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REQUESTS FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

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Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	High
Overall risk of debt distress	High
Granularity in the risk rating	Sustainable
Application of judgment	No

Kenya's debt is sustainable, and its debt dynamics will be bolstered by the fiscal consolidation envisaged under the IMF supported program. While planned fiscal consolidation will help address debt vulnerabilities exacerbated by the global COVID-19 shock, the risk of debt distress continues to be assessed as high. [1] *High deficits—from the past and generated by the current shock—combined with the sharp decline in export and economic growth caused by the pandemic, have deteriorated solvency and liquidity debt indicators, particularly when measured against Kenya's current debt-carrying capacity (evaluated as medium).* [2] *Kenya's debt indicators will improve as fiscal consolidation progresses and exports and output recover from the global shock, although improvement is particularly gradual for indicators in terms of exports. Sustained fiscal consolidation would stabilize debt towards the end of the program and bring it to more prudent levels over the medium term while securing resources to support social spending. Kenya has generally enjoyed strong access to international capital markets, and staff projections assume limited reliance on market financing over the coming three years and roll-over of existing Eurobonds. The DSA suggests that Kenya is susceptible to export and exchange rate shocks; more prolonged and protracted shocks to the economy would also present downside risks to the debt outlook.*

[1] Kenya was first assessed as being at high risk of debt distress in May 2020. IMF Country Report No. 20/156 (May 2020) contains the previous DSA conducted jointly with the World Bank.

[2] The Composite Indicator for Kenya is estimated at 3.01, which translates into a *Medium* Debt-Carrying Capacity Assessment, revised from *Strong*. It is based on the 2020 October WEO and CPIA vintage released on July 2020.

PUBLIC DEBT COVERAGE

1. **Kenya's public debt includes obligations of the central government.** Debt data include both external and domestic obligations and guarantees. The external DSA covers external debt of the central government and the central bank, as well as of the private sector; and stress tests apply to public and publicly guaranteed (PPG) debt. The public DSA covers both external and domestic debt incurred or guaranteed by the central government, and public domestic debt consists of central government debt. In this analysis, total public debt refers to the sum of public domestic and public external debt, however, it does not cover the entire public sector such as extra-budgetary units and county governments.[3] Debt coverage excludes legacy debt of the pre-devolution county governments (whose size is modest).[4] In comparison to peers, Kenya maintains a high standard of debt transparency. The external public debt register includes granular data disclosure, which could be more regularly updated.[5] The DSA uses a currency-based definition of external debt, as nonresidents' direct participation in the domestic debt market, at about one percent of total outstanding government securities, is not significant.

2. **The DSA includes contingent liability stress tests for SOEs, PPPs, and a financial market shock.** In particular, the DSA incorporates:

- 3.1 percent of GDP to capture non-guaranteed debt of state-owned enterprises (SOEs) and Public Private Partnerships (PPPs). Notably, the baseline already incorporates the 0.3 percent of GDP assumed for SOE support as well as amounts borrowed directly by the Kenyan government and on-lent to SOEs.[6]
- 5 percent of GDP for a loan default financial market shock—a value that exceeds the existing stock of financial sector NPLs of about 4 percent of GDP.

BACKGROUND ON DEBT

3. **Kenya's overall public debt has increased in recent years.** Gross public debt increased from 48.6 percent of GDP at end-2015 to an estimated 69 percent of GDP at end-2020, reflecting high deficits, partly driven by past spending on large infrastructure projects, and in 2020 by the COVID-19 global shock. About half of Kenya's public debt is owed to external creditors.

4. **Most of Kenya's external public debt remains on concessional terms.** Nominal PPG external debt at end-2020 amounted to 35.6 percent of GDP, about four percentage points higher than at end-2019.

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[3] County governments have not been allowed to borrow without government guarantee since 2010 and borrowing requires National Treasury (NT) authorization while extra-budgetary units face no such constraint.

[4] A new Constitution was approved by referendum in 2010, devolving substantial powers to 47 new county governments.

[5] Debt statistics bulletins with PPG coverage and debt management strategies are regularly published. Also, the Budget Policy Statement publishes contingent liabilities.

[6] This includes the external debt associated with the Standard Gauge Railway (SGR).

Kenya: Public Debt Coverage

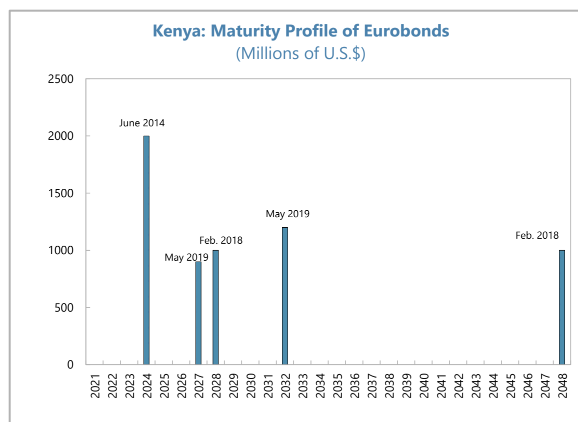
	Subsectors of the public sector	Subsectors Covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

1	The country's coverage of public debt	The central government plus social security, central bank, government-guaranteed debt	
		Default	**Used for the analysis**
2	Other elements of the general government not captured in 1.	0 percent of GDP	0
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2
4	PPP	35 percent of PPP stock	1.1
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5
	Total (2+3+4+5) (in percent of GDP)		8.1

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

- At end-2020, multilateral creditors accounted for about 40 percent of external debt, while debt from bilateral creditors represented close to 33 percent. Of Kenya's bilateral debt, about 63 percent is owed to non-Paris Club members, mainly loans from China to finance construction of the Standard Gauge Railway (SGR) project.

- External commercial debt decreased in 2020, as the authorities prioritized concessional borrowing during the pandemic after several years of reliable access to global financial markets. Commercial debt (mainly Eurobonds and syndicated loans) accounted for about 26 percent of external public debt at end-2020—modestly above its share at end-2015. Eurobonds account for 70 percent of commercial debt (US$6.1 billion), while syndicated loans represent 27 percent (about $2.5 billion).



Kenya: External Public Debt

	2015		2016		2017		2018		2019		2020	
	US$bn	Share	US$bn	Share	US$bn	Share	US$bn	Share	US$bn	Share	US$bn	Share
Multilateral creditors	7.3	46.5	7.6	41.2	8.2	35.8	8.6	32.1	10.2	33.4	13.7	39.7
Bilateral creditors	4.7	29.8	6.3	33.8	7.6	33.3	8.8	32.8	10.1	33.0	11.3	32.7
Commercial creditors	3.6	22.7	4.5	24.2	6.9	30.1	9.2	34.4	10.2	33.1	8.9	25.9
Others (supplier credits)	0.2	1.0	0.1	0.8	0.2	0.7	0.2	0.6	0.2	0.5	0.6	1.7
Total	15.8	100	18.5	100	22.8	100	26.7	100	30.7	100	34.5	100

Source: Kenyan National Treasury.

5. Kenya's domestic public debt reached 33 percent of GDP at end-2020. Domestic debt is issued mostly in the form of Treasury bonds (about 70 percent of the total stock) and Treasury bills. The 91-day, 182-day, and 364-day average interest rates were 6.9 percent, 7.4 percent and 8.3 percent respectively in December 2020. The average time to maturity for government domestic debt securities increased from 5¾ years at end-2019 to 7.9 years at end-2020, as the authorities successfully implemented their strategy to lengthen the maturity profile of domestic debt. About half of government domestic debt securities are held by commercial banks, followed by pension funds.

UNDERLYING ASSUMPTIONS

6. Under the baseline scenario, solid growth is expected over the medium term. Despite a slowdown in 2020 driven by the global COVID-19 shock, medium-term growth prospects remain favorable and broadly in line with past performance. In 2021 the recovery will be driven by manufacturing and services, particularly education, transportation and trade (wholesale and retail)—activities that have recently rebounded after being particularly affected by the lockdowns implemented to address the health crisis. Estimated growth for 2021 is significantly affected by base effects, including the methodological approach that better captured the impact of school closures and their reopening; non-education growth is in line with the historical trend as some sectors show healthy recovery while others still face challenges. The expectation under the baseline is that, after this rebound from the COVID19 shock, the economy will settle at its potential growth (roughly 6 percent) over the medium to long term.[7] Medium-term growth is supported by the reform agenda envisaged under the proposed EFF/ECF program, which should underpin a healthy investment rate, particularly private investment, as well as the favorable prospects for external demand propelling exports. Exports of goods and services are projected to reach 13.3 percent of GDP in 2025, broadly the same share as observed in 2018.[8] Inflation is expected to remain close to the middle of the authorities' target range in the near and medium term.

