the pandemic is well recognized, and their economic performance is outstanding. We support the completion of the program review and the request by the authorities to the modification of some of the indicators. We have issued a comprehensive gray statement, and I would like to emphasize two points.

First, it is important to contain the infections of the pandemic. We are sorry to see the default supply of the COVAX for the agreed vaccination. In this regard, we strongly encourage the authorities to diversify their vaccination supply and put forward enough resources for the vaccination process.

Second, we see the very good discussion between authorities and staff on the SOE reform, which is well-written in the paragraph 23-24 and so on. We believe the SOE reform is critical for reducing the fiscal risks and for the job and growth. In this regard, I believe the evaluation of SOE financial situation is, of course, important. More importantly is to formally commercialize the operation of each SOE, including strengthen the oversight and accountability on each SOEs management team so also increase its efforts on anti-corruption.

Mr. Romero:

We concur with the completion of the first review of Kenya’s EFF and ECF. We praise the authorities’ commitment to achieve the program’s targets and acknowledge that the difficult circumstances presented by the crisis and its third wave constrained the timing of some of the targets, but at the end, we welcome that the country and the authorities could achieve them.

We highlight the authorities’ commitment to developing economic measures to achieve the four objectives of the economic program through this arrangement, aiming to stabilize debt and boost growth. We commend the authorities’ swift response to contain the spread of the COVID-19 pandemic. As informed in the Q&A and answers by the staff, the authorities are seeking to accelerate vaccine rollout and are working from a plan that would achieve over 50 percent population coverage by mid-2022. That is an important effort, but we need additional efforts not only of the authorities and the Kenya’s government, but also the international community, to help this country achieve a faster vaccination process. The main constraint in delivering on this plan seems to be vaccine supply, and I think that this is something that we have to focus on because as long as they do not receive the vaccines on time, they are not going to reactivate their economy.

We take note of the position of the authorities that the minimum income tax suspension should be lifted and fully understand the argument. However, we welcome the possible contingency plan and possible contingency measures that they are looking at, such as the harmonization of the VAT rates with the East African Community, the harmonization of the

VAT rates on the petroleum products, and the increase of the digital tax and other Capital Gains Taxes. It is very important to have options on the table and have the perception on how to use them and the right moment to do it, and we are confident that that will be the case of Kenya.

Strengthening the tax administration and fighting against tax evasion and corruption is the only measure that does not depend on political decisions, and we commit the authorities to work on that field.

The Acting Chair (Ms. Sayeh):

Well noted, and in particular Mr. Romero's comment on the need to facilitate increased access to supplies of vaccines, not just for Kenya but, of course, for all of our poorer member countries. We are, in fact, seeing an uptick in cases in Sub-Saharan Africa currently, which underscores the importance of robust efforts to make sure that supplies are made available.

Mr. Fanizza:

While we have issued a quite supportive gray statement, and I am taking the floor just to congratulate staff and the authorities for their productive engagement, which has resulted in a strong, I would say, program performance; but what is more important, it has resulted in progress in the authorities' economic reform agenda, the implementation of the agenda, which is what counts. Structural reforms play a key role in program design, rightly so.

I wonder whether we should be a bit more parsimonious on setting indicative target structural benchmark because the pressure may be—and, of course, I may be mistaken—seems to be a bit too many, and it is difficult to explain when they are missed. My preferred approach is setting one or two important structural benchmarks and focus on those. That is a minor comment.

The other thing that I wanted to stress is that we are pleased by the advancement in the regulatory framework for the financial sector beyond the traditional banking sector. The background there is that Kenya has been at the forefront of the mobile banking revolution, and also the progress improving the regulatory framework is much appreciated.

The staff representative from the African Department (Ms. Goodman):

Thanks to Directors, again for the points in gray statements, which we very much take to heart, as well as for the points made in today's discussion.

A few key elements to respond to. First, yes, just to confirm that the authorities have announced this aggressive approach to accelerating their vaccine rollout; but in order for them to do so, it is, in fact, the case that the main constraint on this is the supply of vaccines, so to reconfirm that point.

On the question regarding additional TA, TA has really been a very important part and very supportive of the program design, and I think we have benefited greatly as a team from the authorities' very good engagement with staff. When it comes to TA provision, I can say here that TA from the Fiscal Affairs Department, from our colleagues in AFRITAC East, and from the Legal Affairs Department, is all supporting the work on state-owned enterprises, as is TA from bilateral partners, very important support there, but also support from colleagues in MCM and the Statistics Department.

The authorities are at this juncture engaging in a discussion with FAD colleagues on the possibility of working with them on a medium-term revenue strategy, and I think they are quite interested in that, and that could be a very useful engagement that could support the objectives of the program, particularly the domestic revenue mobilization objectives of the program. I think that is a forward-looking area that is very promising.

Finally, on the points regarding data by creditor, I will reconfirm staff absolutely plans to report data by creditor as required under the Debt Limits Policy (DLP) when that new policy comes into force, as Directors are aware. The coming into force of that new policy will also have other implications for this program in terms of our transition to monitoring on a present value basis, and we are looking very much forward to that transition. Obviously, Kenya also reports in terms of its participation in the DSSI also to the G-20, so that is also forthcoming.

Ms. Mannathoko:

Thanks to Directors for supporting the request. The authorities remain strongly committed, including to bringing the primary fiscal deficit below the debt stabilizing level by 2023 through their revenue mobilization and spending rationalization measures. And they are also now looking to focus on prioritizing social spending, working at improving transparency, as we have seen with various publications, and strengthening management of SOEs and public-private partnerships (PPPs), which was highlighted by various Directors. They are looking at fiscal risks there as well as.

Also, to allay some points that were raised over tax measures. The authorities do have contingency tax measures which revolve around enhancing revenue collection, et cetera, and they remain confident that they will be able to prevail both end-June in the courts over the suspended Corporate Minimum Alternative Tax (CMT).

On financial sector stability, they are enhancing asset quality, monitoring financial risks, strengthening the AML/CFT framework and just further developing the regulatory framework for nonbank digital lenders and MFIs. On structural reforms they really recognize that these are crucial to improve the business environment and foster a more inclusive recovery. They are taking measures to also, as we have noted, to show transparency and accountability. We know, the publication of the FY2019-20 COVID-related audit, and they are continuing to drive work on ensuring a business e-registry and taking remedial actions to address deficiencies in various areas. PFM reforms are underway, and they are sustaining the reviews of legislative bills; all these to support this.

I also just really wanted to indicate that we will convey also the Directors stressing in their interventions the importance of contingency planning, containing risks, and we also really appreciate the support for continued flexibility in the program—this is important—and to the extent possible, also parsimony in conditionality.

We wanted to highlight we will also just share with the authorities the emphasis on governance and anti-corruption, sustaining for more activity in that area.

There was also a point on political risk. Maybe this was mentioned, but just to again reassure Directors really that the program does have wide support in Kenya, so the program will be safeguarded in that context.

I want to thank the mission chief, Ms. Goodman, and her team for the excellent work and the productive engagements with authorities during missions and for ensuring flexibility in the program, recognizing the unpredictability of the crisis, of the COVID-19 crisis, as she was saying just now, the resurgence of the virus in the region and the building on the contingency plans. So, we are really appreciative of this, and we also just appreciate they provided a comprehensive report and full responses to Executive Directors.

My authorities really appreciate the program and look forward to continued Fund advice and technical assistance, which for them is still very important. All this remains critical for successful completion of the program.

The Acting Chair (Ms. Sayeh):

Let me thank Directors for the very strong support for the program and for completing this first review. I very much welcome all of the wise counsel to staff and to the Kenyan authorities going forward in taking the program forward. Today's decision confirms that the actions of the Kenyan authorities are well aligned with the goals of their program and that Kenya is, indeed, delivering on key reforms, albeit with some temporary delays.

We all, of course, recognize the extraordinary level of uncertainty at present and the risk going forward, and, of course, to avert risks that emanate from that, continued strong program implementation should help pave the way for a durable and inclusive recovery in Kenya. A very constructive discussion today. We thank Directors for that. Staff will, of course, take note of the Board's guidance as they embark on discussing the second review down the road with the authorities. Let me conclude by thanking the Kenyan authorities for their very strong collaboration and wish them the very best of success in the months ahead, and thank Ms. Mannathoko for her strong collaboration with staff and management in our relationship with Kenya.

The Acting Chair (Ms. Sayeh) adjourned the discussion.

ANNEX

- Gray Statements
- Staff Responses to Executive Directors' Technical Questions
- Constituency Codes

DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

BUFF/ED/21/79
Revised: 6/20/21

June 18, 2021

Statement by Ms. Mannathoko and Mr. Garang on Kenya
Executive Board Meeting 21/64
June 23, 2021

I. Introduction

1. The Kenyan authorities appreciate the constructive engagement with Fund staff during the first review of the Extended Credit Facility and Extended Fund Facility (ECF/EFF) Arrangements, and broadly agree with the key reform priorities articulated by staff.

2. The COVID-19 crisis continues to exact a heavy toll on Kenya, reflected in socioeconomic hardship and the threat of a reversal in hard-won gains in poverty reduction. The authorities have adopted an Economic Recovery Strategy (ERS) designed to lay the foundation for an inclusive recovery and reposition the economy on a sustainable growth path. The ERS builds on gains from the earlier Economic Stimulus Program (ESP), prioritizing employment creation, focusing on enhancing budgetary allocations, supporting MSMEs, facilitating private sector-led development, and boosting social protection and natural disaster risk management, among other things.

3. Directors' support is sought for the completion of this EFF/ECF review and the request for modification of PCs. The authorities have continued to honor commitments under the RCF/RFI letter of intent, ensuring transparency in the use of COVID-related resources. They have initiated regular reporting on pending bills and are reviewing their legal and regulatory structures to enhance accountability, and transparency in the use of public funds. The Auditor General submitted the results of comprehensive audits covering all FY2019/2020 COVID-19 related expenditures to Parliament in late May, and they were published in early June. Remedial measures are ongoing to resolve a few issues raised in the audits, especially those related to the procurement of healthcare equipment. The authorities are also strengthening public accountability through ongoing enhancements of the public procurement portal, enabling publication of comprehensive information on firms that received procurement contracts, including the names of their beneficial owners.

II. Recent Pandemic and Economic Developments and Outlook

4. While Kenya has started to relax containment measures that were instituted when the third wave of infections began, cases will likely continue to rise until there is wider vaccination coverage and herd immunity is achieved. Kenya participates in the COVAX facility and received its first doses in March, vaccinating about 2 percent of the population by end-May 2021. The authorities are mobilizing resources alongside donor support to procure more doses from a range of sources. They have taken steps to significantly ramp up the vaccination campaign targeting 14.5 million people by end July 2022, and the balance needed to reach 60 percent of the population by 2023.

5. Economic activity is projected to rebound to 6 percent in 2021 from 0.3 percent in 2020 on the account of improved agriculture output, manufacturing, and improved performance in other sectors. Despite risks from the third wave of infections, the authorities remain optimistic that the impact of the geographically concentrated containment measures on the GDP would be minimal. At the same time, the remittances, and exports of key sectors such as tea and horticulture are expected to remain resilient, supporting improvement of the current account balance. In the medium term, economic activity is expected to pick up, buoyed by growth in agriculture, trade, and manufacturing, as the pandemic comes under control.

6. Inflation is projected to remain near the mid-point of the authorities' target range in 2021 through the medium term, anchored by prudent monetary policy. International reserves remain adequate, covering about 5 months of imports.

