FOR AGENDA

EBS/83/41
Correction 1

CONFIDENTIAL

March 18, 1983

To: Members of the Executive Board

From: The Acting Secretary

Subject: Kenya - Request for Stand-By Arrangement

The following corrections have been made in EBS/83/41 (2/23/83):

Page 6, item 4., line 2: for "September 1, 1982 and January 15, 1983,"
read "September 1, 1983 and January 15, 1984,"

Page 27, para. No. 2., line 4: for "until April 2, 1984."
read "until April 2, 1984, and SDR 152.8 million until July 15, 1984."

Corrected pages are attached.

Att: (1)

During 1982 the current account deficit of the balance of payments was reduced by over 3 percentage points to about 7 per cent of GDP, below the program's target of 8 per cent, largely on the basis of a more restrictive import policy made necessary by low foreign exchange reserves. This tightening of the import policy reversed the progress made earlier in liberalizing the trade system, with the introduction of a new import tariff scheme in late 1981. A complete and detailed review of developments under this stand-by arrangement is available in SM/83/24.

III. The 1983/84 Financial Program

1. Introduction

The objective of the 1983/84 financial program is to continue the medium-term balance of payments adjustment began under the previous stand-by arrangement, while creating the conditions for raising the growth rate to a more adequate level. In 1983 the domestic economy is projected to grow by about 3 per cent, but to resume higher rates thereafter. The growth of domestic prices is expected to be limited to 13 per cent. Growth impetus will stem from the agricultural and the agroindustrial sectors, which are partly export-oriented, and thus important beneficiaries of the recent exchange rate action. Most of the devaluation gain will be passed on to producers.

The fiscal adjustment initiated in 1981/82 will continue in 1982/83, with a further narrowing of the deficit to 4.7 per cent of GDP (6.7 per cent excluding grants). As in previous years, the brunt of the adjustment in this fiscal year will fall on budgetary expenditures, which in real terms are expected to decline by 2 per cent; partly as a result of revenue measures taken last December, revenue will grow by 3 per cent in real terms.

Credit policy will be geared to provide financing for private sector activity, while budgetary recourse to net bank credit will be substantially reduced, with overall credit expanding in line with income. Money and quasi-money is projected to grow less rapidly than nominal GDP in order to contain the rise of domestic prices. To that end, overall domestic credit will be allowed to increase by 17 per cent, while growth in money and quasi-money is set at 13 per cent. The increase in net bank credit to the government in terms of the stock of monetary aggregates at the beginning of the period will decline from 14.6 per cent in FY 1981/82 to 5.5 per cent in FY 1982/83. The moderation in the growth of net bank credit to the government will free available resources and permit the financing of the private sector.

As a result of the expected domestic and external developments and the financial policies announced by the authorities, the current account deficit of the balance of payments is expected to decline from 7.1 per cent of GDP (8.0 per cent excluding grants) in 1982 to 5.9 per cent (7.1 per cent excluding grants) in 1983 and to a lower level in subsequent years. This adjustment will be generated in part by the realignment in the level of prices of internationally traded goods, resulting from the 15 per cent depreciation of the Kenya shilling in terms of the SDR effected between December 3, 1982 and early January 1983. As a result, there will be a restrained import demand and a higher level of export incentives, which will make unnecessary the continuation of the export compensation scheme in the near future.

The proposed stand-by arrangement contains the following performance criteria:

1. Quarterly ceilings on total domestic credit of the banking system;

2. Quarterly subceilings on net credit to the Central Government;

3. A ceiling on external loans contracted or guaranteed by the Government on commercial terms in a maturity range of 1-12 years, with a subceiling on such loans in the maturity range of 1-5 years;

4. Two reviews of fiscal, monetary, exchange rate, and import policies before September 1, 1983 and January 15, 1984, respectively.

5. The standard provisions relating to multiple currency practices, and restrictions on payments and transfers for current international transactions and on imports for balance of payments reasons. The quantitative performance criteria are summarized in Table 3 and a summary of the program is provided in Table 4. Credit ceilings have been fixed only for end-March and end-June 1983, the second half of the current fiscal year. Ceilings for September and December 1983 will be determined during the first review, when the policies embodied in the 1983/84 budget will also be discussed. Ceilings for March and June 1984 will be set during the second review.

In 1982 the Government of Kenya requested exceptional assistance from its main donors. In two meetings (London, November 1982 and Nairobi, January 1983), the main donors agreed to an important increase in their aid programs, including a large amount of balance of payments support in the form largely of commodity assistance. This additional assistance forms an integral part of the program, both for the financing of the balance of payments and the budget. Of the new assistance about SDR 67 million, SDR 64 million in balance of payments support and SDR 3 million in additional project assistance is expected to be drawn in 1983. About SDR 41.6 million of this aid is expected to accrue to the 1982/83 budget.

2. Budgetary policy

The main fiscal objective of the program is a further reduction of the overall budgetary deficit from 6.5 per cent of GDP (7.8 per cent excluding grants) in 1981/82 to 4.7 per cent (6.7 per cent excluding grants) in

Kenya--Stand-By Arrangement

Attached hereto is a letter dated January 28, 1983 from the Minister of Finance and the Governor of the Central Bank, requesting a stand-by arrangement and setting forth the objectives and policies which the Government of Kenya intends to pursue. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of eighteen months from _______, 1983 Kenya will have the right to make purchases from the Fund in an amount equivalent to SDR 175.95 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 45.2 million until April 15, 1983, SDR 73.4 million until September 2, 1983, SDR 101.6 million until November 2, 1983, SDR 129.8 million until April 2, 1984, and SDR 152.8 million until July 15, 1984. None of these limits shall apply to a purchase under the stand-by arrangement that would not increase the Fund's holdings of Kenya's currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this arrangement shall be made from ordinary resources until total purchases under this arrangement reach the equivalent of SDR 359,348, then from ordinary resources and with borrowed resources in the ratio of 1 to 1.2 until purchases under this arrangement reach the equivalent of SDR 21,007,615; and then with borrowed resources; provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Kenya shall not make purchases under this arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 per cent of quota, or increase the Fund holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 per cent of quota:

(a) during any period in which the data at the end of the preceding period indicate that the limit on total domestic credit of the banking system or the limits on net credit from the banking system to the Government, both described in paragraph 13 of the letter of January 28, 1983, are not observed; or

(b) during any period after September 1, 1983, or January 15, 1984, respectively, in which suitable performance criteria have not been established in consultation with the Fund as contemplated by paragraph 16 of the letter of January 28, 1983, or after such performance criteria have been established, while they are not being observed; or

(c) during the entire period of this stand-by arrangement, if Kenya

(i) fails to observe the limit on the contracting of public or publicly guaranteed external debt on commercial terms, described in paragraph 14 of the attached letter, or

(ii) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(iii) introduces or modifies multiple currency practices, or

(iv) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(v) imposes or intensifies import restrictions for balance of payments reasons.

When Kenya is prevented from purchasing under the arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Kenya and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Kenya's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Kenya. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Kenya and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Kenya, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources would be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Kenya will consult the Fund on the timing of purchases involving borrowed resources.

8. Kenya shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Kenya shall repurchase the outstanding amount of its currency