Kenya: Selected Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018	2019	2020
	Actual						Prel.	
Real GDP growth (percent)	5.9	5.4	5.7	5.9	4.8	6.3	5.4	-0.1
CPI inflation, average (percent)	5.7	6.9	6.6	6.3	8.0	4.7	5.2	5.3
CPI inflation, eop (percent)	7.1	6.0	8.0	6.3	4.5	5.7	5.8	5.6
Current account balance (percent of GDP)	-8.8	-10.4	-6.9	-5.8	-7.2	-5.7	-5.8	-4.8
Overall fiscal balance (percent of GDP) [1]	-5.2	-6.1	-8.4	-7.4	-9.1	-7.4	-7.7	-7.8
Gross international reserves (in billions of US$)	6.4	8.0	7.5	7.5	7.1	8.1	9.1	8.3
Gross international reserves (months of imports)	3.8	5.4	5.6	4.7	4.3	4.8	6.1	4.7
Total public debt (gross, percent of GDP) [1]	41.1	46.8	47.9	53.5	57.4	59.3	62.1	65.9
Private investment (percent of GDP)	14.3	17.2	15.1	9.0	9.7	8.6	8.0	7.0
Credit to the private sector (y/y growth, percent)	20.1	22.2	17.3	4.4	2.5	2.4	7.1	7.7

Sources: Kenyan authorities and IMF staff estimates and projections.
[1] Fiscal years (e.g., 2020 refers to FY 2019/20).

[7] For comparison, the DSF published at the time of the May RCF, which did not reflect the assumption of IMF program engagement as under the current EFF/ECF arrangements, assumed a long-term growth rate of 5.8 percent.

[8] See the External Sector Assessment for a discussion on export performance and longer-term competitiveness challenges.

7. The fiscal deficit reached 7.8 percent of GDP in 2019/20, 1.2 percentage points less than the deficit approved in the supplemental budget. Tax revenues declined to 13.6 percent of GDP in 2019/20—reflecting the economic slowdown and policy measures to address the COVID-19 shock, but also the gradual downward trend observed since 2013/14. Kenya's revenue collection remains in line with the regional average. The decline in the deficit since 2016/17 has been mainly achieved through spending cuts to both current outlays and development spending. With strong adjustment under the proposed program, Kenya would reach the average debt-stabilizing primary deficit, estimated at 1.2 percent of GDP, in 2023; over the medium term the overall deficit is expected to decline and stay below 4 percent of GDP, with the primary surplus at 0.5 percent of GDP. In 2021 a significant share of financing is expected to come in the form of concessional and semi-concessional borrowing, including from the IMF and other multilaterals; financing from commercial lenders is estimated at $1.1 billion as part of the authorities plan' to limit reliance on external commercial borrowing in the coming years to reduce debt-related vulnerabilities. Having generally enjoyed strong access to the international capital markets, the authorities are also considering debt management operations if market conditions are favorable; debt management operations are not reflected in the baseline. Kenya is also expected to tap global capital markets to roll over Eurobonds as they mature.

Kenya: Selected Macroeconomic Assumptions

	2017	2018	2019	2020	2021	Long-term 1/
Real GDP Growth						
Current DSA	4.8	6.3	5.4	-0.1	7.6	6.0
Previous DSA (May 2020)	4.8	6.3	5.4	0.8	5.5	5.8
Primary Fiscal Deficit (percent of GDP)						
Current DSA	4.5	3.7	3.6	4.1	3.7	-1.0
Previous DSA (May 2020)	4.5	3.7	4.0	4.1	3.1	0.3
Non-interest Current Account (percent of GDP)						
Current DSA	5.0	4.1	3.8	2.8	3.5	3.6
Previous DSA (May 2020)	5.0	3.5	2.9	2.9	2.8	2.8

Source: IMF staff estimates.
1/ Average for 2027-41.

8. The current account deficit amounted to 4.8 percent of GDP in 2020—one percentage point lower than in 2019. The current account performance was supported by resilient exports—tea and horticulture—and lower global energy prices; tourism receipts contracted on account of the COVID-19 crisis, while remittances performed strongly. Over the medium term, staff projects a stable current account deficit, supported by exports recovering from the COVID-19 shock and moderate import growth as the pace of development expenditure, which has a high import content, stabilizes. Under the baseline the current account deficit is expected to be financed by a diversified set of sources, including FDI and financial and non-financial corporate borrowing.

9. The realism tools flag some optimism compared to historical performance, but staff is of the view that the projections are reasonable (Figure 4). While protecting social spending, the baseline scenario assumes an improvement of the primary balance of 3.7 percentage points of GDP over the next three years, which falls in the top quartile of the distribution for LICs. Staff is of the view that this is realistic and in line with the authorities' plan for fiscal consolidation under the program as set out in the 2021 Budget Policy Statement (BPS). The authorities' commitment to fiscal

consolidation, including actions taken during the pandemic to broaden the tax revenue base and identify offsets to compensate for COVID-related expenditures, provide assurances that the fiscal adjustment under the program is achievable (see ¶19). The global and domestic recovery from the COVID shock and base effects associated with the crisis, including the methodological approach that better captured the impact of school closures and their reopening, substantiate the near-term growth trajectory during planned fiscal consolidation. Export growth is projected to be slightly higher than the recent past, which is justified as exports recover from Kenya's early 2019 drought and the 2020 global shock. By 2025, exports of goods and services are projected to return to a similar level as the share of GDP observed in 2018, supported by Kenya's improving business environment, key infrastructure projects coming to completion, large potential in a range of agricultural products, and the Big 4 Agenda push to stimulate manufacturing with a strong export emphasis. In the outer years, it is assumed that Kenya will continue to depend on concessional financing as part of a continuing commitment to reduce debt-related vulnerabilities.

Kenya: Summary Table of Projected External Borrowing Program from April 1, 2021 to June 30, 2022

PPG external debt	Volume of new debt April 2021 - June 2022		PV of new debt 1/ April 2021 - June 2022 (program purposes)	
	USD million	Percent	USD million	Percent
By sources of debt financing	**12,376**	**100**	**10,342**	**100**
Concessional debt, of which	**4,765**	**39**	**2,787**	**27**
Multilateral debt	2,420	20	1,451	14
Bilateral debt	2,345	19	1,336	13
Other	0	0	0	0
Non-concessional debt, of which	**2,611**	**21**	**2,555**	**25**
Semi-concessional	282	2	226	2
Commercial terms	2,329	19	2,329	23
Debt for Debt Management Operations (Non-Concessional)	**5,000**	**40**	**5,000**	**48**
By Creditor Type	**12,376**	**100**	**10,342**	**100**
Multilateral	2,702	22	1,677	16
Bilateral - Paris Club	579	5	343	3
Bilateral - Non-Paris Club	1,766	14	993	10
Private	2,329	19	2,329	23
Private for Debt Management Operations	5,000	40	5,000	48
Uses of debt financing	**12,376**	**100**	**10,342**	**100**
Infrastructure	4,295	35	3,522	34
Social Spending	755	6	428	4
Budget Financing	2,326	19	1,391	13
Potential Debt Management Operations 2/	5,000	40	5,000	48

Source: IMF calculations using Authorities' data.

1/ Contracting and guaranteeing of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate. For commercial debt, the present value is defined as the nominal/face value.

2/ "Planned potential borrowing for debt management operations to improve the debt profile (in terms of PV and debt service). Debt management operations are not reflected in the baseline.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

10. Kenya's debt carrying capacity is assessed as Medium, given an estimated Composite Indicator (CI) of 3.01. The CI captures the impact of various factors through a weighted average of an institutional indicator,[9] real GDP growth, remittances, international reserves, and world growth. Kenya's CI is based on the October 2020 WEO and the World Bank's CPIA vintage released in July 2020. The debt carrying capacity, in turn, determines the PPG external debt thresholds and total public debt benchmarks.[10]

Kenya: Composite Indicator and Thresholds

Country	Kenya
Country Code	664
Debt Carrying Capacity	Medium

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Medium	Medium 3.01	Strong 3.12	Strong 3.13

APPLICABLE EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	180
GDP	40
Debt service in % of	
Exports	15
Revenue	18

APPLICABLE TOTAL public debt benchmark	
PV of total public debt in percent of GDP	55

11. The revision to Kenya's debt carrying capacity assessment from Strong to Medium was primarily driven by the revision to global growth that occurred with the October 2020 WEO (see Text Table, page 8). The 10-year global growth average was downgraded from 3.5 percent in the previous assessment to 2.9 percent under the current assessment[11]. With global growth having the largest weight, the revision explains close to 70 percent of the change in the composite indicator score. The downward revision to Kenya's 10-year average growth (from 5.7 percent to 5.1 percent), contributed about 14 percent of the fall in the composite indicator score. Lower reserves coverage contributed to a lower score, while higher remittances growth supported a higher score. Consistent with the shift to Medium debt carrying capacity, applicable thresholds under the LIC DSF also are reduced, as indicated above.

[9] The World Bank's Country Policy and Institutional Assessment (CPIA).

[10] See Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries, Section V.

[11] Global growth projections have been revised up since October 2020 WEO, although the outlook remains uncertain.