III. Program Performance

7. Performance under the program has been strong, with all performance criteria (PCs), continuous PCs, and structural benchmarks (SBs) for end-March met. That said, some indicative targets (ITs) for end-March 2021 were missed by narrow margins, partly due to the challenging COVID-19 environment. The authorities met the fiscal balance target for end-March by a wide margin and planned tax policy measures were fully implemented with slightly less than expected tax revenue yields due to the pandemic. Though three structural benchmarks (SBs) at end-April and end-May were not met on time, the authorities remained committed with two having been subsequently completed, and the last one expected to be completed soon.

8. The FY2021/2022 budget submitted to Parliament reflects the authorities' ambitious multi-year plan to reduce debt-related vulnerabilities, while supporting social spending. They are also developing a strategy to manage fiscal risks from State Owned Enterprises (SOEs). Looking ahead, the authorities are requesting modifications to PCs on net international reserves for end-June 2021; the IT on tax collection for end-June 2021; and one end-June 2020 SB on the common payroll system across different public sector entities. They remain optimistic about the successful implementation of this program and its long-term impact on the country's economic development.

IV. Macroeconomic Policies and Measures

Fiscal Policy and Debt Management

9. The authorities remain committed to fiscal and debt sustainability and are pursuing a multi-year growth-friendly fiscal consolidation centered on revenue mobilization and expenditure prioritization, while safeguarding social spending and jobs programs that support poverty reduction. The authorities are conscious of the need to ensure adequate social programs for the most vulnerable households, while prioritizing key public investments. They are also addressing fiscal risks from SOEs and PPPs, while strengthening public financial management (PFM), enhancing commitment controls and cash management, and fostering good governance and transparency in the management of public resources. Efforts to prevent accumulation of domestic arrears and to improve fiscal transparency will also buttress reform endeavors. Given the ongoing uncertainty in the outlook, the FY2021/2022 budget proposal has a contingency plan, including commitment to phase out tax exemptions and conduct expenditure reviews with the support of the World Bank.

10. The Kenya Revenue Authority (KRA) has identified measures to enhance revenue administration reforms and collections, including automation and leveraging iTax, a simplified web-based tax collection platform. The KRA continues to broaden the revenue base, revamp the audit function, and apply clear measures to recover tax arrears. The authorities have also appealed against the High Court ruling that suspended the imposition of a Corporate Minimum Tax (CMT) and are confident that they will ultimately prevail. KRA expects a gradual recovery in fiscal performance with some improvement evident this fiscal year.

11. The fiscal authorities are also strengthening debt management. Consistent with program objectives, they plan to introduce a new debt anchor and meet accountability requirements to ensure public buy-in and parliamentary oversight. The authorities continue to limit foreign debt and ensure proper debt reporting and transparency. Measures are taken to avoid bunching of repayments and to contain debt vulnerabilities. To ensure coordination and timely sharing of data, including on debt, the authorities have established an inter-agency working group within the Macro and Fiscal Affairs Department in the national treasury, to ensure high-quality economic statistics and support evidence-based decision making.

Monetary and Financial Sector Policies

12. The authorities will maintain an accommodative monetary policy stance while containing inflation, ensuring that monetary policy continues to anchor price expectations. The CBK is also strengthening the monetary policy framework and inflation targeting regime, while ensuring exchange rate flexibility. When the MPC met recently it resolved to ensure effective communication, modernize macroeconomic modelling and forecasting frameworks, enhance operations of financial markets, and improve governance to promote monetary transmission mechanisms and policy credibility.

13. The CBK had lowered its central bank policy rate in March and April 2020, in the wake of the pandemic, and reduced the cash reserve ratio, alongside measures to temporarily

ease repayment conditions for borrowers in businesses and households impacted by the pandemic. The CBK also undertook a series of liquidity support measures and reduced charges on mobile money transactions to disincentivize the use of cash. Mobile money has been the backbone of the cash transfer program and general economic transactions during the pandemic.

14. The financial sector remains on a solid footing and is well-capitalized and profitable, despite emerging risks on borrowers' balance sheets, including elevated non-performing loans (NPLs). The share of NPLs in gross loans has risen to 14.6 percent in March 2021 from 14.1 percent in December 2020, as business activity remains subdued. Banks continue to make the required provisions for NPLs. The capital adequacy ratio and liquidity ratio have remained well above statutory standards through end-March 2021. That said, the authorities continue to monitor potential financial risks. The CBK is closely monitoring loan restructuring, strengthening the credit referencing mechanism, sustaining reforms to the regulatory and supervisory framework, and further strengthening bank capital buffers, even as the authorities enhance the use of mobile money, embrace digital platforms and promote access to affordable finance. Attention is also directed at prompt resolution of troubled institutions, an example being the recent liquidation of two troubled banks.

Structural Reforms, Governance and Accountability

15. The authorities are accelerating key structural reforms for good governance and accountability, enhancing asset declaration, upgrading the AML/CFT framework, and improving the business environment and the macroeconomic statistics that enable increased transparency. They remain committed to improving public financial management systems and aligning the payrolls for national and county governments. The medium-term focus is on integrating semi-autonomous agencies (SAGAs), and strengthening procurement systems, among other things.

16. The authorities have initiated reviews of various legislative bills to improve accountability for use of public resources. These include the Conflict of Interest Act targeted for end-September 2021, the Access to Information Act, the Criminal, Bribery, and Evidence Acts, the Anti-corruption and Economic Crimes Act, the Asset Recovery Act, the Prevention of Organized Crimes Act, and the Proceeds of Crime and Anti-Money Laundering Act. These bills will impact access to information, criminalize acts of corruption, boost recovery of public assets and improve the ease of doing business.

V. Conclusion

17. Our Kenyan authorities reaffirm their commitment to prudent macroeconomic policies and laying the foundation for stronger post-COVID-19 recovery with inclusive growth. They look forward to Executive Directors' support towards the completion of the first review under the EFF/ECF arrangements.

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GRAY/21/1710

June 21, 2021

Statement by Mr. El Qorchi and Mr. Ahmed on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

1. We thank staff for a well-written report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. We broadly concur with the staff appraisal as well as recommended policy priorities and support the proposed decisions.

2. We commend the authorities' swift response to the pandemic and the economy's recovery since mid-2020. Kenya was hit severely by the third wave of COVID-19 and its vaccination program faced serious challenges on delays in international vaccine shipments in May. In this regard, we welcome the authorities' steps to ramp up the vaccination campaign to reach 60 percent of the population by mid-2023.

3. We note positively that Kenya's economic growth is projected to rebound to 6 percent in 2021, from almost flat last year, helped by the easing of coronavirus restrictions and the government's support programs. Inflation is projected to remain close to the mid-point of the central bank's target range in 2021. International reserves remain adequate, covering about 5 months of imports. However, the outlook is subject to high uncertainty. The crisis has set back development goals and exacerbated existing debt vulnerabilities. Against this background, we welcome the authorities' commitment to policies that chart a clear path to reduce vulnerabilities and support sustainable, inclusive growth.

4. The authorities have advanced their reform agenda amid a challenging environment and the program is broadly on track. We support completion of the first reviews of the Extended Arrangement Under the EFF and ECF, and the authorities' request for modifications of Performance Criteria (PC) on net international reserves; the Indicative Target (IT) on tax collection; and one end-June 2020 SB on common payroll system across different entities within the public sector. We note that all end-March 2021 PCs and the continuous PC and structural benchmarks (SBs) were met. End-March ITs were missed by narrow margins due to temporary factors not related to changes in policies—which remain

fully aligned with the program objectives. We also note the delay in completion of three SBs for end-April and end-May. Given elevated uncertainty, we support flexibility in the program design, including recognition of near-term challenges around tax yields and SOE contingent liabilities.

5. We view the planned multi-year fiscal consolidation effort, laid out in the FY2021/22 Budget, as essential to lay the ground for a return to durable growth and to safeguard debt sustainability while supporting the social spending. We commend the steps already taken to mobilize additional tax revenues along with prioritizing and limiting recurrent spending to contain the deficit. We support bringing the primary deficit below its debt-stabilizing level during the program and restoring tax revenue, which had fallen even before the COVID-19 shock, to levels achieved in recent years.

6. We agree that the near-term structural reform agenda should focus on urgent priorities. Financial weaknesses in several state-owned enterprises (SOEs) are a key risk. We call for a strong focus on containing fiscal risks and stress that any extraordinary SOE support be consistent with Kenya’s limited fiscal space. We are encouraged by plans for fiscal structural reforms on revenue administration, spending efficiency, and fiscal transparency. We also emphasize the importance of continuing to improve the anti-corruption framework, welcome the publication of audits of all COVID-19 related expenditures, and look forward to the implementation of the AML/CFT agenda.

7. We commend the Central Bank of Kenya’s proactive policy response during a very challenging period. We support maintaining an accommodative monetary policy stance while keeping inflation well-anchored, and continuing to allow the shilling exchange rate to act as a shock absorber. We note that while the financial sector remains well capitalized and profitable, the shock has exacerbated preexisting asset quality weaknesses, and support close supervision of credit risks and adequate provisioning.

With these remarks, we wish the Kenyan authorities success in their endeavors.

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GRAY/21/1713

June 21, 2021

Statement by Mr. Sigurgeirsson and Mr. Damgaard on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the informative report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. Kenya has been hit by multiple waves of the pandemic, but the authorities' swift introduction of new containment measures helped push down infection rates when the latest wave hit in March-April. The economic recovery is now underway, although risks are tilted to the downside. Given the broadly satisfactory program performance, **we support the completion of the first reviews under the EFF and ECF as well as the modification of PCs, IT, and SBs.**

It is critical that fiscal policy strikes an appropriate balance between short-term support during the pandemic and medium-term debt sustainability. We welcome the budget that was submitted to the Parliament at the end of May. It narrows the overall fiscal balance, while still providing targeted support to sectors affected by the pandemic. We encourage the authorities to develop contingency plans to raise additional revenues and/or cut non-essential spending, should fiscal developments turn out to be worse than expected. Moreover, we welcome the dialogue with the donor community to accelerate vaccination plans. In the medium term, the authorities will need to enhance revenue mobilization by introducing new tax measures. On the spending side, the public wage bill should be kept under control and spending efficiency increased. We welcome the plans to replace the nominal debt ceiling with a debt-to-GDP anchor. Once the crisis has abated, it is important to bring the debt-to-ratio on a firm downward path in line with the new fiscal anchor.

Monetary policy should continue to be data dependent. We welcome the measures taken by the Central Bank of Kenya (CBK) to counter the impact of the crisis, including the interest rate cuts in the spring of 2020. We also take positive note of the assessment that the Shilling continues to serve as a useful shock absorber. Banks remain profitable and well-capitalized, but banks' asset quality should be carefully monitored as crisis-related measures, such as loan moratoria, are phased out. In this context, we welcome the requirement for banks to consult the CBK for approval of dividend payments. We also welcome the sharp increase in the use of mobile money following the CBK's decision to waive the fees on fund transfers from bank accounts to mobile wallets. This initiative will both serve to limit the spread of the virus and improve financial inclusion.

Ambitious structural reforms will be necessary to enhance resilience and potential growth. We agree with the near-term priorities of addressing SOE challenges and moving forward with the governance and fiscal structural agendas. The oversight of SOEs needs to be strengthened, and the SOEs' dependence on fiscal support should be reduced. On governance, we welcome the audits of Covid-related expenditures and the publication of information on awarded contracts and beneficial ownership by the Kenya Medical Supplies Authority. At the same time, we urge the authorities to publish beneficial ownership information in the Public Procurement Information Portal as specified in the end-June SB. We also call on the authorities to forcefully implement the comprehensive anti-corruption laws, which are already in place, including an effective implementation of the AML/CFT framework.

