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**FOR
AGENDA**

EBS/81/241
Supplement 1

CONFIDENTIAL

January 7, 1982

To: Members of the Executive Board
From: The Acting Secretary
Subject: Kenya - Request for Stand-By Arrangement

This paper provides supplementary information to the paper on Kenya's request for a stand-by arrangement which was circulated as EBS/81/241 on December 10, 1981. A summary of Kenya's financial program is also attached.

Att: (1)

INTERNATIONAL MONETARY FUND

KENYA

Request for Stand-By Arrangement
Supplementary Information

Prepared by the African Department and the Exchange
and Trade Relations Department

(In consultation with the Legal, Fiscal, and
the Treasurer's Departments)

Approved by J.B. Zulu and W.A. Beveridge

January 7, 1982

1. Preliminary fiscal data for the first five months of FY 1981/82 indicate that actual ordinary recurrent revenue was running about 7 per cent above the projection for the period, while actual total expenditure was about 4 per cent in excess. Although the higher-than-expected revenue offset the excess expenditure, a lag in foreign loan disbursements and in the placement of government debt with nonbank financial intermediaries contributed to a deficit to be financed by the banking system by some K Sh 380 million larger-than-anticipated. Preliminary information indicates that substantial sales of government debt to nonbank financial institutions took place in December, and also that revenue collections picked up compared to preceding months. It is tentatively estimated that net bank credit to the Government was on target at end-December.
2. In mid-December producer prices of cereals for the next crop year were increased by between 21 per cent (wheat) and 60 per cent (rice), while those for sugar and cotton were raised by 6 per cent and 13 per cent, respectively. Producer prices for cashew nuts and sunflower seeds were increased by up to 60 per cent, while farm gate prices for dairy products and beef were raised by between 16 per cent and 30 per cent, respectively. The increases in producer prices were reflected in consumer price increases for a number of foodstuffs. Thus, consumer prices of fats and edible oil were raised by between 25 per cent and 30 per cent, and the prices of a wide range of baby foods and salt went up considerably; prices of meat, rice, sugar, and milk rose by between 16 per cent and 24 per cent.
3. In an effort to promote energy conservation, the Government has been allowing the full passthrough to consumers of petroleum import and transformation costs. The domestic retail price of gasoline was increased by 11 per cent and that of diesel by 14 per cent in late October; simultaneously, the price of kerosene was increased by 37 per cent. After these increases the average domestic retail price of petroleum products went up

by 19 per cent, or in line with the recent devaluation of the Kenya shilling in domestic currency terms. The price of a gallon of premium gasoline is now equivalent to US\$3.60.

For the information of Executive Directors, a summary of the financial program is attached.

Kenya: Summary of the Financial Program

I. Assumptions

- i. Real GDP growth of 4 per cent in 1981 and 1982.
- ii. Inflation declining from 12 per cent in 1980 to 10 per cent in 1981 and further to 8 per cent in 1982.
- iii. Terms of trade deterioration of 7.5 per cent in 1981, followed by 1 per cent improvement in 1982.
- iv. Deficit in the balance of payments current account narrowing from 13 per cent of GDP in 1980 to 10 per cent in 1981 and further to 8 per cent in 1982.
- v. Overall balance of payments deficit widening from 3 per cent of GDP in 1980 to 5 per cent in 1981, and possibly turning into a marginal surplus in 1982.

II. Principal elements of the program

1. External policy

- a. Exchange rate. A 15 per cent depreciation in terms of the SDR on September 21, 1981 followed a 5 per cent one on February 3, 1981.
- b. Import system. Simplification of import licensing system through the publication of new import schedules and gradual replacement of quantitative restrictions with tariffs. With the publication of the last two budgets, 1,700 tariff items have been raised. Prior to the end of FY 1981/82 20 per cent of all items in restricted categories will be shifted to the category of free imports. The Government intends to accelerate the transfer in the following two years. Review of import policy prior to August 1982 is performance criterion for third drawing.

2. Employment and wage policies

No general salary increases in the public sector during FY 1981/82; circular to all ministries restricting wage increases to in-grade promotions. Recruitment into the civil service has been limited to filling vacancies in absolutely necessary posts, with other staffing needs being met with redeployment of existing staff.

3. Fiscal policy

Reduction of overall deficit from 10.6 per cent of GDP in FY 1980/81 to 7.5 per cent of GDP in FY 1981/82. Reduction in the volume of expenditure, mainly from constraints in the wage and salary bill, and economies in defense, education, and other is equivalent to about 4 per cent of GDP. An effective monitoring system is in place. Discretionary revenue effort and the impact of devaluation is larger than 1 per cent of GDP. A review of fiscal policy is a performance criterion for second drawing.

4. Monetary policy

Performance criteria in the form of credit ceilings on total domestic bank credit and net bank credit to Government for January, June, and September 1982 coinciding with phasing of drawings. Total credit expansion for credit ceiling purposes to slow down to 20 per cent in FY 1981/82 from 24 per cent in FY 1980/81, and monetary expansion to be limited to 11 per cent, slightly lower than the expected growth in money GDP. Interest rates quoted by commercial banks, which had been raised in several steps over the past year and a half, were raised again in September 1981 by one percentage point for lending operations and two percentage points for deposit liabilities. Given the estimated current rate of inflation of 10 per cent, the maximum deposit rate and most lending rates are now positive in real terms. Credit ceilings for June 1982 will be set at the time of the first stand-by review, prior to April 1, 1982; credit ceilings for September 1982 will be set at the time of the import policy review tentatively scheduled for June or July.

5. External medium-term borrowing

Contracting of public and publicly guaranteed debt on commercial terms limited to US\$160 million.