Kenya: Sources of Change in the Assessment of Debt Carrying Capacity

Component	Coefficients (A)	Current Assesment: 10-year average values (B)	Current Assesment: CI Score components (A*B) = (C)	Previous Assessment: 10-year average values (B)	Previous Assessment: CI Score components (A*B) = (C)
Country Policy and Institutional Assessment (CPIA)	0.4	3.7	1.44	3.7	1.44
Real GDP growth, percent	2.7	5.1	0.14	5.7	0.16
Import coverage of reserves, percent	4.1	39.4	1.60	42.3	1.72
Import coverage of reserves^2, percent	-4.0	15.5	-0.62	17.9	-0.71
Remittances, in percent of GDP	2.0	3.0	0.06	2.8	0.06
Global growth, in percent	13.5	2.9	0.40	3.5	0.47
Composite Indicator (CI) Score			**3.01**		**3.12**
Composite Indicator (CI) Rating			**Medium**		**Strong**

12. Besides the six standardized stress tests, there are two tailored stress tests:

- One tailored stress test combines contingent liabilities of a one-time debt shock (equivalent to 8.1 percent of GDP) to capture a scenario reflecting both contingent liabilities from SOEs (equal to the indicated standard level of 2 percent of GDP), contingent liabilities from PPPs (equal to the indicated level of 35% of the existing PPP stock, or 1.1 percent of GDP) and a need for bank recapitalization (equal to the indicated standard level of 5 percent of GDP).
- The second tailored stress test is a market financing shock which is applied to low income countries with market access, such as Kenya. The scenario assesses rollover risks resulting from a deterioration in global risk sentiment, temporary nominal depreciation, and shortening of maturities of new external commercial borrowing.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

13. Debt indicators in terms of exports breach thresholds under the baseline driven by the slowdown in exports and higher external debt (Table 1, Table 3, and Figure 1). Higher debt, the debt amortization profile, and lower exports of goods and services caused by the COVID-19 shock help explain the breaches of one solvency (PV of PPG external debt-to-export ratio) and liquidity (debt-service-to-exports ratio) indicator. Based on the debt-carrying capacity analysis (2020 October-vintage WEO), the solvency indicator remains above threshold (180 percent) during 2021–27, while the liquidity indicator exceeds its threshold (15 percent) throughout the 10-year projection. The solvency indicator gradually declines as exports recover; the long-term decline in the liquidity indicator is interrupted by Eurobond repayments in 2024 and 2028. When compared with the May 2020 DSA, the reassessed classification of Kenya's debt carrying capacity contributed to more protracted breaches.

14. The PV of PPG external debt as a share of GDP remains firmly below the 40 percent indicative threshold throughout the projection period (Table 1 and Figure 1). Reflecting fiscal consolidation efforts and a borrowing mix that favors concessional borrowing, this solvency indicator is expected to decline from 28.7 percent in 2021 to almost 17 percent in 2041. It also remains below the threshold under the most extreme shock—a one-time depreciation. The external

debt service-to-revenue ratio exceeds its threshold (18 percent) in 2024, reflecting the maturity of the Eurobond in that year. If market conditions are favorable, the authorities are considering debt management operations to further improve the already smooth debt service profile. Support provided by the G20 under the Debt Service Suspension Initiative (DSSI), requested by Kenya in January 2021, helped reduce debt service by about US$640 million in 2021.

15. Standard stress test results highlight the sensitivity of debt indicators to exports (Figure 1 and Table 1). Specifically, under the most extreme shock scenario (shock to export growth), the PV of debt-to-exports and the debt service-to-exports ratios breach the threshold over the projection period. Under the most extreme scenario, the debt service-to-revenue ratio is above the threshold until 2025.

16. Market financing risks have receded for Kenya (Figure 5). The EMBI spread has fallen from 727 basis points in 2020Q1 to 498 basis points during the 3 months ending in January 2021 and remains below the threshold (570 basis points). Gross financing needs have also declined, from 15 percent of GDP at the time of the previous DSA to 13 percent of GDP currently, staying below the threshold (14 percent of GDP) that indicates high risks. As noted above, relief provided by the G20 under the DSSI reduced financing needs in 2021. Fiscal consolidation efforts under the proposed program would help reduce gross financing needs below the threshold except in 2024, when rollover of the Eurobond upon maturity will increase financing needs to 14.3 percent of GDP. As is the case for emerging and frontier economies, financing risks could be affected by global liquidity conditions. If global market conditions were to unexpectedly tighten, financing risks for Kenya may increase. The shift in the deficit financing mix towards domestic resources calls for monitoring risks, although the recent success in extending the maturity profile of domestic debt mitigates some domestic refinancing risk.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

17. While average indebtedness in PV terms remains unchanged when compared with the last DSA, under the current baseline the public debt-to-GDP ratio remains above the 55 percent benchmark—for a country rated at medium debt-carrying capacity—until 2027 (Figure 2 and Table 2).[12] In PV terms, the average PV debt-to-GDP ratio amounts to 62.8 percent during 2020–25, 0.3 percentage point of GDP above the average figure discussed at the time of the DSA for the RCF (May 2020). Public sector debt is projected to increase from 62.4 percent of GDP (PV terms) in 2020 to 64.2 percent in 2022, followed by a gradual decline. It remains above the threshold until 2027. Supported by fiscal consolidation under the program, including revenue mobilization measures, the PV of public debt-to-revenue ratio would initially increase from 360 percent in 2020 to 373 percent in 2021, before gradually declining to 248 percent in 2030 and to 105 percent in 2040.

[12] Under *Strong* debt carrying capacity the threshold on PV of public debt is 70 percent of GDP.

18. The alternative scenarios indicate that the PV of debt-to-GDP ratio would remain above the indicative benchmark for most of the projection period (Figure 2 and Table 4). Under the most extreme shock scenario (shock to GDP growth), the PV of the public debt-to-GDP ratio would breach the 55 percent benchmark for a country with medium debt-carrying capacity during 2021–35.

RISK RATING AND VULNERABILITIES

19. Kenya's risk of debt distress remains high in the context of the ongoing global COVID-19 shock. The shock has led to a sharp temporary decline in export and GDP growth and triggered a strong fiscal response, interrupting planned consolidation. Consequently, the mechanical signal from debt indicators has worsened, particularly those expressed in terms of exports. Potential risks associated with SOEs will be closely monitored under the Fund-supported program, inter alia through financial evaluations of the nine largest SOEs facing financial risks (***prior action***), with the number of SOEs assessed increasing to 15–20 before the end of FY20/21. This analysis will inform the development of a strategy to manage and reduce SOE-related risks (***structural benchmark***). Kenya's external and public debt vulnerabilities also reflect high past deficits, partly due to large infrastructure projects. Given the assessment of debt-carrying capacity as medium, the mechanical signal indicates sustained breaches of solvency and liquidity indicators under the baseline scenario —the PV of external debt-to-exports and external debt service-to-exports ratios as well as PV of public debt-to-GDP. The larger breach of liquidity indicators in 2024 under the baseline is mainly attributed to a Eurobond repayment; staff projects Kenya should be able to roll this maturity over, given its historical record of strong global market access and commitment to fiscal consolidation under the proposed program. The DSA suggests that Kenya is susceptible to export and exchange rate depreciation shocks (Figure 1).

20. Kenya's debt remains sustainable and supported by fiscal consolidation under the program. With the debt-stabilizing primary balance achieved and surpassed during the program, debt would begin declining as a share of GDP already during the last year of the EFF/ECF arrangements. Indicators measured against exports will also gradually improve with the recovery of exports toward levels Kenya has achieved in recent years, supported by the post-pandemic global recovery and reforms under the EFF/ECF program to enhance competitiveness. Given the duration of mechanical threshold breaches under the baseline, consolidation efforts would need to be sustained after the program concludes to bring debt down to a healthier level.

- While the PV of public debt-to-GDP ratio remains above the indicative threshold (50 percent), the authorities' commitment to fiscal consolidation under the program provides additional safeguards for debt sustainability. Important actions have already been taken to permanently broaden the tax revenue base in the midst of the pandemic, alongside expenditure savings to limit expansion of the deficit from the COVID-19 shock. The multiyear fiscal consolidation plan highlighted in the 2021 Budget Policy Statement (BPS) is premised on a more conservative approach to revenue projections and a commitment to additional policy steps to increase tax revenues and control expenditures under the EFF/ECF program with the specific objective of anchoring debt sustainability.

- Kenya's PV of external debt as a share of GDP is below the 40 percent indicative threshold and will gradually decline over time. The slowdown in exports on the back of the COVID-19 shock and the scheduled rollover of the 2024 Eurobond drive the breaches in PV of external debt to exports and external debt service to exports. Kenya's external debt indicators are expected to gradually improve as fiscal consolidation progresses, exports recover after the global shock dissipates, and Kenya makes progress to unlock its substantial export potential.
- In addition, in connection with Kenya's good prospects for capital market access at favorable terms, debt management operations (not reflected under the baseline) that seek to refinance syndicated loans and the 2024 Eurobond with long-dated debt instruments could offer a meaningful possibility to further improve the external debt profile.