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GRAY/21/1714

June 21, 2021

Statement by Mr. Bevilaqua, Mr. Velloso, and Mr. Coelho on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the report and Ms. Mannathoko and Mr. Garang for their helpful statement.

The COVID-19 pandemic continues to pose significant challenges to Kenya. The near-term priority should be keeping the pandemic at bay and accelerating the distribution of vaccines, while mitigating the economic costs of the health crisis through well-targeted policy support. Like staff, we believe that program performance has so far been satisfactory, and the authorities remain committed to the program's objectives. We therefore support the authorities' request for completion of the first review under the EFF/ECF arrangement.

While we are encouraged by the scope and direction of the program, risks to the outlook remain elevated. In addition to continued COVID-19 challenges, we note considerable risks to the outlook, including heightened debt vulnerabilities and a potential pickup in political tension in the run-up to and aftermath of the upcoming general elections. *Staff comments on whether the program commands wide support among Kenya's main stakeholders are welcome.*

The authorities' steadfast commitment to addressing structural imbalances remains critical for a successful outcome of the program. This will require streamlining public administration and tax exemptions; broadening the tax base; addressing financial vulnerabilities; increasing access to affordable finance; enhancing operational tools in the context of increasing financial sector complexity; and improving governance and transparency in line with the anti-corruption legislation. Also, special consideration should be given to improving governance and efficiency of state-owned enterprises (SOEs) and mitigating fiscal risks stemming from SOEs. *In this regard, we would be grateful if staff could elaborate further on the reasons for the additional fiscal costs from SOEs in FY21/22 mentioned in paragraphs 17 and 25. Are these mostly one-off costs related to the pandemic or a sign of more entrenched difficulties?*

We take positive note that, according to staff, the financial sector remains stable and profitable. Regulatory ratios remain strong and banks' return on assets and on equity have recently increased. It is also reassuring that a recent review by the central bank found no systemic risk in the banking system. This is very good news. However, as the moratorium on loan repayments and other support measures to borrowers are lifted, we encourage the authorities to remain vigilant and act promptly, as needed, to protect the banking system's stability.

Finally, we take note that public debt remains at high risk of distress. We are reassured that staff believes that Kenya's capacity to repay the Fund is adequate, its debt remains sustainable, and the debt dynamics is expected to improve as the program is implemented. *We would welcome, however, staff's further elaboration on recent changes to Kenya's debt carrying capacity outlook.*

With these remarks we wish the Kenyan authorities success in their future endeavors.

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GRAY/21/1716

June 21, 2021

Statement by Mr. Fanizza and Ms. Cerami on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for a clear report and Ms. Mannathoko and Mr. Garang for their informative Buff statement. We concur with staff's assessment that the program performance has been satisfactory and support the authorities' requests for completion of the first reviews and modification of PCs, IT, and SBs under the ECF/EFF arrangements. We provide a few remarks.

- **The authorities should continue to prioritize the policy response to the pandemic**. The authorities are right to remain focused on the fight against the pandemic, as recent waves of contagion and bottlenecks in the vaccination campaign have slowed down the recovery and affected program performance. We agree with staff that a possible COVID resurgence remains the top risk to the outlook and program execution. Against this backdrop, the substantial progress made in some key reforms and the renewed authorities' commitment to the program are encouraging.
- **The new budget is a welcome step towards fiscal stabilization**. We welcome that the revised budget submitted to the Parliament is consistent with program objectives and support the authorities' fiscal strategy towards fiscal sustainability, based on further efforts to enhance the mobilization of revenue and the rationalization of spending. Like staff, we also support the proposed changes to the fiscal framework, which would replace the current nominal ceiling on debt issuance with a medium-term debt-to-GDP anchor of 55 percent of GDP in present value (PV) terms, and would introduce an important accountability requirement.
- **The central bank policy response to the pandemic has been comprehensive and effective.** The monetary policy has rightly been expansionary, and the current stance

remains appropriate. Foreign exchange interventions have remained limited, and the financial sector, aided by ad-hoc regulatory measures, has continued to support the economy while remaining stable. We commend the central bank for the progress in reforms to enhance the collection of supervisory data and develop the regulatory framework for non-bank digital lenders and microfinance institutions. *We would appreciate more details on these regulatory developments.*

- **We support the appropriately sequenced structural reforms agenda.** As the authorities remain focused on the pandemic in the near term, we support a gradual and well sequenced approach to structural reforms. In this respect, starting with strengthening the financial position of SOEs and the corruption framework, which are key enablers for subsequent reforms and where substantial progress has already been made is the right approach. However, the authorities should not overlook the challenges of ensuring an inclusive recovery and advance reforms to foster business and employment opportunities, as soon as feasible.

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GRAY/21/1719

June 21, 2021

Statement by Mr. Zhang and Ms. Yang on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the well-written report and Ms. Mannathoko and Mr. Garang for the informative Buff statement. In view of the authorities' adequate program performance and continuing strong commitment, we support the completion of the first reviews and the request for modifications to conditionality. We broadly agree with the staff appraisal and would like to offer the following comments.

We commend the authorities' fiscal efforts in striking a balance between the need to reduce debt vulnerability and continue supporting the economy. To reduce the downside risk, one of the top priorities at this stage is to speed the vaccine rollout and prevent the resurgence of the pandemic. We encourage the authorities to diversify the vaccine supply given the default of the COVAX and at the same time ensure adequate financing for fulfilling the vaccination targets. The proposed debt ceiling framework of a medium-term debt-to-GDP anchor in PV terms and introduction of an accountability requirement is superior to the existing nominal debt ceiling and can provide better guidance to policymakers to support healthy levels of debt, further strengthening spending efficiency and undertaking further tax policy and revenue administration measures in later years which are critical to reduce debt vulnerabilities. *Given the uncertainty around the court's final ruling on CMT suspension, staff's elaboration on the details and prospects of contingency tax measures to meet the tax revenue targets is welcome.*

We see the CBK's accommodative monetary policy stance as appropriate and welcome the white paper on strengthening the monetary policy framework. The accommodative monetary policy stance is warranted while inflation expectations are well-anchored. We look forward to further measures to enhance the effectiveness of central bank operations and monetary policy implementation. While Kenya's banking sector remains well capitalized and liquid, the exacerbated asset quality weakness and rising NPL ratio warrant close supervision and monitoring.

Advancing structural reforms is essential to deliver satisfactory program performance. We welcome the progress in assessing the financial situation of SOEs with the largest fiscal risks and support the authorities' commitment to improving oversight, monitoring and governance of SOEs. *Staff's updates on plans of least-costly approaches to address the financial challenges of individual SOEs are welcome.* We underscore the importance of the operationalization and effective implementation of anti-corruption laws, including the AML/CFT framework. Finally, we encourage the authorities to improve public financial management systems and address the challenges in aligning the payrolls for national and county governments.

With these remarks, we wish the authorities every success in their policy endeavors.

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GRAY/21/1720

June 21, 2021

Statement by Mr. Dresse and Mr. Manchev on Kenya (Preliminary) Executive Board Meeting 21/64 June 23, 2021

We thank staff for the focused report, and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. The authorities' commitment to the program objectives has kept the program broadly on track despite the increasing challenges and risks. The authorities' structural reform agenda is rightly focused on immediate policy needs at this early stage of the program, given the high uncertainty and delays in vaccine supply and inoculation. Thus, we support the proposed decisions and requested modifications of the PCs, SBs and ITs to better align the program objectives in the FY2021/22 budget with the updated macroeconomic framework and outlook.

Fiscal policy public finance and debt management

We welcome the authorities' strong commitment to fiscal consolidation in this uncertain juncture. We also commend their efforts to provide support to the economy in key areas and to strengthen transparency and accountability of pandemic-related spending. However, challenges to fiscal performance have increased. We encourage the authorities to resolve the issue with the High Court Suspension of the recently introduced Corporate Minimum Alternative Tax implementation in a timely manner, and thus to guarantee the revised FY2021/22 primary balance target under the program, or fully implement the necessary contingency measures. The additional fiscal support for the SOEs, which has not been budgeted yet, is anticipated to reach 0.5 percent of GDP. According to the RAM, it represents a short-to-medium-term risk with medium impact to the economy, and we urge the authorities and staff to expeditiously complete the financial evaluation of the key SOEs and prepare remedial actions to properly address this risk. *Staff's further elaboration on the progress and strategy would be highly appreciated, especially in view of the considerable political risks.*

We welcome staff and the authorities' efforts to protect social expenditures and ensure sufficient financing for Kenya's vaccination strategy. The proposed adjustments to the budget to extend targeted support to sectors affected by the pandemic look reasonable given that the COVID-19 shock erased the poverty reduction gains of the last 5 years and is expected to further hamper the long-term human capital accumulation. Looking ahead, we would encourage staff to provide further insights on how the program can better protect fiscal space for the authorities' development agenda and support private credit and investment.

Further strengthening of the public finance management and fiscal framework are critical to ensure long-term debt sustainability. While the current accommodative fiscal stance is justified to limit scarring and support the economy, risks related to debt sustainability remain worrisome. Kenya should urgently build up capacity to mobilize revenues, lower cost of compliance, and implement risk-based frameworks to reduce tax abuse. The planned introduction of an e-procurement system with World Bank assistance, reinforcement of debt management framework and practices, and public-private partnership structure should help rationalize spending and reduce debt vulnerabilities. Going forward, we urge staff and the authorities to soon begin with the technical work needed to allow for effective monitoring of Kenya's debt limits in PV terms, starting with the Third EFF/ECF Review.

Governance and structural reforms

The ambitious program goals hinge on further progress of governance and other structural reforms. We agree with staff that the authorities' focus in anticipation of the next reviews should be on operationalization and swift implementation of the existing legal framework to address corruption and AML/CFT. Timely implementation of the measures provided in paragraphs 28 and 29 of the staff report will be of critical importance in this regard. We note that the preparatory work to strengthen institutional oversight and governance arrangements in the SOE sector is also underway, supported by IMF technical assistance. However, we believe that more ambitious deadlines than those provided in paragraph 24 of the staff report may be needed for these reforms to mitigate risk to the FY 2021/22 budget and to medium-term debt sustainability. *Staff comments are welcome.*

Monetary policy and financial stability

We agree that the monetary policy accommodation should continue until the recovery takes a firm pace. The shilling should continue to serve as a shock absorber and foreign exchange interventions should remain minimal and limited to cases of excessive market volatility. We welcome the Central Bank of Kenya's plans to further strengthen its monetary policy and forecasting frameworks and communication, as well as to advance with the centralized data electronic warehouse project. Reforms of the regulatory and supervisory frameworks should continue, as well as implementation of the measures to effectively liquidate insolvent banks. We encourage the authorities to expeditiously proceed with adoption of the legal framework to regulate the non-bank digital lenders and microfinance institutions.

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GRAY/21/1721

June 21, 2021

Statement by Mr. Hendrick and Mr. Corvalan Mendoza on Kenya (Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the report and Ms. Mannathoko and Mr. Garang for their informative Buff statement.

We support the authorities' request for the completion of the first reviews under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) as well as the modification of PC's, IT, and SBs. Their commitment to the program's objectives is clear to stabilize the economy and minimize post COVID-19 scarring, as well as to avoid a reversal in hard-won gains in poverty reduction. The country had a robust economic growth in the past decade, which was temporarily put on hold during the pandemic and the authorities deployed an Economic Recovery Strategy (ERS) that aims to set the foundation for an inclusive and sustainable economic recovery.

