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September 12, 2008

The Acting Chair's Summing Up
Kenya—2008 Article IV Consultation and Ex Post Assessment of Kenya's Longer-Term Program Engagement with the Fund
Executive Board Meeting 08/79
September 10, 2008

Executive Directors agreed with the thrust of the staff appraisal. They commended the Kenyan authorities for maintaining economic stability in the wake of post-election turmoil in early 2008, and for their sound macroeconomic policies and progress with economic reform in recent years, which have contributed to strong economic growth and poverty reduction. Directors regretted the interruption of economic activity that resulted from the post-election turmoil, but were encouraged that a recovery seems to be underway following the return to political stability.

Directors noted, however, that downside risks remain, particularly from rising food and fuel prices and weakening global demand. They underscored that sound policies and continued structural and governance reforms are essential to maintain macroeconomic stability, restore strong growth, and advance toward the Millennium Development Goals.

Directors supported the focus of the 2008/09 budget on removing growth bottlenecks and improving social cohesion. At the same time, they stressed the importance of fiscal restraint in light of the strong recovery and inflationary pressures, and urged the authorities to accommodate spending priorities within a smaller-than-budgeted deficit. Directors encouraged the authorities to adopt a fiscal anchor based on the ratio of total public debt to GDP in light of the planned sovereign bond issue. They advised that the size, timing, and modalities of the planned international sovereign bond issue be carefully considered to safeguard debt sustainability, and that the proceeds be used for high-return infrastructure projects. In this context, Directors stressed the importance of establishing a comprehensive debt management strategy, and advised the authorities to continue to seek concessional financing as the best source for public investment.

Directors welcomed the recent tightening of monetary policy and the authorities' readiness to tighten further to prevent the second-round effect of rising food and fuel prices. They urged the authorities to take more decisive steps to reduce monetary growth to rates consistent with their inflation objective. They called for quick action to address the upward methodological bias in the compilation of the consumer price index. Directors supported the authorities' plans to reform the monetary operations framework, including through the introduction of inflation targeting. However, they stressed that more analytical work is needed and institutional and statistical pre-conditions should be put in place before inflation targeting is adopted.

Directors observed that the managed float exchange rate regime has served Kenya well. They considered that the appreciation of the real exchange rate is broadly consistent with Kenya's improving economic fundamentals, which have helped to attract financial inflows. Nevertheless, Directors stressed the importance of monitoring developments in competitiveness in view of the widening external current account deficit.

Directors agreed that far-reaching structural reforms and infrastructure improvements will be required to achieve the authorities' Vision 2030 growth objectives. Priority reforms should include those in the financial sector, public financial management, and the regulatory and trade regimes. Directors believed that public-private partnerships can play a useful role in building Kenya's infrastructure, provided the contractual arrangements are transparent and the contingent liabilities are fully assessed.

Directors stressed the importance of continued progress on governance and transparency reforms. They welcomed the authorities' intention to update the 2006/07 Governance Action Plan, under which advances had been made in important areas, including public procurement and business regulation. Directors encouraged more progress in areas where original objectives have not been met, including for wealth declarations and verifications for senior public officials. Further improvements in public financial management would also be important.

Directors broadly concurred with the findings and recommendations of the Ex Post Assessment of Kenya's long-term program engagement with the Fund. They agreed that macroeconomic policy design under past programs was broadly appropriate and that implementation was generally sound. However, they noted that aspects of the past engagement were disappointing—in particular, the protracted focus on governance issues. Directors were concerned that program conditions on governance were not always macro-critical, did not take into consideration constraints of Kenya's legal and political systems, or paid sufficient attention to program ownership. Directors welcomed the improved ownership and performance in recent years and believed that the Fund should continue to play a key role in helping the authorities design and implement sound policies. In this regard, they welcomed the consideration being given by the authorities to modalities for future engagement with the Fund, possibly in the context of a Policy Support Instrument.

Directors welcomed the authorities' decision to publish all reports, including the reports for the 2008 Article IV consultation and Ex Post Assessment of Kenya's longer-term program engagement with the Fund.

The next Article IV consultation with Kenya is expected to be held on the standard 12-month cycle.