21. Debt sustainability is also supported by Kenya's generally smooth debt service profile, the authorities' commitment to protect the public sector balance sheet from SOE-related contingent liabilities, and reasonable prospects for restoring Kenya's strong debt carrying capacity. While the protracted breaches of most debt burden indicators are a source of concern, including SOE-related contingent liabilities, there are mitigating factors that help support the debt sustainability assessment. The relatively smooth debt service profile—except for the 2024 Eurobond maturity—is on a clear declining trajectory over the projection period during which breaches are most pronounced, signaling a strengthening in debt servicing capacity. The authorities' commitment to absorb potential fiscal costs associated with materialization of SOE-related contingent liabilities with a limited impact on the programmed fiscal envelope will help avoid further deterioration in the public sector balance sheet. With global growth rebounding during the projection period, Kenya's track record of strong debt carrying capacity, and the authorities' commitment to pursue strong policies to replenish external buffers, there are reasonable prospects of restoring a strong debt-carrying capacity over the medium term, which will help reduce the number of indicators breaching the thresholds and the breaches' duration. Stable and strong remittances would also continue to be an important source for foreign currency receipts, helping offset the slowdown in tourism receipts.

22. The debt profile also calls for a strong debt management framework and its effective implementation. The authorities' active plans for managing their portfolio risks, including through refinancing maturities coming due on better terms to improve the overall debt profile, are a source of resiliency. In this context, the authorities are encouraged to further strengthen their debt management capacity to manage and prepare for large repayments of commercial borrowing. As part of this strategy, the authorities' plans to refinance loans at a longer maturity to limit refinancing risks is welcome. At the same time, concessional borrowing should continue to play an important role in financing investment projects due to its lower cost and longer maturity profile, while non-concessional borrowing should be limited to finance those projects that are critical for the authorities' development strategy and have high social and economic returns. Looking ahead, efficient investment in infrastructure will raise growth and export potential, both of which will support Kenya's external debt sustainability. Delivering on fiscal consolidation, while seeking to preserve social and development spending, would further reduce risks. At the same time, the authorities are encouraged to expand the coverage of public debt to include county governments,

extra budgetary units, and non-guaranteed SOE debt, and continue improving public debt management and revenue administration.

AUTHORITIES' VIEWS

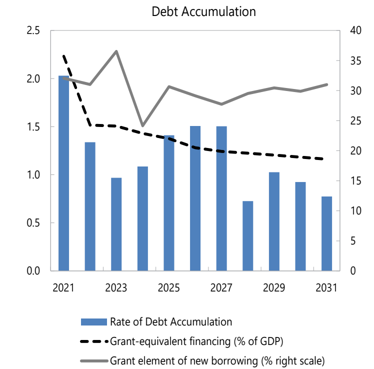
23. While underscoring the high degree of uncertainty on the outlook, the authorities acknowledged that debt and debt service indicators have deteriorated, reflecting the adverse impact of the global COVID-19 shock that contributed to larger primary deficits and lower growth. They noted that higher public debt was driven by the increased utilization of external commercial financing of the past, although during 2020 Kenya avoided utilizing commercial borrowing and relied heavily on the domestic debt markets. The authorities emphasized their commitment to fiscal consolidation under the program, including continued efforts to improve tax revenues, strengthen exports to help improve liquidity and solvency debt indicators, and continue to rely on concessional financing. The authorities acknowledged that Kenya remains at high risk of debt distress—overall and external debt. They committed to limit the use of commercial borrowing to the amounts allowed under the IMF supported program and observe the IMF Debt Limits Policy. The authorities noted that they are actively seeking debt management operations to lower the costs of debt and refinancing risks, especially by seeking to refinance syndicated loans and the 2024 Eurobond with long-dated debt instruments. The authorities committed to implement reforms to deepen the domestic debt markets to enhance efficiency in the secondary market and lower the cost of government debt securities across the yield curve. The authorities also committed to increase debt transparency through expanded coverage and reporting of public debt.

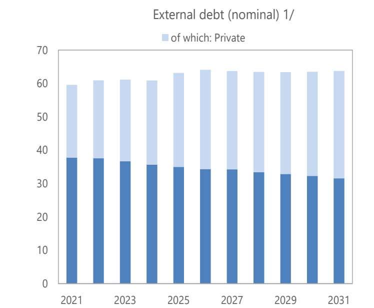
Table 1. Kenya: External Debt Sustainability Framework, Baseline Scenario, 2018–41

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
External debt (nominal) 1/	51.5	54.3	58.7	59.6	60.9	61.1	60.9	63.1	64.1	63.8	41.3	35.1	62.5
of which: public and publicly guaranteed (PPG)	30.6	31.5	35.6	37.8	37.6	36.7	35.7	35.0	34.3	31.5	24.1	19.0	34.7
Change in external debt	3.6	2.8	4.4	0.9	1.3	0.2	-0.3	2.3	0.9	0.3	-3.5		
Identified net debt-creating flows	-0.7	0.6	2.5	0.8	1.8	1.5	1.5	1.5	1.4	1.3	2.0	3.5	1.3
Non-interest current account deficit	4.1	3.8	2.8	3.5	3.6	3.6	3.8	3.7	3.7	3.6	4.0	5.8	3.7
Deficit in balance of goods and services	9.8	9.3	8.2	9.1	9.4	9.7	9.9	10.0	10.1	10.2	8.8	11.5	9.9
Exports	13.2	12.1	10.0	11.2	11.8	12.4	12.9	13.3	13.4	15.0	21.1		
Imports	23.0	21.4	18.2	20.4	21.3	22.1	22.8	23.3	23.5	25.2	29.8		
Net current transfers (negative = inflow)	-5.7	-5.5	-5.0	-5.7	-5.9	-6.0	-6.1	-6.1	-6.0	-6.8	-8.1	-5.5	-6.2
of which: official	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	0.0	0.0	-0.4	0.1	0.0	0.0	0.0	-0.2	-0.4	0.2	3.4	-0.2	-0.1
Net FDI (negative = inflow)	-1.7	-1.2	-0.2	-0.3	-0.4	-0.5	-0.6	-0.7	-0.7	-0.7	-0.6	-1.4	-0.6
Endogenous debt dynamics 2/	-3.1	-2.1	-0.1	-2.4	-1.4	-1.6	-1.7	-1.6	-1.6	-1.7	-1.5		
Contribution from nominal interest rate	1.7	2.0	2.0	1.8	1.8	1.9	1.8	1.9	1.9	1.9	1.1		
Contribution from real GDP growth	-2.7	-2.5	0.1	-4.2	-3.2	-3.5	-3.4	-3.4	-3.5	-3.6	-2.5		
Contribution from price and exchange rate changes	-2.1	-1.5	-2.1	...	...	...	...	...	...	...	...		
Residual 3/	4.4	2.3	1.9	0.1	-0.4	-1.3	-1.8	0.8	-0.4	-1.0	-5.4	1.5	-0.9
of which: exceptional financing	0.0	0.0	0.0	-1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	28.7	28.7	28.3	27.3	26.3	25.7	25.2	22.7	16.8		
PV of PPG external debt-to-exports ratio	...	...	288.3	255.8	239.2	219.8	204.2	193.6	188.5	151.5	79.8		
PPG debt service-to-exports ratio	19.6	31.9	26.5	19.1	22.7	20.1	29.7	18.4	17.1	16.1	7.9		
PPG debt service-to-revenue ratio	14.4	22.0	15.5	13.0	15.8	14.0	21.0	13.1	12.1	12.7	8.3		
Gross external financing need (Million of U.S. dollars)	17,743	21,052	23,612	27,875	30,583	36,489	44,486	49,323	55,874	74,955	88,395		
Key macroeconomic assumptions													
Real GDP growth (in percent)	6.3	5.4	-0.1	7.6	5.7	6.1	6.1	6.1	6.1	6.0	6.0	5.0	6.2
GDP deflator in US dollar terms (change in percent)	4.5	3.1	4.1	-0.5	0.6	1.1	1.5	1.7	1.8	0.1	0.1	4.4	0.7
Effective interest rate (percent) 4/	3.9	4.2	3.8	3.3	3.3	3.3	3.1	3.3	3.3	3.2	2.6	7.6	3.2
Growth of exports of G&S (US dollar terms, in percent)	10.7	-0.6	-14.1	20.7	12.0	12.5	11.9	11.1	8.7	8.4	8.4	1.3	10.9
Growth of imports of G&S (US dollar terms, in percent)	5.7	1.2	-11.8	19.9	11.1	11.3	11.1	10.2	9.0	7.7	5.3	3.5	10.1
Grant element of new public sector borrowing (in percent)	...	...	...	32.0	31.0	36.5	24.1	30.7	29.1	31.0	32.5	...	30.2
Government revenues (excluding grants, in percent of GDP)	18.0	17.5	17.0	16.5	17.0	17.9	18.2	18.6	18.9	19.0	20.3	18.4	18.4
Aid flows (in Million of US dollars) 5/	1,087	1,476	1,923	3,055	2,335	2,457	2,707	2,911	2,905	3,550	5,312		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	2.2	1.5	1.5	1.4	1.4	1.3	1.2	1.0	...	1.4
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	36.5	37.0	42.4	28.7	35.9	34.7	37.4	40.9	...	35.8
Nominal GDP (Million of US dollars)	87,824	95,371	99,110	106,041	112,750	120,936	130,160	140,398	151,536	205,789	373,341		
Nominal dollar GDP growth	11.2	8.6	3.9	7.0	6.3	7.3	7.6	7.9	7.9	6.1	6.1	9.6	6.9
Memorandum items:													
PV of external debt 7/	...	...	51.8	50.5	51.6	51.7	51.6	53.9	55.0	54.9	34.1		
In percent of exports	...	...	519.9	450.1	436.7	417.2	399.6	405.4	410.8	366.8	161.6		
Total external debt service-to-exports ratio	135.1	161.1	213.7	205.7	202.8	218.0	240.0	241.6	253.0	224.0	96.0		
PV of PPG external debt (in Million of US dollars)			28,453	30,465	31,884	32,975	34,288	36,124	38,238	46,646	62,869		
(PVt-PVt-1)/GDPt-1 (in percent)				2.0	1.3	1.0	1.1	1.4	1.5	0.8	0.6		
Non-interest current account deficit that stabilizes debt ratio	0.4	1.0	-1.6	2.6	2.2	3.4	4.1	1.5	2.8	3.4	7.5		