Revenue-based fiscal consolidation seems appropriate and efforts made to enhance the transparency in the use of COVID-related resources are welcome. Mechanisms to increase accountability, and transparency in the use of public funds like Auditor General submission to Parliament of audits of all FY2019/2020 COVID-19 related expenditures and its publication would help generate trust to society on how public resources are spend and adds to better governance behavior.

Real GDP growth of 0.3 percent in 2020 is projected to rebound to 6 percent in 2021. A better performance in agriculture, manufacturing, and other sectors are helping the economy. If vaccination roll out speeds up, the economic performance buttressed by favorable external sector, like tea and horticulture exports plus remittances inflows, would remain supportive. Other macroeconomic variables like inflation dynamics and the level of international reserves remains adequate.

We welcome the authorities' efforts to meet the program's fiscal balance target by a sufficient margin. We are encouraged by the FY2021/2022 budget submitted to Parliament, which considers an ambitious multi-year plan to reduce debt-related vulnerabilities, while supporting social spending. The authorities are aware of the fiscal risks from State Owned Enterprises (SOEs) and PPP's, and to mitigate such risks are deploying a strategy that would require good implementation.

Public debt sustainability is warranted for the medium-term, backed by a revenue-based fiscal consolidation. The Kenya Revenue Authority (KRA) would become a center piece of this strategy to improve revenue collection through automation and leveraging iTax, as well as simplified web-based tax collection platform. Broadening the revenue base would be essential to secure a stable inflow for the treasury, which are much needed for development purposes. In that vein, we take positive note of the authorities' understanding on the need to reinforce public financial management (PFM). We also see merit on their commitment to reinforce controls and cash management, while fostering good governance and transparency. The latter is crucial to boost confidence and credibility on the economic policy.

For any small open economy, a flexible exchange (FX) rate act as a first line of defense to external shocks. We welcome the central bank efforts to strengthen its monetary policy framework and inflation targeting regime. We see merit on their continuous work to ensure effective communication, modernize macroeconomic modelling and forecasting frameworks, while limiting its footprint in the FX market only to smooth excess volatility. These steps aim at the right direction.

The share of non-performing loans in gross loans are still high at 14.6 percent in March of this year, explained by subdued business activity. We encourage the authorities to monitor the financial system closely and adhere to best international practices for the regulation and supervision. Special consideration is warranted due to prompt resolution of troubled institutions.
Steps made to tackle AML/CFT challenges are welcome. The plan to advance on beneficial ownership information for public tenders, declarations of senior public officials, among other measures, aim in the right direction.

With these comments, we wish the people of Kenya every success in these challenging times.

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GRAY/21/1722

June 21, 2021

Joint Statement by Ms. Levonian, Mr. Trabinski, Ms. Kashima, Mr. Mochtar, Mr. White, Mr. Nghiem, Ms. Vasishtha, Ms. Zhunusbekova, Mr. Khurelbaatar, and Ms. Kikuchi on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for their comprehensive reports and Ms. Mannathoko and Mr. Garang for their informative buff statement.

Despite the challenging environment, Kenya's program performance is broadly on track with most performance criteria and indicative targets met. Nonetheless, we note that risks to the program remain, amid elevated uncertainty. Against this background, we support the completion of the first review of Kenya's arrangements under the Extended Fund Facility and the Extended Credit Facility, and requests for modifications of the performance criteria and structural conditionality. As we broadly agree with the thrust of the staff's appraisal, we limit ourselves to the following points for emphasis.

Although fiscal targets are within the program objectives and rightly targeted at near-term priorities, we are concerned about the elevated fiscal risks in an environment of high uncertainty. We welcome the authorities' revenue enhancing and expenditure rationalization measures which are critical to achieving the program's fiscal objectives. We encourage the authorities to continue prioritizing investments in health, education, and other long-term enablers of growth, along with ongoing measures to support vulnerable groups. We also take positive note of the authorities' plan to bring forward some tax measures to offset the revenue loss due to the suspension of the Corporate Minimum Alternative Tax (CMT) by the court. However, fiscal risks remain high, especially relating to costs arising from a possible slower recovery, additional COVID-related spending, and contingent liabilities from SOEs. *Given the uncertainty, could staff share their views on the potential impact of the CMT cancellation/lower rates on long-term fiscal consolidation plans and whether the program envisages alternative measures to compensate for the revenue loss?*

The successful implementation of the COVID-19 vaccination program remains key to sustaining the recovery. In light of the challenges posed by supply constraints related to the COVAX program, we welcome the authorities' active engagement with international partners beyond COVAX to secure sufficient supply. *Could staff provide an update on the status of the discussions with international partners?*

While the financial sector remains stable and profitable, asset quality has been deteriorating. It is concerning that the NPL ratio is rising while the full effects of the expiration of the moratorium on loan repayments and other measures are not visible yet. Therefore, we encourage the authorities to remain vigilant, strengthen oversight, and stand ready to provide liquidity support to safeguard financial sector stability.

Advancing key reforms in the areas of governance, SOE modernization, and fiscal prudence will be important to strengthen economic growth in the medium-term. In this context, we take positive note of the high priority placed by the authorities on improving management of SOEs. We also welcome the efforts to improve fiscal governance and strengthen the anti-corruption framework, and echo staff's position that further efforts are needed to enhance transparency and accountability.

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GRAY/21/1724

June 21, 2021

Statement by Mr. von Kleist and Ms. Koh on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the insightful report and Ms. Mannathoko and Mr. Garang for their Buff. We gladly take note that the third wave of the pandemic in Kenya has eased in recent weeks and infection numbers appear to plateau (on an elevated level) for the moment, although the situation remains precarious. To support the recovery, it is essential for the authorities to vigorously implement the structural reform agenda and pursue prudent policies, also amid a busy election schedule.

Based on the broadly satisfactory performance in these early stages of the program, we consent to the completion of the first program reviews. Similarly, we consider the proposed modifications of performance criteria and structural conditionality as appropriate. Thus, and with the continued validity of our comments made at the program request, we will limit ourselves to a few remarks below.

Overall, we welcome the authorities' budget planning, that balances continued essential support to the economy in the ongoing crisis with an early gradual rebuilding of buffers, thereby also helping to mitigate the need for more abrupt tightening at a later stage. Strengthening the domestic revenue base is a key element in ensuring stable public finances over the long term, to be able to reliably meet spending needs for economic development. We understand that the authorities are challenging the High Court’s suspension of the Corporate Minimum Alternative Tax. *Could staff, nevertheless, provide additional information on the authorities’ contingency plans (e.g. alternative tax measures not giving rise to constitutional concerns)?*

Containing fiscal risks in the SOE sector and strengthening public financial management, transparency and good governance across the public sector is key. We welcome the anti-corruption safeguards, not least because parts of Kenyan civil society have raised their concerns about IMF support, stating that it would only enable more corruption. Additionally, we note with concern the recently published report by the Auditor-General[1] indicating deficiencies, which according to the foreword have "*led to fiscal indiscipline*" that "*in turn threaten[s] economic growth*", and criticizing "*reluctance to cooperate with the auditors during the audit process*". *As these allegations could have a material impact on the use of Fund resources and the Fund's reputation, also keeping in mind the public criticism sparked after the program approval, we would welcome it if staff could comment further on the Auditor-General's report*.

We emphasize that ensuring a transparent and efficient use of fund resources should continue to receive highest attention, not least in view of the public criticism in Kenya. *Is outreach and stakeholder inclusion taking place?*

We highly appreciate the authorities' commitment to accelerate and broaden the inoculation of the Kenyan population. Beyond the challenge of dealing with scarcity in the supply of vaccines, we encourage the authorities to continue carrying out the vaccination campaign with unwavering determination.

[1] http://oagkenya.oagkenya.go.ke/index.php/reports/doc_download/2890-report-of-the-auditor-general-for-the-national-government-for-the-year-2019-2020

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GRAY/21/1731

June 21, 2021

Statement by Mr. Azal, Mr. Just, and Mr. Pucnik on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for their comprehensive set of reports, and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. The third COVID-19 wave in March and April 2021 prolonged economic restrictions and slowed the anticipated pace of recovery. While the authorities have begun to implement measures to broaden the revenue base and reduce the fiscal deficit, the recovery will largely depend on the success of the vaccine rollout. In view of the authorities' adequate program performance, **we concur with staff's appraisals and support the completion of the first reviews under the Extended Fund Facility and the Extended Credit Facility arrangements.**

Continued fiscal consolidation efforts should further improve the government balance and stabilize the debt-to-GDP ratio. We commend the fiscal strategy which aims at achieving the primary deficit target through revenue-enhancing and expenditure-curbing measures. Increased revenue mobilization through improved tax collection will be critical going forward. On the expenditure side, we support the efforts to improve expenditure management, which should further advance the efficiency and effectiveness of government spending. Addressing the weaknesses of state-owned enterprises (SOEs), often recognized as fiscal drainers, should be a key priority of structural reforms. Fiscal consolidation efforts and necessary structural reforms should endeavor to protect fiscal space in order to continue servicing debt.

Effective debt management is an intrinsic part of sound fiscal policy that aims for sustainable debt levels and preserving financial stability. Debt sustainability remains a major challenge for Kenya. In this context, we concur with the authorities to replace the existing debt ceiling with a forward-looking framework based on a debt anchor of 55 percent of GDP and an accountability requirement, which will be a more effective tool for fiscal policy actions while improving transparency and financial stability.

Continuing supervisory vigilance in the banking sector is crucial to mitigate systemic risks. The actual size of nonperforming loan levels, which continued to rise from already elevated levels after the end-March 2021 expiration of the moratorium on loan repayments, might be fully evident only after several months. We encourage the authorities to closely monitor banks and their credit portfolios to ensure they remain well-provisioned. In this context, we concur with the policy of retained dividend payments with conceivable exceptions to strengthen bank capital for possible loan loss provisions. Given the appropriate prudential standards are maintained and further strengthened, we welcome the high private sector credit growth. We note the risk-weighted capital adequacy ratio, well above the statutory requirements, which may be an effective tool for the expansion of bank businesses and thus ensuring a sustainable contribution of the financial sector to economic growth. *Can staff elaborate on reasons behind the high risk-weighted capital adequacy ratio?*

SOE reform should be a strategic tool for increasing the state sector's competitiveness. The ongoing reformation of Kenya's SOEs is a critical aspect of the country's further development and in mitigating fiscal risks stemming from SOEs. In this regard, we are encouraged that substantial progress has been made in assessing SOEs' financial situation. Additional fiscal support to viable SOEs is justified in the course of restructuring and the pandemic, but should be revisited as soon as conditions are favorable. Reforms should aim at transforming viable SOEs from fiscal support users into subjects of levers of sustainable economic growth.

We welcome the steps taken to tackle AML/CFT challenges. Enhanced risk-based supervision of politically exposed persons will be particularly important to mitigate political risk prior to and during the presidential elections scheduled for August 2022. The intentions to operationalize the Beneficial Ownership Information E-Register, making publicly available the National Risk Assessment findings, and the implementation of the Action Plan all aim in the right direction to strengthen the resilience to corruption.

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GRAY/21/1733

June 21, 2021

Statement by Ms. Senich and Ms. Lyngaas on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the thorough report and Ms. Mannathoko and Mr. Garang for the helpful Buff statement. Fund financing helped the Kenyan authorities weather the pandemic shock and access necessary finance to fund their public health response. **We agree with staff that Kenya has made broadly satisfactory progress in the Extended Arrangements under the Extended Fund Facility and Extended Credit Facility and support the completion of the first review and the authorities' requests for modifications.** We regret that G20 Debt Service Suspension Initiative (DSSI) relief for Kenya was lower than previously anticipated and contributed to the need for modification of the end-June target on net international reserves. We call on all creditors to fully implement the DSSI. Looking ahead, addressing pandemic risks is a prerequisite for a sustainable recovery, and we appreciate the attention in the staff report to vaccination targets and vaccine spending.