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

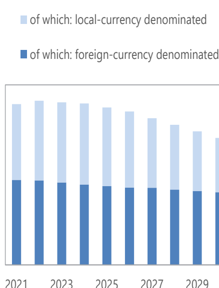
Table 2. Kenya: Public Sector Debt Sustainability Framework, Baseline Scenario, 2018–41

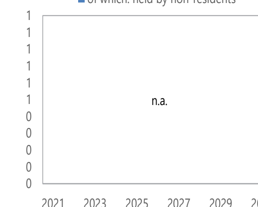
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
Public sector debt 1/	60.2	62.1	68.7	71.5	72.9	72.3	71.8	70.0	68.2	53.7	29.4	45.9	65.8
of which: external debt	30.6	31.5	35.6	37.8	37.6	36.7	35.7	35.0	34.3	31.5	24.1	19.0	34.7
Change in public sector debt	3.4	1.9	6.5	2.8	1.5	-0.7	-0.5	-1.8	-1.8	-2.7	-1.8		
Identified debt-creating flows	3.2	2.6	5.9	1.8	0.7	-1.5	-2.5	-3.1	-3.5	-2.7	-1.6	3.3	-2.0
Primary deficit	3.7	3.6	4.1	3.7	2.0	0.4	-0.3	-0.9	-1.3	-0.9	-0.4	3.7	-0.1
Revenue and grants	18.2	17.7	17.3	16.9	17.3	18.2	18.5	18.9	19.2	19.3	20.6	18.8	18.7
of which: grants	0.3	0.2	0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3		
Primary (noninterest) expenditure	21.9	21.3	21.4	20.6	19.3	18.6	18.2	18.0	17.9	18.4	20.2	22.5	18.5
Automatic debt dynamics	-0.5	-1.0	1.8	-1.9	-1.3	-1.9	-2.1	-2.3	-2.3	-1.7	-1.2		
Contribution from interest rate/growth differential	0.0	-0.1	1.4	-2.6	-1.9	-2.2	-2.2	-2.3	-2.3	-2.3	-1.7		
of which: contribution from average real interest rate	3.4	2.9	1.4	2.2	2.0	2.1	1.9	1.8	1.7	0.9	0.1		
of which: contribution from real GDP growth	-3.4	-3.1	0.1	-4.8	-3.9	-4.2	-4.1	-4.1	-4.0	-3.2	-1.8		
Contribution from real exchange rate depreciation	-0.5	-0.8	0.3	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	0.2	-0.7	0.7	1.7	1.3	1.1	2.1	1.4	1.8	0.5	0.2	1.0	1.1
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	62.4	63.0	64.2	63.4	62.9	61.1	59.5	45.4	22.6		
PV of public debt-to-revenue and grants ratio	...	...	360.0	372.6	370.8	348.7	339.2	324.0	309.3	234.8	110.0		
Debt service-to-revenue and grants ratio 3/	46.2	56.1	52.2	47.6	61.9	68.3	79.3	72.0	69.8	46.6	16.5		
Gross financing need 4/	12.1	13.5	13.2	11.8	12.7	12.9	14.4	12.7	12.1	8.1	3.0		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	6.3	5.4	-0.1	7.6	5.7	6.1	6.1	6.1	6.1	6.0	6.0	5.0	6.2
Average nominal interest rate on external debt (in percent)	3.4	3.9	3.6	3.0	2.7	2.7	2.4	2.5	2.4	2.4	1.9	4.3	2.5
Average real interest rate on domestic debt (in percent)	8.5	6.9	2.6	5.8	5.6	5.4	5.2	4.8	4.7	3.4	1.8	2.5	4.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.6	-3.2	1.1	...	...	...	...	...	...	...	...	-2.5	...
Inflation rate (GDP deflator, in percent)	2.4	4.0	8.2	3.9	4.6	5.0	5.1	5.1	5.1	5.1	5.1	7.5	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	2.5	2.4	0.7	3.5	-0.9	2.2	3.6	4.9	5.7	6.4	8.2	4.8	4.7
Primary deficit that stabilizes the debt-to-GDP ratio 5/	0.3	1.7	-2.5	0.9	0.6	1.1	0.2	0.9	0.5	1.8	1.5	-0.1	1.2
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus social security, central bank, government-guaranteed debt. Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2021–31

(In percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of debt-to GDP ratio											
Baseline	29	28	27	26	26	25	25	24	24	23	23
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	29	28	28	28	28	28	28	28	28	28	28
B. Bound Tests											
B1. Real GDP growth	29	29	30	29	28	28	27	26	26	25	25
B2. Primary balance	29	29	30	30	29	28	28	28	27	27	26
B3. Exports	29	30	32	31	30	30	29	29	28	27	26
B4. Other flows 3/	29	30	30	29	28	28	27	26	26	25	24
B5. Depreciation	29	36	30	29	29	28	28	27	27	26	26
B6. Combination of B1-B5	29	32	32	31	30	30	29	28	28	27	26
C. Tailored Tests											
C1. Combined contingent liabilities	29	30	30	29	28	28	28	28	27	27	26
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	29	32	30	30	29	28	28	27	26	26	25
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	**256**	**239**	**220**	**204**	**194**	**188**	**183**	173	166	159	151
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**256**	**241**	**225**	**214**	**209**	**210**	**208**	**200**	**195**	**190**	**184**
B. Bound Tests											
B1. Real GDP growth	**256**	**239**	**220**	**204**	**194**	**188**	**183**	173	166	159	151
B2. Primary balance	**256**	**245**	**244**	**229**	**217**	**212**	**207**	**198**	**191**	**183**	174
B3. Exports	**256**	**306**	**379**	**352**	**333**	**324**	**313**	**296**	**282**	**268**	**253**
B4. Other flows 3/	**256**	**250**	**241**	**224**	**212**	**207**	**200**	**189**	**181**	172	163
B5. Depreciation	**256**	**239**	**194**	**181**	171	167	162	154	148	143	137
B6. Combination of B1-B5	**256**	**299**	**235**	**293**	**278**	**271**	**262**	**248**	**237**	**226**	**215**
C. Tailored Tests											
C1. Combined contingent liabilities	**256**	**257**	**240**	**224**	**213**	**210**	**205**	**197**	**190**	**183**	175
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**256**	**239**	**220**	**205**	**195**	**189**	**183**	173	165	157	150
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	**19**	**23**	**20**	**30**	**18**	**17**	**17**	**20**	**17**	**17**	**16**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**19**	**22**	**19**	**28**	**18**	**16**	**16**	**19**	**16**	**16**	**16**
B. Bound Tests											
B1. Real GDP growth	**19**	**23**	**20**	**30**	**18**	**17**	**17**	**20**	**17**	**17**	**16**
B2. Primary balance	**19**	**23**	**21**	**31**	**20**	**18**	**18**	**22**	**18**	**19**	**18**
B3. Exports	**19**	**27**	**30**	**45**	**29**	**27**	**27**	**32**	**28**	**28**	**27**
B4. Other flows 3/	**19**	**23**	**20**	**30**	**19**	**18**	**18**	**21**	**18**	**18**	**17**
B5. Depreciation	**19**	**23**	**20**	**29**	**18**	**16**	**16**	**20**	15	**15**	15
B6. Combination of B1-B5	**19**	**26**	**28**	**41**	**26**	**24**	**24**	**29**	**24**	**24**	**23**
C. Tailored Tests											
C1. Combined contingent liabilities	**19**	**23**	**21**	**30**	**19**	**18**	**18**	**21**	**17**	**17**	**17**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**19**	**23**	**20**	**31**	**21**	**20**	**20**	**21**	**24**	**15**	15
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	13	16	14	**21**	13	12	12	15	12	13	13
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	13	15	13	**20**	13	12	12	14	12	12	12
B. Bound Tests											
B1. Real GDP growth	13	16	15	**23**	14	13	13	16	14	14	14
B2. Primary balance	13	16	14	**22**	14	13	13	16	14	14	14
B3. Exports	13	16	14	**22**	14	13	13	16	15	15	15
B4. Other flows 3/	13	16	14	**22**	14	12	13	16	14	14	14
B5. Depreciation	13	**20**	18	**26**	16	15	15	**18**	14	15	15
B6. Combination of B1-B5	13	17	16	**24**	15	14	14	17	15	15	15
C. Tailored Tests											
C1. Combined contingent liabilities	13	16	14	**21**	14	12	13	15	13	13	13
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	13	16	14	**22**	15	14	14	16	**18**	12	12
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

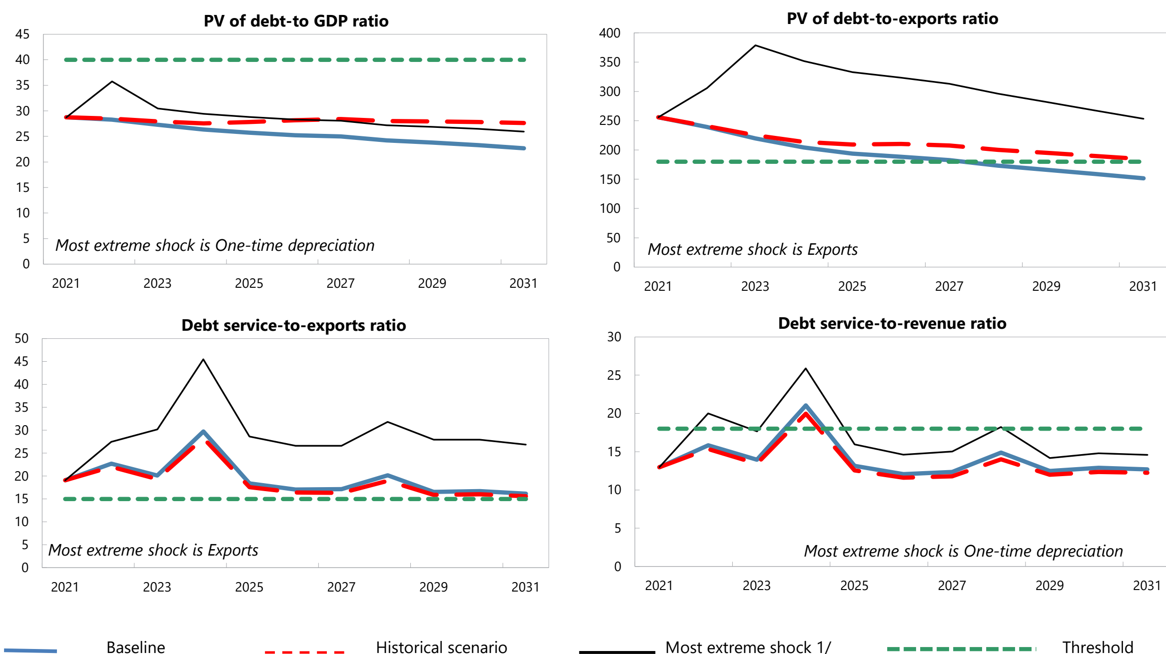
Table 4. Kenya: Sensitivity Analysis for Key Indicators of Public Debt, 2021–31

(In percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of Debt-to-GDP Ratio											
Baseline	**63**	**64**	**63**	**63**	**61**	**59**	**57**	54	51	48	45
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**63**	**64**	**66**	**68**	**70**	**71**	**72**	**72**	**72**	**72**	**72**
B. Bound Tests											
B1. Real GDP growth	**63**	**68**	**71**	**72**	**72**	**71**	**70**	**68**	**66**	**64**	**62**
B2. Primary balance	**63**	**67**	**71**	**70**	**68**	**66**	**63**	**60**	**57**	54	51
B3. Exports	**63**	**66**	**68**	**67**	**66**	**64**	**61**	**58**	55	51	49
B4. Other flows 3/	**63**	**66**	**66**	**66**	**64**	**62**	**59**	**56**	53	50	47
B5. Depreciation	**63**	**68**	**65**	**63**	**60**	**57**	53	49	45	42	38
B6. Combination of B1-B5	**63**	**64**	**68**	**68**	**66**	**64**	**61**	**58**	55	52	49
C. Tailored Tests											
C1. Combined contingent liabilities	**63**	**72**	**71**	**70**	**68**	**66**	**63**	**60**	**57**	54	51
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**63**	**64**	**63**	**63**	**61**	**60**	**57**	54	51	48	45
Public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	373	371	349	339	324	309	294	279	264	249	235
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	373	372	362	367	369	371	374	375	375	375	375
B. Bound Tests											
B1. Real GDP growth	373	389	391	389	379	370	361	351	342	332	323
B2. Primary balance	373	386	390	378	361	345	329	313	296	281	265
B3. Exports	373	380	375	364	348	332	316	300	283	267	251
B4. Other flows 3/	373	378	364	353	337	322	307	291	275	259	244
B5. Depreciation	373	392	359	340	317	295	275	255	236	216	198
B6. Combination of B1-B5	373	372	376	365	349	333	317	301	285	269	254
C. Tailored Tests											
C1. Combined contingent liabilities	373	414	388	377	360	343	327	311	295	279	264
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	373	371	349	340	325	310	294	279	263	248	233
Debt Service-to-Revenue Ratio											
Baseline	48	62	68	79	72	70	59	56	52	49	47
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	48	61	67	80	75	75	68	69	68	69	69
B. Bound Tests											
B1. Real GDP growth	48	64	75	89	82	80	70	69	65	64	62
B2. Primary balance	48	62	72	88	76	75	67	64	59	55	52
B3. Exports	48	62	69	80	73	70	60	57	54	51	48
B4. Other flows 3/	48	62	69	80	72	70	60	57	53	50	48
B5. Depreciation	48	60	68	79	71	68	58	56	51	49	46
B6. Combination of B1-B5	48	60	69	85	75	72	63	61	56	52	49
C. Tailored Tests											
C1. Combined contingent liabilities	48	62	79	84	75	77	67	64	56	53	50
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	48	62	69	80	74	72	61	57	58	48	46

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 1. Kenya: Indicators of Public and Publicity Guaranteed External Debt under Alternatives Scenarios, 2021–31



Customization of Default Settings		
	Size	Interactions
Tailored Tests		
Combined CLs	No	
Natural Disasters	n.a.	n.a.
Commodity Prices [2/]	n.a.	n.a.
Market Financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.8%	2.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	5	5

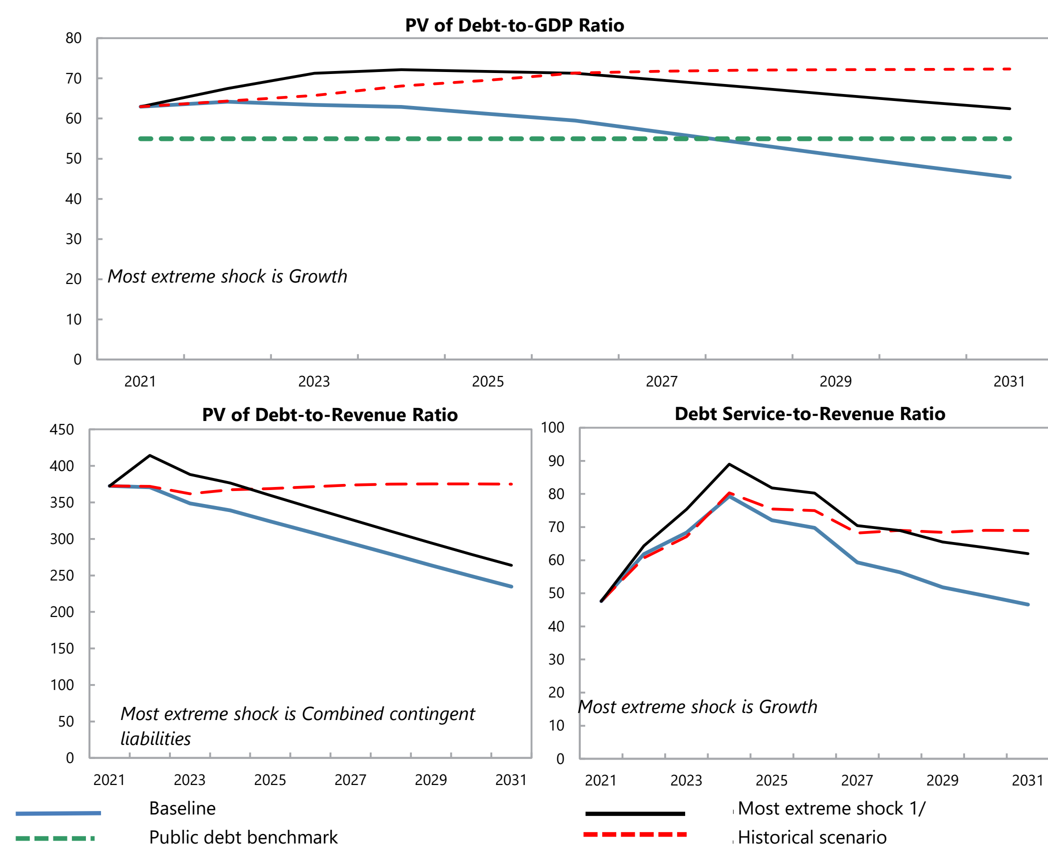
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Kenya: Indicators of Public Debt Under Alternative Scenarios, 2021–31