We welcome the authorities' commitment to implementing fiscal consolidation in line with program objectives. We support their plan to adopt a medium-term debt anchor and accountability requirements and commend their efforts to shield vulnerable communities from the impact of consolidated social spending. We support the modification of the adjuster to the primary balance floor which will allow flexibility for additional spending should donor grants exceed projections. We note, however, that delays in the implementation of the Corporate Minimum Alternative Tax (CMT) could result in the authorities missing their tax collection targets. *We welcome staff's clarifications on what tax measures are under consideration as contingency options if the CMT is not restored.*

We welcome the authorities' progress in improving fiscal governance and reducing opportunities for corruption but believe more could be done to strengthen institutional oversight. We are pleased that the financial evaluation of the nine SOEs with the largest fiscal risks to the budget, a prior action, will inform the authorities' approach to addressing financing pressures. We agree with staff on the importance of completing the financial evaluation to inform the appropriate strategy to address the fiscal risks from the largest

SOEs. Though the production of multiple audits related to COVID-19 expenditures is encouraging, we agree with staff that the authorities need to follow up on audit findings, including through further investigation and prosecution of criminal activities. We would welcome regular updates from staff on progress in these areas.

We agree with staff's assessment that the banking system remains sound, though there is a need for vigilance given the risk that non-performing loans could rise. Staff indicate that commercial banks increased their holdings of debt as a proportion of their assets by roughly five percent in 2020, exacerbating preexisting asset quality issues. We join staff in encouraging the authorities to publish the findings of the recent National Risk Assessment and Action Plan and continue efforts to strengthen Kenya's AML/CFT regime, noting the effectiveness of Kenya's efforts to counter money laundering and terrorist financing will be assessed in November 2021.

We note that World Bank budget support is playing an important role alongside Fund financing to support Kenya's economic reform effort and welcome the strong Fund-Bank coordination.

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GRAY/21/1736

June 21, 2021

Statement by Mr. Mouminah, Mr. Alhomaly, and Mr. Rawah on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the well-focused report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. We are in broad agreement with staff's analysis and policy recommendations and would like to make the following comments.

1. **We support the completion of the first reviews under the EFF and ECF arrangements and the associated decisions.** We welcome the staff's assessment that the program performance has been broadly satisfactory, reflecting the authorities' commendable perseverance to advancing the reform agenda despite the challenging circumstances. We take note that the significant risks to the program are mitigated by several factors, including the close engagement with the authorities, the embedded flexibility under the program to confront immediate challenges while preserving the core objectives, as well as the authorities' commitment to adopt contingency measures should risks materialize and their continued engagement with donors. Separately, we positively note staff's assessment that Kenya's capacity to repay the Fund is adequate.

2. **Adopting a multi-year fiscal strategy that balances between addressing short-term crisis-related needs, given the elevated uncertainty, and preserving fiscal sustainability over the longer run is called for.** In this connection, we positively note the staff's assessment that the 2021/22 draft budget is in line with the Fund program objectives and welcome the authorities' plan to utilize the available fiscal space to support affected sectors. Once conditions normalize, however, fiscal consolidation efforts should resume to address public debt vulnerabilities. In this vein, we support the authorities' commitment to bring the primary fiscal deficit below the debt stabilizing level in 2023 bolstered by a policy mix consisting of revenue mobilization and spending rationalization measures. Also, we welcome the authorities' proposed framework targeting strengthening the debt management framework and fiscal transparency through the introduction of a medium-term debt-to-GDP anchor and an accountability requirement.

3. **On fiscal reforms, further progress is called for in several areas.** In particular, continued efforts are needed to further strengthen the anti-corruption framework, including with respect to the AML/CFT, as well as ensuring its effective implementation and operationalization. We take positive note of the ongoing efforts towards addressing SOEs financial challenges as well improving governance and monitoring, which need to be further advanced with a view to better managing associated fiscal risks.

4. **Finally, the monetary policy and the financial sector measures have been appropriately focused on ensuring adequate liquidity and supporting recovery while safeguarding the financial stability.** At the same time, the financial sector remains stable and profitable with well-capitalized and liquid banks. Nonetheless, we echo staff's call for closely monitoring potential risks in the banking sector, including with regard to asset quality, and encourage the authorities to act proactively and decisively to address associated challenges.

With these remarks, we wish the authorities further success.

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GRAY/21/1737

June 21, 2021

Statement by Mr. Bhalla and Mr. Singh on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

1. We thank the staff for their analytical staff report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement.

2. In the backdrop of limited access to vaccines and high incidence of Covid-19-led surge in poverty, and given the satisfactory performance under the ECF/EFF arrangements and the commitment towards meeting the program's objectives, we support the authorities' request for completion of the first review and modification of performance criteria (PC), indicative targets (ITs), and structural benchmarks (SBs).

3. Given that both personal income and corporate tax revenue have been on a declining trend that had set in 2015, **we encourage authorities to continue to accelerate efforts towards strengthening revenue administration and tax policy reforms**. While we appreciate authorities' reversal of most emergency tax relief measures and the introduction of measures to improve tax performance during the pandemic, we hope that the social safety nets for the vulnerable segments of the population are continued until the incidence of the virus is contained.

4. There has been an appreciating trend in the real effective exchange rate since 2012. **Is this appreciation leading to over-valuation or is it a bounce back to "equilibrium"? Also, what is the likely impact of such an appreciating exchange rate on the export competitiveness of the country and the current account sustainability?**

5. A positive aspect of the financial sector is that the banking system remains well-capitalized and profitable. Nevertheless, the NPL ratio has been rising and remains elevated. Given the importance of the banking system in supporting economic recovery, there is **a need for active supervision of risks and potential corporate insolvencies impairing the bank balance sheets**. On governance, we very much appreciate the authorities' plan to ensure comprehensive information, including beneficial ownership information and

progressive disclosures. We encourage authorities to **accelerate the national risk assessment on money laundering and terrorism financing** that will help Kenya develop an AML/CFT strategy as well as address the current deficiency in FATF requirements.

6. We wish the authorities the very best in their policy endeavours and the future programme.

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GRAY/21/1738

June 21, 2021

Statement by Mr. Mozhin, Mr. Palei, and Mr. Tolstikov on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the informative report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. We support the authorities' request for completion of the first review under the ECF/EFF arrangements and proposed modification of performance criteria, indicative target and structural benchmark. As we broadly agree with the staff assessment and recommendations, we will make only a few comments for emphasis.

After a substantial slowdown in 2020, economic activity is projected to rebound, although substantial risks remain. Kenya is facing the third wave of the pandemic, amidst relatively slow vaccination. While we welcome the authorities' efforts in obtaining additional vaccines on top of COVAX-provided supplies, we note that the goal to vaccinate 60 percent of the population by 2023 leaves the economy at risk of further bouts of the pandemic. Additional risks emanate from possible political tensions in the electoral period, climate-related vulnerabilities and contingent liabilities of SOEs. Effective implementation of economic policies and reforms supported by the ECF/EFF arrangement is essential to mitigate these risks and ensure sustainable growth.

Commitment to fiscal and debt sustainability remains key for program success. Kenya's public debt will exceed 70 percent of GDP in FY20/21 and increase further until FY 22/23. The DSA shows that Kenya's debt is sustainable, but at a high risk of debt distress, which requires additional efforts to alleviate debt pressures. Therefore, we welcome the authorities' commitment to reduce primary deficit to its debt stabilizing level in 2023 through revenue mobilization and expenditure prioritization.

Changing Kenya's debt ceiling from a nominal number to a debt-to-GDP target can provide better guidance to policymakers. However, we wonder if debt ceiling expressed in *present value terms* is superior to traditional *nominal debt-to-GDP ratio*. *Staff comments are welcome.*

The accommodative monetary policy stance remains appropriate but should be data driven. Headline inflation has accelerated due to higher energy prices and reached 5.9 percent in May. The Central Bank of Kenya (CBK) needs to closely monitor inflation developments. A flexible exchange rate regime continues to serve as a shock absorber and FX interventions should be limited to containing disorderly market movements. We take positive note that the banking sector remains well-capitalized and profitable, despite elevated non-performing loans. However, the authorities should keep close watch on the NPL developments, especially in view of phasing out of the moratorium on loan repayment.

Maintaining momentum in structural reforms implementation is imperative to supporting sustainable and equitable growth. The authorities should continue their efforts in strengthening the anti-corruption framework, upgrading the AML/CFT framework, addressing financial weaknesses in state-owned enterprises, and improving the business environment. We welcome the publication of audits of COVID-related expenditures and the forthcoming disclosure of beneficial ownership information of companies that are awarded government contracts. We also take positive note of the progress in addressing challenges from SOEs.

With these remarks, we wish the authorities further success.

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GRAY/21/1739

June 21, 2021

Statement by Mr. Romero Tarazona and Mr. Cartagena Guardado on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the comprehensive reports and Ms. Mannathoko and Mr. Garang for their insightful Buff statement.

We welcome the completion of the first review of Kenya's EFF and ECF, despite the difficult circumstances that the COVID-19 pandemic has provoked. We note that all the PCs were met and the ITs had small deviations at end-march, while two out of five SBs were completed, and the others will be completed soon. We praise the authorities' commitment to achieving the program's targets and acknowledge that the difficult circumstances presented by the crisis, and its third wave, constrained the timing of some of the targets. We highlight the authorities' commitment to developing economic measures to achieve the four objectives of their economic program through this arrangement, aiming to stabilize debt and boost growth. Thus, we concur in the completion of this review and agree with the request for modification of the program's conditionality.

We commend the authorities' swift response to contain the spread of the COVID-19 pandemic. We note with concern that the third wave of infections presents additional challenges, lowering the prospects for economic growth and reducing the fiscal deficit. We acknowledge the authorities' efforts to advance in the vaccination process and underscore the urgency of hastening the process in order to reduce contagions and fatalities, while safely boosting the population and workers of high-contact economic sectors. The challenges that Kenya faces as a result of its low vaccination rate highlight the urgency of the international community's engagement in supporting Kenya, and countries alike, with a more equitable access to the world's supply of vaccines. *We think additional actions to achieve the 60 percent immunization level in 2022, rather than 2023, are necessary. We would like staff to comment on the likelihood of accelerating the vaccination process and what should be done to achieve such a goal.*

We welcome the authorities' efforts to balance the near-term fiscal needs with the medium-term targets of reducing debt vulnerabilities under the arrangement. The measures pursued by the government in strengthening revenue mobilization and improving the quality of spending are instrumental in this regard. We underscore the authorities' emphasis on prioritizing spending in social sectors, especially on job generation activities, and on engaging in a growth friendly fiscal consolidation. We also welcome that authorities are aiming to lower the fiscal deficit and the replacement of the nominal anchor with the debt-to-GDP ratio. We note positively the good economic prospects and rebound for this year and the following, despite the fact that authorities will have to navigate under significant uncertainties. Very relevant changes and reforms are on course, such as the commitment to reduce or eliminate tax exemptions, to conduct expenditure reviews, and introduce a new debt anchor. We noted that other tax revenue sources have been identified by Kenya's authorities, such as the automatization of the tax administration (the iTax), the implementation of a web collection platform, and broadening of the tax base for different taxes. We note that political risks are rising, as well as possible social resistance to tax reforms, elimination of benefits, and the broadening of the tax base; thus, *we welcome additional staff comments on political developments, the likelihood of approving and implementing such reforms, and how failure to achieve such a goal will affect the program.*

We welcome Kenya's accommodative monetary policy and the resilience of the financial sector. We commend the continued efforts to reform the monetary policy operational framework and to maintain the stability of the financial system. The authorities' efforts to strengthen the monetary policy framework, the inflation targeting regime, and to maintain a flexible exchange rate to act as a shock absorber, will be instrumental in maintaining price stability. We are encouraged by the authorities' efforts to continue strengthening prudential regulation and supervision, the AML/CFT framework, and CBK's engagement with banks to revisit capital planning and reassess the flexibility of the reform part of building banking resilience. We encourage authorities to closely monitor the rising NPLs and to strengthen financial resilience.