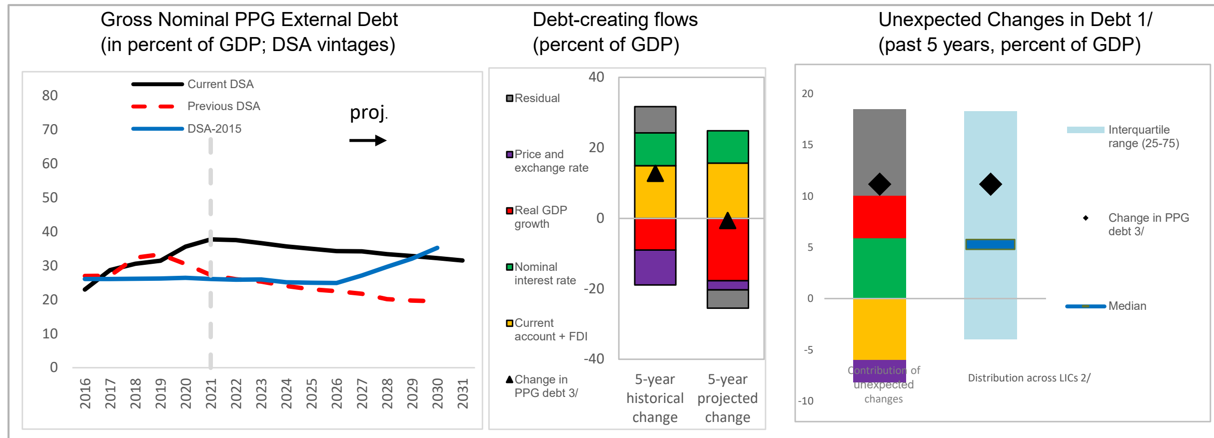
Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	33%	33%
Domestic medium and long-term	45%	45%
Domestic short-term	21%	21%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.8%	2.8%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.0%	4.0%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	3	3
Domestic short-term debt		
Avg. real interest rate	1%	1%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

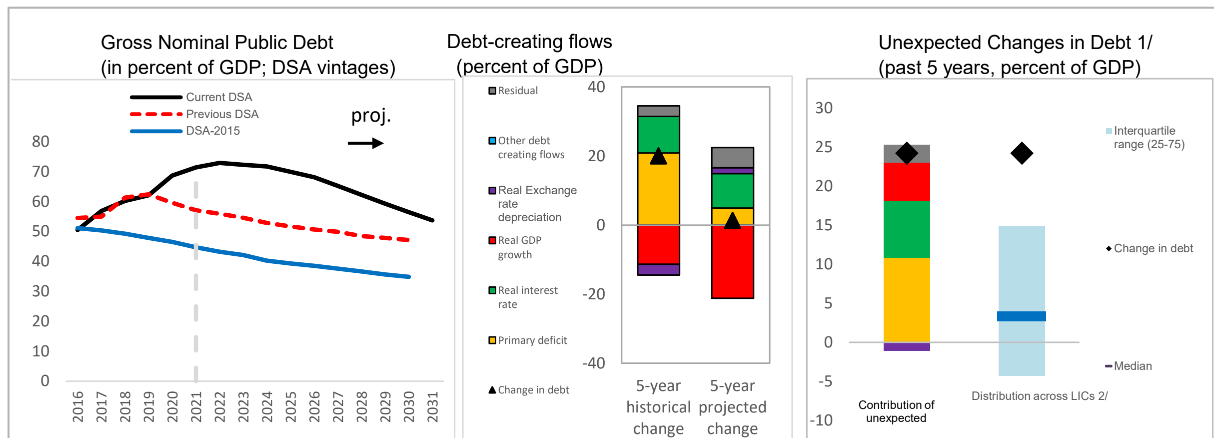
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Kenya: Drivers of Debt Dynamics–Baseline Scenario External Debt



Public Debt



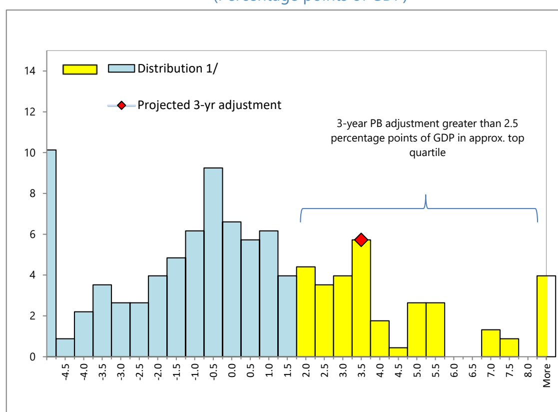
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

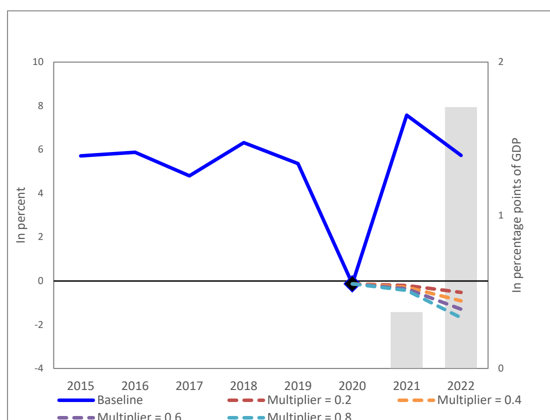
Figure 4. Kenya: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



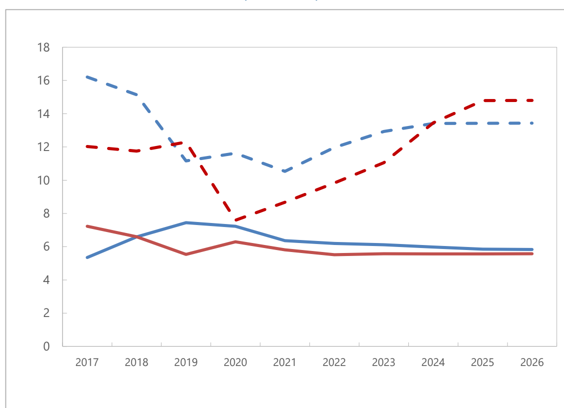
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(% of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

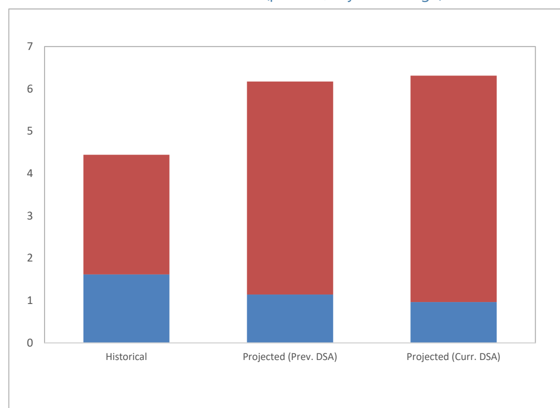
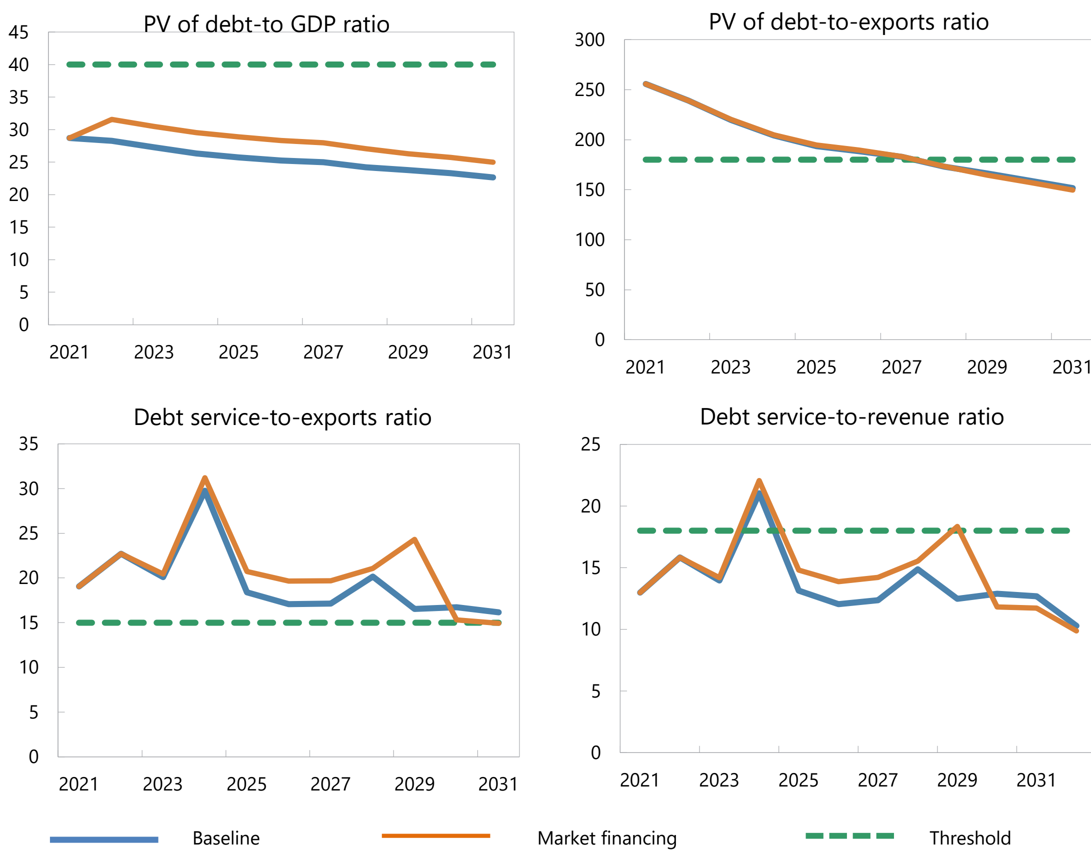