Finally, we praise the authorities for their determination to implement structural reforms. We highlight the authorities' commitment to addressing the sources of fiscal risks derived from the SOE and concur that it is instrumental in enhancing its governance and transparency. We also commend the authorities for the completion of all COVID related audits, which have helped to ensure transparency and accountability. We recognize the importance of structural reforms for good governance and accountability, enhancing asset declaration, upgrading the AML/CFT framework, and improving the business environment and macroeconomic statistics, which are very aligned with the objective of increasing transparency and attracting investments.

We wish the authorities and the people of Kenya well in these still challenging circumstances.

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GRAY/21/1743

June 22, 2021

Joint Statement by Mr. Buissé, Mr. Ronicle, Mr. Rozan, and Ms. Clapham on Kenya (Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the helpful paper and Ms. Mannathoko and Mr. Garang for the helpful buff statement.

We support the completion of the first review under the Extended Credit Facility and Extended Fund Facility Arrangements (ECF/EFF) and welcome staff's assessment that the program is broadly on track. We commend the authorities for continuing to make progress on implementing their reform agenda against a very challenging backdrop, and despite the program facing significant risks.

We note that the authorities have asked to modify three performance criteria. **Overall, we agree with staff that it is critical that there is flexibility in the program to allow the authorities to respond to immediate challenges, whilst still aiming towards achieving the overall program objectives.** We therefore support the request for modification on targets regarding international reserves and the common payroll system. With regards to the proposed modification to the indicative target on revenue collection we note that shortfalls in revenue collection have been a recurrent problem. Whilst the current environment is extremely challenging, we would emphasize the need for the authorities and staff to be prudent and realistic in their assessment of the measures required to meet revenue targets, and their forecasts of what is achievable. With this in mind, and noting the sizeable downward revisions for growth in 2020 and 2021, *could staff comment on the tradeoffs between supporting economic growth and improving domestic revenue over the next few years?* Whilst we can support the modification, we need to be reassured that the Government of Kenya is committed to achieving its targets on revenue collection and any amendment is based on a clear plan for getting back on track in the future.

We welcome the submission of a FY2021/22 budget to Parliament last week and noted the progress that has been made on a number of reform priorities. We were particularly pleased to see commitment to increase the capacity and voice of the Public Debt Management Office in public debt management. This is a key area of need for the National Treasury, and it will be essential that this office is sufficiently resourced to successfully execute its debt management functions going forward. *Could staff elaborate on their assessment of Kenya's debt, including the upward trend in debt service, and downward revisions to the forecasted benefit from Kenya's participation in the DSSI for the first semester of 2021?* We noted that the budget statement set out significant cuts to the human capital and social sector, which seem to have been disproportionately impacted in comparison with other areas, particularly major infrastructure investment. **We would urge the authorities to continue to prioritise support for the poorest and most marginalised groups to mitigate the impacts of the pandemic.**

We also noted the progress that has been made on the state owned enterprise reform agenda. However, we are concerned that the language on SOEs in last week's Budget Statement lacked the necessary clarity and ambition to achieve the wider reform that is required, in particular on SOE oversight. *Could staff provide an update on this?*

Finally, ensuring a timely rollout of a vaccination programme in Kenya will be critical to enable economic recovery and the successful completion of the program. We welcome the authorities' commitment to accelerating the roll out of the COVID-19 vaccination programme, and their plans to allocate further budget towards this. *Could staff clarify where further financing to support the vaccination roll out is expected to come from?*

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GRAY/21/1744

June 22, 2021

Statement by Mr. Sylla and Mr. Bangrim Kibassim on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank the staff for the report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement.

We support the completion of the first reviews under the ECF/EFF arrangement as well as the authorities' request for modification. Kenya has shown good signs of recovery as a result of the authorities' decisive policy response to COVID-19 and the country's resilience to global supply chain shocks. We welcome the efforts aimed at enhancing transparency of COVID-19 related spending and addressing supply constraints to expand vaccine coverage. Moreover, we appreciate the authorities' commitment to the program objectives under such a challenging environment. Although the medium-term outlook is somewhat positive, we agree that risks could stem from delays in vaccines rollout, political tensions, contingent liability from SOEs as well as weak implementation of key reforms. Against this backdrop, going forward, we encourage the authorities to sustain the support to the economy in the near-term and continue their structural reform agenda needed to reduce vulnerabilities and strengthen the recovery. *Given that COVID-19 cases are likely to increase despite authorities 'efforts, could staff share their insights on risks if supply constraints persist.* We broadly concur with staff's policy recommendations and we would add the following specific remarks.

The authorities should maintain an appropriate fiscal response to mitigate the impact of the COVID-19 and preserve fiscal sustainability. We welcome the commitments expressed in the authorities' *Letter of Intent* to maintain an effective response in favor of health sector and most affected segments of the economy. We support their efforts to seek additional financing from donors to address the cost of COVID-19 vaccines. At the time the country is hit by a third wave of COVID-19 and socioeconomic hardship as underscored in the Buff statement, risks posed by the pandemic are still acute. Therefore, authorities' responses envisaged under the *Economic Stimulus Program* and *Economic Recovery Strategy* are instrumental for strengthening the recovery. While tax collection is affected by the pandemic, the suspension by the high court of the implementation of the Corporate Minimum Alternative Tax (CMT) although understandable could impact the revenue strategy. In this context, we welcome authorities' intention to consider additional tax measures if the CMT is delayed as well as the other measures to improve revenue and spending efficiency. They should make progress towards achieving the objectives of the fiscal strategy including the reduction of primary deficit. Finally, fiscal consolidation is essential and will contribute in enhancing the fiscal space needed to fund priority social programs and development expenditure.

Addressing debt vulnerabilities on the medium-term should remain a key priority. Although public debt is assessed sustainable, we note that it remains at high risk of debt distress. In this regard, the replacement of the current debt ceiling by a forward-looking framework considering a medium-term debt-to-GDP anchor is critical as it will increase transparency, credibility, and flexibility. Furthermore, the effective implementation of the budget beyond FY2021/22 prioritizing debt reduction through additional revenue and spending measures will support authorities' objectives on the medium-term. In this context, we acknowledge their commitments and efforts to strengthen the debt management framework during the present program.

We share the view that the accommodative monetary policy adopted in response to the COVID-19 should continue and emerging vulnerabilities in the financial system tackled in time. The supportive measures executed to date by the Central Bank of Kenya (CBK) have well helped the economy and allowed to alleviate the impact of the COVID-19. The inflation is stable and remains within the central bank's target range while exchange rate policy fulfils its role of shock absorber. Therefore, we commend the adoption of initiatives aiming at increasing the resilience of the monetary policy framework, strengthening the financial sector and easing access to credit. Although the banking system is resilient and the level of regulatory ratios is satisfactory, we are of the view that pursuing a close supervision and the reforms elaborated in the Banking Sector Charter is critical. This is justified notably by the augmentation of credit risks and the need to achieve digital supervision and financial stability.

In view of challenges exacerbated by the pandemic and authorities' ambition to improve potential growth, an effective application of reforms in governance, fiscal frameworks is paramount and should not be delayed. We support authorities' reform agenda, notably for promoting best practices. We are also encouraged by their commitments – supported by IMF's technical assistance – to address financial challenges in SOEs and improve transparency and accountability in governance. Given the criticality of revenue mobilization in the achievement of fiscal targets, we appreciate the ongoing modernization of revenue administration and progress in PFM including procurement systems. That said, additional efforts are necessary to reinforce the anti-corruption and AML/CFT frameworks and enhance social inclusiveness and the business environment. These are essential steps to create conditions conducive for economic growth, boost human capital and private sector development as indicated by Ms. Mannathoko and Mr. Garang in their Buff statement. With these remarks we wish success to the Kenyan authorities in their endeavor.

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GRAY/21/1745

June 22, 2021

Statement by Mr. Mohieldin and Ms. Merhi on Kenya
(Preliminary)
Executive Board Meeting 21/64
June 23, 2021

We thank staff for the well-focused report and Ms. Mannathoko and Mr. Garang for their helpful Buff statement. The COVID-19 shock has hit Kenya's economy hard. Nevertheless, the economic recovery is now underway, although risks are tilted to the downside. Given the broadly satisfactory program performance as well as the authorities' commitment to reform, we support the completion of the first reviews of the Extended Arrangement Under the EFF and ECF, and the authorities' request for modifications of Performance Criteria (PC) on net international reserves; the Indicative Target (IT) on tax collection; and one end-June 2020 SB on common payroll system within the public sector. Amid heightened COVID-19 uncertainty, discussions rightly focused on supporting Kenya's pandemic response while reducing debt vulnerabilities, advancing the broader structural reform and governance agenda as well as strengthening the monetary policy framework and supporting financial stability. Against this background, we would like to highlight the following:

- **We commend the authorities for their decisive policy actions which were paramount in preventing a deeper economic downturn and spurring economic recovery.** Indeed, the support measures have been appropriately focused on protecting the most affected, including through ramping up both health and social spending. We take note that the authorities are mobilizing resources alongside donor support to accelerate the procurement of more doses in the coming months, as they are facing delays in vaccine shipments. We also welcome the steps taken to significantly ramp up the vaccination campaign - targeting 14.5 million people by end July 2022, as well as to reach 60 percent of the population by 2023- as this will be key for a sustained recovery.

- **Fiscal policy should continue to support the health and economic needs of the population until the recovery is firmly established.** Once the pandemic recedes, the focus of fiscal policy should shift to reducing the level of deficits through a growth-friendly fiscal consolidation centered on stronger revenues and careful spending prioritization while putting the debt on a downward path within the timeframe of the program. We welcome in this regard the FY2021/2022 budget submitted to Parliament which reflects the authorities' ambitious multi-year plan to reduce debt-related vulnerabilities while supporting social spending. We also are reassured that the budget proposal includes a contingency plan, including a commitment to phase out tax exemptions and conduct expenditure reviews with the support of the World Bank.

- **We welcome the authorities' continued efforts to advance the governance agenda as well as their commitment to reduce and manage fiscal risks from State Owned Enterprises (SOEs).** We look forward in this regard to the completion of the expanded fiscal risk analysis that quantifies contingent liabilities stemming from high-risk SOEs, which is expected to be included in the annual Budget Review and Outlook paper.

With these remarks, we wish the authorities the best.

Kenya

Staff's Responses to Technical Questions Posed by Executive Directors in Advance of EBM/21/64—June 23, 2021

Outlook/Risks

1. ***Staff comments on whether the program commands wide support among Kenya's main stakeholders are welcome.***

- There is broad support for the program in Kenya. The authorities have by their words and actions demonstrated full commitment to the program and its objectives. This extends beyond the National Treasury and the Central Bank, as seen recently by the Salaries and Remuneration Commission's decision last week to freeze public sector wages and the Office of the Auditor General's comprehensive audits of COVID-19-related spending. Beyond the public sector, most business organizations, think tanks, and mainstream media have been supportive of the program. On social media, an initial wave of criticism subsided as more information about the program became available. The initial criticism centered on concern about indebtedness and weak governance, and these remain frequently expressed concerns with saliency in the broader political debate. There has over time been growing recognition of the program's central focus on addressing weaknesses in those areas. As highlighted in Staff Report, potential pressures from the upcoming political calendar remain a risk to the program.

2. ***In light of the challenges posed by supply constraints related to the COVAX program, we welcome the authorities' active engagement with international partners beyond COVAX to secure sufficient supply. Could staff provide an update on the status of the discussions with international partners?***

- The authorities are seeking to accelerate deployment of vaccines and to meet the goal of 60 percent population coverage before the previously targeted mid-2023. Current plans are targeting over 50 percent population coverage by mid-2022. As part of this plan, a large batch of Johnson & Johnson vaccines has recently been ordered and is expected to arrive in August, and discussions with the World Bank on an approximately $130 million loan to support the vaccination program are at an advanced stage.

3. ***Finally, ensuring a timely rollout of a vaccination programme in Kenya will be critical to enable economic recovery and the successful completion of the program. We welcome the authorities' commitment to accelerating the roll out of the COVID-19 vaccination programme, and their plans to allocate further budget towards this. Could staff clarify where further financing to support the vaccination roll out is expected to come from?***

- The Ksh. 14.3 billion (about $130 million) for vaccines beyond those that will be provided by COVAX are expected to be provided through a World Bank loan that is at an advanced stage of discussions. Together with the Ksh. 7.6 billion already appropriated in the FY2020/21 budget and vaccines expected from COVAX, this funding is expected to be sufficient to vaccinate over 50 percent of the population.

4. ***Although the medium-term outlook is somewhat positive, we agree that risks could stem from delays in vaccines rollout, political tensions, contingent liability from SOEs as well as weak implementation of key reforms. Against this backdrop, going forward, we encourage the authorities to sustain the support to the economy in the near-term and continue their structural reform agenda needed to reduce vulnerabilities and strengthen the recovery. Given that COVID-19 cases are likely to increase despite authorities 'efforts, could staff share their insights on risks if supply constraints persist.***

- Recognizing the high probability of the persistence of the pandemic, staff incorporated the impact of recurrent waves of COVID-19 infections similar to what has been seen thus far into its 2021 macroeconomic baseline. Delays in the COVID-19 vaccination program and/or new more difficult virus waves remain key risks to the outlook in the medium term. The authorities' recent efforts to accelerate deployment of vaccines and to meet the goal of 60 percent population coverage before the previously targeted mid-2023 is key in mitigating these risks. If global vaccine supply constraints delay Kenya's vaccination program, the authorities will need to continue to deploy their forceful, but targeted approach of movement restrictions in hotspot areas and other targeted COVID-19 containment measures to try to restrain the spread of the virus.

5. ***The challenges that Kenya faces as a result of its low vaccination rate highlight the urgency of the international community's engagement in supporting Kenya, and countries alike, with a more equitable access to the world's supply of vaccines. We think additional actions to achieve the 60 percent immunization level in 2022, rather than 2023, are necessary. We would like staff to comment on the likelihood of accelerating the vaccination process and what should be done to achieve such a goal.***

- As noted above, the authorities are seeking to accelerate vaccine rollout and are working from a plan that would achieve over 50 percent population coverage by mid-2022. The main constraint in delivering on this plan is global vaccine supply.

6. ***We note that political risks are rising, as well as possible social resistance to tax reforms, elimination of benefits, and the broadening of the tax base; thus, we welcome additional staff comments on political developments, the likelihood of approving and implementing such reforms, and how failure to achieve such a goal will affect the program.***

- Progress towards program objectives, including tax base broadening and spending restraint, have continued to advance. Up until now, these have not been impacted by political disputes such as those surrounding the Building Bridges Initiative and the proposed constitutional amendment relating to institutional arrangements in Kenya.

As indicated in the Staff Report (¶39) there is a risk that program implementation could come under pressure as elections approach, putting program objectives for addressing debt vulnerabilities in jeopardy. So far this has not been in evidence. The political saliency of popular concern about high debt levels and widespread recognition of the need for fiscal consolidation makes the outcome of such a situation difficult to predict.

Fiscal Policy and Debt Sustainability

7. ***Whilst the current environment is extremely challenging, we would emphasize the need for the authorities and staff to be prudent and realistic in their assessment of the measures required to meet revenue targets, and their forecasts of what is achievable. With this in mind, and noting the sizeable downward revisions for growth in 2020 and 2021, could staff comment on the tradeoffs between supporting economic growth and improving domestic revenue over the next few years? Whilst we can support the modification, we need to be reassured that the Government of Kenya is committed to achieving its targets on revenue collection and any amendment is based on a clear plan for getting back on track in the future.***

- As discussed in the staff report (¶14-17), the authorities' implementation of tax policy measures has been fully in line with program commitments. However, the third COVID-19 wave and temporary tightening of containment measures are expected to have a short-lived impact on tax collection. In FY20/21, the performance of tax revenues will also be affected by the unexpected suspension of the minimum tax from a High Court ruling, which the authorities are optimistic will be lifted. A decision is anticipated at end June 2021. Compared to program approval estimates, staff anticipates that in FY20/21 the overall tax shortfall will be Ksh.13 billion (0.1 percent of GDP), of which almost half can be attributed to the suspension of the minimum tax. In FY21/22, tax targets are not revised because prospects for nominal GDP growth have not materially changed compared to program approval estimates and the authorities remain committed to achieving original tax targets—including by bringing forward tax measures to compensate for a further suspension of the minimum tax or a substantial reduction of its expected yield (Ksh.20 billion on a full year basis) in case this should become necessary.

- Beyond FY21/22, the authorities' program targets important increases in revenue mobilization through the adoption of additional tax measures for 0.8-0.9 percent of GDP in line with the recommendations of past IMF TA (¶18, also EBS/21/29). With the anticipated recovery of the economy as Kenya moves beyond the pandemic period, staff sees scope to implement the policy measures needed to achieve the adjustment path envisaged under the EFF/ECF program without a significant negative fallout on growth.

8. ***Given the uncertainty around the court's final ruling on CMT suspension, staff's elaboration on the details and prospects of contingency tax measures to meet the tax revenue targets is welcome.***

- The yield of the corporate minimum alternative tax (CMT) is Ksh. 20 billion on an annual basis. As indicated in the Staff Report (¶16), if the CMT suspension is upheld or its yield substantially reduced in FY21/22, the authorities have committed to safeguard tax collection by bringing forward some tax measures discussed in the context of past IMF TA. The possible contingency measures contemplated by the authorities include harmonization of VAT rates with the East African Community, harmonization of VAT rates on petroleum products, an increase in the rate of digital tax, or taxes on capital gains (rate). Final determination of the specific measure to be selected from the list shared with staff would depend, *inter alia*, on the scale of need.

9. ***However, fiscal risks remain high, especially relating to costs arising from a possible slower recovery, additional COVID-related spending, and contingent liabilities from SOEs. Given the uncertainty, could staff share their views on the potential impact of the CMT cancellation/lower rates on long-term fiscal consolidation plans and whether the program envisages alternative measures to compensate for the revenue loss?***

- Please see above – answer to question 8.

10. ***We understand that the authorities are challenging the High Court's suspension of the Corporate Minimum Alternative Tax. Could staff, nevertheless, provide additional information on the authorities' contingency plans (e.g. alternative tax measures not giving rise to constitutional concerns)?***

- Please see above – answer to question 8.

11. ***We welcome staff's clarifications on what tax measures are under consideration as contingency options if the CMT is not restored.***

- Please see above – answer to question 8.

12. ***In this regard, we would be grateful if staff could elaborate further on the reasons for the additional fiscal costs from SOEs in FY21/22 mentioned in paragraphs 17 and 25. Are these mostly one-off costs related to the pandemic or a sign of more entrenched difficulties?***

- Staff anticipates additional SOEs support of Ksh. 65 billion (0.5 percent of GDP) overall may be needed in FY21/22 (not included in the draft budget). This amount is expected to cover liquidity gaps in a few SOEs with major fiscal risks, in particular Kenya Airways (KQ) and Kenya Power and Lighting Company (KPLC). The financial vulnerabilities in these companies stem from longstanding structural problems: in the case of KQ an overly expansive business model supported by large-scale investments, and in the case of KPLC, losses due to implicit subsidies provided to green energy producers and final consumers. These problems have been exacerbated by the pandemic shock.

- The recently completed in-depth financial evaluations also identified liquidity gaps for several SOEs (other than KQ and KPLC). The liquidity gaps are major inputs to the authorities' consideration of least cost restructuring strategies which, after accounting for additional cost-savings efforts by the companies, will determine the exact amount of extraordinary budget support needed in FY21/22. The consultation with SOEs on least-cost strategies has already begun and is expected to be finalized in the coming months. Staff's expectations are that the liquidity gaps for most of the 18 SOEs would be covered by cost saving / restructuring and additional budget support for these companies would remain limited.

- Staff will revisit the estimate for additional SOE support during the second reviews, based on the least cost strategies identified by the authorities.

13. **We welcome the progress in assessing the financial situation of SOEs with the largest fiscal risks and support the authorities' commitment to improving oversight, monitoring and governance of SOEs.** ***Staff's updates on plans of least-costly approaches to address the financial challenges of individual SOEs are welcome.***

- As a first step of a multi-staged SOE reform agenda, the National Treasury conducted a risk-based in-depth evaluation of major SOEs to evaluate possible contingent liabilities and fiscal risks stemming from the SOE sector. (The financial evaluation of KQ by the international aviation expert is expected to be finalized in the coming weeks).

- The in-depth financial evaluation identified the medium-term liquidity gaps for each selected SOEs. The calculations were based on a set of conservative assumptions, such as SOEs achieving and maintaining a sustainable financial position over the medium-term (reflected in a minimum quick ratio of 1); FY2021-22 being affected by COVID-19 in the same way as FY2020-21; and a no reform scenario, i.e. no cost-savings via restructuring, no borrowing or extraordinary budgetary support. The aggregated liquidity gap for the 18 selected SOEs based on this stylized set of assumptions was estimated at Ksh 382 billion or 3.2 percent of GDP.

- In the next step, the estimated liquidity gaps will serve as major inputs to consideration of least cost restructuring strategies. Filling the liquidity gap will require a range of liquidity management choices. Profitable SOEs, such as Kenya Airports Authority may rely on new borrowing, while the unprofitable ones, such as KPLC, will need to implement cost saving measures to cover their liquidity gaps. SOEs that provide social services (hospitals, universities) will most likely require some element of continued government support to address their liquidity challenges.

- The discussion around restructuring strategies is expected to conclude in the coming months and should be followed by the budgeting of identified necessary extraordinary SOE support via a supplementary budget.

14. ***According to the RAM, it represents a short-to-medium-term risk with medium impact to the economy, and we urge the authorities and staff to expeditiously complete the financial evaluation of the key SOEs and prepare remedial actions to***

properly address this risk. Staff's further elaboration on the progress and strategy would be highly appreciated, especially in view of the considerable political risks.

- Please see above – answer to question 13.

15. ***We note that the preparatory work to strengthen institutional oversight and governance arrangements in the SOE sector is also underway, supported by IMF technical assistance. However, we believe that more ambitious deadlines than those provided in paragraph 24 of the staff report may be needed for these reforms to mitigate risk to the FY 2021/22 budget and to medium-term debt sustainability. Staff comments are welcome.***

- By end-May, the authorities finalized the risk-based in-depth financial evaluation of 18 SOEs, and the evaluation of Kenyan Airways by the international aviation expert is expected to be finalized in the coming weeks. In the next step, the authorities are anticipated to use the findings of the financial evaluations as inputs to decide on least-cost restructuring strategies.

- With the help of Fund TA, the authorities also formulated a strategy to enhance the institutional capacity at the National Treasury to anticipate, monitor, manage and mitigate financial risks stemming from SOEs and to ensure that decisions on support to SOEs take into account Kenya's limited fiscal space, in line with the end-May SB. An action plan to implement the recommendations of the TA mission is being prepared.

- Going forward, the authorities are expected to improve the reporting of fiscal risks associated with SOEs by including in the annual Budget Review and Outlook paper an expanded fiscal risk analysis that quantifies contingent liabilities stemming from high-risk SOEs and initiate coverage of PPPs (end-Sept SB).

- In staff's view, the above steps constitute substantial and appropriate actions to mitigate SOE related risk to the FY 2021/22 budget and to medium-term debt sustainability. Meanwhile LEG's TA is underway with a focus on supporting the authorities as they review the state ownership arrangements, performance monitoring, and governance of SOEs. Staff will follow-up on these reform areas after the findings of the mission become available.

16. ***We also noted the progress that has been made on the state-owned enterprise reform agenda. However, we are concerned that the language on SOEs in last week's Budget Statement lacked the necessary clarity and ambition to achieve the wider reform that is required, in particular on SOE oversight. Could staff provide an update on this?***

- The Budget Statement noted an urgent need to evaluate the financial position and governance of key SOEs/State Corporations and educational institutions, and also that the Government is exploring targeted reforms to strengthen these entities, including Public Universities. These reforms will be elaborated on in an action plan to the SOE strategy currently under development, and complemented by a blueprint for legal and institutional that is also underway. Both areas are being supported by IMF technical assistance.

17. ***Could staff elaborate on their assessment of Kenya's debt, including the upward trend in debt service, and downward revisions to the forecasted benefit from Kenya's participation in the DSSI for the first semester of 2021?***

- Debt service payments have not increased as percentage of GDP in FY21/22-FY22/23 compared to program approval (Table 2b).

- Central government interest payments temporarily increase to 4.5-4.7% of GDP in FY21/22 - FY22/23. This is primarily driven by the notable increase in net domestic credit as source of financing of large fiscal deficits to mitigate the negative effects of COVID-19 shock. The evolution of foreign-debt repayments, in turn, reflects the maturity profile of existing foreign debt.

- In comparison to the estimates provided at the time of program approval, the downward revision in the DSSI debt relief in the first half of 2021 is primarily explained by the reconciliation of the amounts eligible for suspension in discussions with DSSI creditors and the non-participation of several private sector creditors (banks), which were previously assumed to participate in the DSSI.

18. ***We would welcome, however, staff's further elaboration on recent changes to Kenya's debt carrying capacity outlook.***

- As noted in the DSA at the time of the program approval (Country Report 2021/072), Kenya's debt-carrying capacity was revised from Strong to Medium, reflecting: the negative impact of the COVID-19 shock on the global growth, which accounted for close to 70 percent of the change in the composite indicator score; Kenya's growth (with a respective contribution of 14 percent); as well as lower reserves coverage offset in part by higher remittances growth.[1]

- Per the operational procedures that have been established in line with the LIC DSF Guidance Note, an upward revision in Kenya's debt-carrying capacity would require two consecutive Strong signals from the evaluation methodology. The positive revision in global growth prospects and overall improvement in Kenya's economic outlook in the April 2021 WEO forecast round have already provided one of these signals. If confirmed in the October 2021 WEO round, this would result in an upward revision in Kenya's debt-carrying capacity, which would be reflected in the planned DSA for the 2nd ECF/EFF review.

- An upward revision in Kenya's debt-carrying capacity would raise the applicable thresholds of debt burden indicators under the LIC DSF, widening the safety margins around the debt sustainability assessment.

[1] All inputs are in the form of 10-year averages across 5 years of historical data and 5 years of projection.

19. ***Changing Kenya's debt ceiling from a nominal number to a debt-to-GDP target can provide better guidance to policymakers. However, we wonder if debt ceiling expressed in present value terms is superior to traditional nominal debt-to-GDP ratio. Staff comments are welcome.***

- The observation in Box 2 of the Staff Report that the existing fixed nominal debt ceiling (in Ksh trillion) does not provide adequate guidance to policymakers was limited to the Kenyan context and was not intended to be generalized. In Kenya's case, where a significant share of borrowing is on concessional terms but the country also enjoys access to capital markets, measuring debt in PV terms provides a more accurate picture of the burden associated with a given nominal debt level. This is consistent with the authorities' policy objective of prioritizing utilization of available concessional financing. In addition, the debt-related convergence criterion of the East African Monetary Union is also specified in NPV terms.

Monetary and Financial Policies

20. ***We commend the central bank for the progress in reforms to enhance the collection of supervisory data and develop the regulatory framework for non-bank digital lenders and microfinance institutions. We would appreciate more details on these regulatory developments.***

- Modernizing data management is one of the key reforms being undertaken by the CBK to improve regulation and supervision of financial institutions. The CBK is on course to pilot the Application Program Interfaces (APIs), which will connect the IT systems of banks to the Centralized Electronic Data Warehouse (EDW). The project will enable the supervisors to access data on a near real-time basis to facilitate enhanced monitoring and deployment of prompt corrective actions as needed.

- The Central Bank of Kenya (Amendment) Bill, 2020 on Digital Lenders was republished in April 2021. The Bill seeks to empower CBK to license, supervise and regulate digital lenders. In December 2020, the CBK finalized the review of the Microfinance Act, and the regulatory and supervisory framework for microfinance institutions. The legislative drafting of the Bill was completed in December 2020. In March 2021, the Bill was forwarded to the National Treasury for approval by Cabinet and subsequent tabling for consideration by the National Assembly. The bill seeks to enhance the regulatory and supervisory framework of microfinance institutions by enhancing the licensing framework, strengthen the corporate governance structures, and raising the minimum capital requirements to ensure resilience of microfinance banks. The introduction of consolidated supervision, and cyber risk, business continuity planning and management allows for a consistent and efficient approach to regulation and in tackling risk associated with use of technology.

21. ***We note the risk-weighted capital adequacy ratio, well above the statutory requirements, which may be an effective tool for the expansion of bank businesses and thus ensuring a sustainable contribution of the financial sector to***

economic growth. Can staff elaborate on reasons behind the high risk-weighted capital adequacy ratio?

- The Kenyan banking system entered the COVID-19 crisis with solid fundamentals and poised to expand lending following the discontinuation of interest rate caps. Banks have injected additional capital to accommodate the expected rise in credit losses and provisioning due to the implementation of IFRS 9. The shareholders' funds increased by 5.6 percent from 2019 to 2020. The suspension of dividend payments ensured accumulation of retained earnings by banks to ensure adequate capital cushions to ride out the pandemic shock. Overall, banks maintained significant levels of Tier 1 capital throughout the crisis. Risk-weighted assets grew at a slower pace than the growth in capital given the difficult prospects for new lending during the pandemic.

- Although the capital adequacy ratio remained well above the regulatory requirement, it marginally decreased from 19.2 percent in December 2020 to 18.9 percent in March 2021.

Structural Reform

22. ***There has been an appreciating trend in the real effective exchange rate since 2012. Is this appreciation leading to over-valuation or is it a bounce back to "equilibrium"? Also, what is the likely impact of such an appreciating exchange rate on the export competitiveness of the country and the current account sustainability?***

- The external sector assessment in the Staff Report to support the program request (Country Report 2021/072) found that Kenya's external balance is broadly in line with the level implied by fundamentals and desirable policies. That assessment estimated the real effective exchange rate (REER) gap in the range of +3 to +9 percent. The shilling acted as an important shock absorber during the COVID-19 shock, with an 8 percent depreciation against the US dollar overall in 2020. Despite more recent appreciation, it remains close to 7 percent weaker than its end-2020 value. The declining market shares of Kenyan exports in recent years are likely explained by both price and non-price competitiveness factors. The team is considering looking deeper at issues around competitiveness for the joint 2nd program reviews and Article IV consultation.

Governance

23. ***Additionally, we note with concern the recently published report by the Auditor-General indicating deficiencies, which according to the foreword have "led to fiscal indiscipline" that "in turn threaten[s] economic growth," and criticizing "reluctance to cooperate with the auditors during the audit process." As these allegations could have a material impact on the use of Fund resources and the Fund's reputation, also keeping in mind the public criticism sparked after the***

program approval, we would welcome it if staff could comment further on the Auditor-General's report.

- The Auditor General has demonstrated effectiveness in producing 3 audits of COVID-19 spending – one specialized forensic audit of utilization of COVID-19 funds national government entities, the earlier audit of the Kenya Medical supplies Authority (KEMSA) and an earlier audit of the utilization of COVID-19 funds at the subnational level.

- The publication earlier this month of two audits – the specialized forensic audit of utilization of COVID-19 funds by national government entities and a consolidated audit of total national government spending in FY19/20 (undertaken annually) – was a key action under the program. Together, Kenya has now undertaken comprehensive audits of all FY19/20 COVID-19-related expenditure, a structural benchmark for end-May. Formally, publication of the audits was slightly delayed, but the transparency and comprehensiveness of the information in the public domain is essential.

- The recently published COVID-19 audits identified violations of the Procurement Act and the Public Finance Management Acts by the ministry of health, KEMSA and referral hospitals. They point to some structural deficiencies in the weakness of information systems, the incompleteness of records, insufficient internal controls and oversight, and violation of operative public financial management rules. This highlights the need for effective follow up by the appropriate authorities in Kenya. The KEMSA audit prompted investigations by Parliament and by the Ethics and Anti-Corruption Commission. Criminal charges against individuals involved seem likely.

- The consolidated audit shows significant accounting problems in several ministries and agencies but also points to improvement (percentage of entities receiving an unqualified opinion rose from 56 last year to 63, while the percentage receiving an adverse or disclaimer of opinion fell from 10 last year to 6).

24. ***We emphasize that ensuring a transparent and efficient use of fund resources should continue to receive highest attention, not least in view of the public criticism in Kenya. Is outreach and stakeholder inclusion taking place?***

- The mission team and the resident representative are in close contact with a wide range of stakeholders. This includes regular dialogue with a broad grouping of civil society organizations with interests in social policy, as well as engagement with parliament, academics, think tanks, and various interest groups and associations. As part of outreach, staff has actively sought to inform the public about the program and to clear misconceptions. This has included an internet story explaining the program's objectives, production and updating of a webpage addressing frequently asked questions about the program, as well as responding to questions from media and elsewhere. In connection with the 1st Review, a digital plan has been prepared that will include a video interview with the mission chief and a series of postings on Twitter, Facebook, YouTube, and IMF.org.

- Another dimension of engagement relates specifically to the governance agenda. Kenya recently submitted a request for Technical Assistance in the area of Public Access to Information which the Fund will support. Staff will work with the Commission of Administrative Justice (Ombudsman) to assist in rolling out the Access to Information Act and will engage with other stakeholders in this context.

CONSTITUENCY CODES

OEDAE
Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF
Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG
Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP
Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR
Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC
China

OEDCE
Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO
Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC
Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF
France

OEDGR
Germany

OEDIN
Bangladesh, Bhutan, India, and Sri Lanka

OEDIT
Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA
Japan

OEDMD
Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI
Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE
Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO
Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU
Russian Federation and Syrian Arab Republic

OEDSA
Saudi Arabia

OEDST
Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ
Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK
United Kingdom

OEDUS
United States