Figure 5. Kenya: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	13	498
Breach of benchmark	No	No
Potential heightened liquidity needs	Low	

1/ Percent of GDP. Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ Basis points. EMBI average spreads for Nov 2020 - Jan 2021.



Sources: Country authorities; and staff estimates and projections.

Statement by the Executive Director, Ms. Ita Mary Mannathoko,
and by the Senior Advisor of the Executive Director, Mr. Ted Sitimawina
April 2, 2021

I. Introduction

1. Our Kenya authorities appreciate the constructive engagement with staff during recent program negotiations for arrangements under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF). They broadly concur with the staff appraisal and policy recommendations.

2. The COVID-19 pandemic has upended steady and robust economic growth in Kenya that averaged almost six percent for a decade. Growth has declined significantly, while macroeconomic vulnerabilities have risen. While emergency measures were put in place quickly, and the emergency financing received under the Rapid Credit Facility (RCF) in May 2020—for which the government is grateful—has supported their response plan, fiscal and balance of payments needs remain. The authorities are determined to stabilize the economy and set a basis for resurgence of growth and shared prosperity through the Post COVID-19 Economic Recovery Strategy. The strategy seeks to enable an effective pandemic response by maintaining support to the health sector and the vulnerable; reduce debt vulnerabilities through revenue-based fiscal consolidation; advance the structural reform and governance agenda; strengthen the monetary policy framework; and support financial stability.

3. To support these objectives, our authorities request 38-month arrangements under the EFF and ECF with blended access at 305 percent of quota to be disbursed as budget support. They expect that together with support from development partners and other financing sources, including the G20 Debt Service Suspension Initiative, the proposed arrangements will fill the fiscal and external financing gaps over the medium term. The authorities have completed the required prior actions and look forward to Executive Directors' support for the arrangements.

II. Recent Economic Developments and Outlook

4. Real GDP growth dropped sharply from 5.4 percent in 2019 to an estimated -0.1 percent in 2020, reflecting severe disruption in economic activity. The typically resilient, critical services sector covering accommodation and food services was the most affected by domestic containment measures. The education sector also contracted, while agriculture benefitted from favorable weather and alongside construction remained strong. Following the partial lifting of containment measures, economic activity is rebounding with trade and transportation picking up. Medium-term prospects remain strong with growth projected at 7.6 percent in 2021, but the COVID-19 shock has given rise to substantial uncertainties around most estimates, particularly for the medium term.

5. Inflation has remained within the target range (5±2.5 percent), as disruptions to supply chains from the pandemic were limited and did not translate into significant price pressures. Over the past year, broadly stable headline inflation was supported by lower food price inflation in the first half of 2020 following the strong performance seen in agriculture, which compensated for higher fuel prices.

6. Kenya's external sector has remained resilient supported by agricultural exports, especially tea and non-flower horticulture. Exports of goods rose by 3.3 percent in 2020 while the value of imports declined by 12.5 percent reflecting lower oil import prices. Remittances rose, notwithstanding the global downturn. The net effect was that the current account deficit narrowed to an estimated 4.8 percent of GDP in 2020 from 5.8 percent in 2019. The flexible exchange rate served as a shock absorber, strengthening external sector resilience.

III. Fiscal Policy and Debt Management

7. During the program period and beyond, the authorities will pursue revenue-based fiscal consolidation to stabilize public debt and bring it onto a downward trajectory. The adjustment goal is to reduce the primary fiscal deficit to below its debt-stabilizing level. They will implement measures to broaden the tax base, as recommended by the IMF and enacted in April and June 2020. In addition, they are strengthening revenue administration and will implement further tax policy measures in the ensuing fiscal years. Our authorities' commitment to fiscal consolidation is reflected in the recent reversal of most emergency tax relief measures and the introduction of measures to improve tax performance in the midst of the pandemic.

8. On the expenditure side, measures will largely focus on rationalizing non-priority spending without compromising allocations to social and growth enhancing development programs. In this regard, the authorities will be guided by an indicative target to ensure that health and other social expenditures, including transfers to vulnerable groups and free primary and secondary education are protected. To ensure prudent management of available public resources, they will further strengthen public financial management (PFM), particularly in budget control and execution processes, and cash management.

9. A related near-term priority that the program will help sustain is to contain the impact of the pandemic, maintaining support for the health sector and those most impacted by the shock. Besides allocations to the health sector, spending will also protect vulnerable groups and stimulate economic activity in key areas. The support packages focus on providing liquidity support to businesses through accelerated payment of VAT refunds and pending bills to suppliers, cash transfers to urban poor, stimulating activity in hard-hit sectors, with an emphasis on creating youth employment, and supporting small and medium-sized businesses through a recently launched credit guarantee scheme. The authorities will also unwind emergency spending on non-priority areas, adding to the January 1, 2021 reversals of tax cuts.

10. On debt, the authorities are pursuing a financing strategy that balances domestic and external financing and utilizes concessional financing where available. They are also taking steps to extend the maturity of domestic debt. In recognition of external debt vulnerabilities, the authorities will confine external non-concessional financing to funding essential projects critical to the development agenda for which concessional financing is not available, and for liability management purposes. External financing in this manner would complement domestic financing and help prevent an unnecessary crowding-out of private sector credit. The authorities maintain their preference for an asymmetric net international reserves (NIR) adjustor also on non-grant budget flows, given the uncertainties around the timing of donor flows and their inherent import content.

IV. Monetary and Financial Sector Policies

11. The CBK remains committed to ensuring price stability in line with its mandate. In this regard, headline inflation will be kept within the target range of 5 ± 2.5 percent consistent with the monetary policy consultation clause (MPCC). Given the current environment, the CBK will maintain an accommodative monetary policy stance to support the economy as it recovers. The authorities note that their swift policy reaction to the COVID-19 shock, including monetary policy easing, emergency liquidity provision and pre-emptive loan restructurings, provided essential support to an economy under stress. The authorities will also maintain the flexible exchange rate policy which has served the economy well and will limit interventions to smoothing excess volatility.

12. The CBK has been working to strengthen its monetary policy framework and will publish a white paper by June 2021, outlining the requisite reforms. Once the COVID-19 shock abates and conditions permit, reforms will focus on refining the macroeconomic modeling and forecasting frameworks, and improving the operations of financial markets, including fully developing a Centralized Security Depository that will improve monetary policy transmission and promote efficiency and transparency in the government domestic debt market. In addition, they will improve communication of monetary policy decisions to make them more effective. The monetary policy framework will be supported by reforms carried out to strengthen CBK's internal capacity and enhance monetary policy transmission, including the repeal in November 2019 of interest rate caps on commercial bank loans under section 33B of the Banking Act. Additionally, to address concerns of illicit financial flows, corruption and counterfeits that targeted large denominations, the old series Ksh1,000 currency notes were demonetized successfully in an exercise that concluded on September 30, 2019.

13. Safeguarding financial stability and expanding access to affordable finance remain key priorities as the financial sector supports the economy through the COVID-19 pandemic. While the banking sector remains stable and resilient, supervisory and regulatory processes continue to focus on ensuring prudent asset classification and provisioning practices. In this context, the CBK advised banks to revisit their capital planning and reassess the resilience of their portfolios and potentially curtail dividend payments. They will continue to improve prudential regulation and supervision, with a view to addressing the increased complexity of the financial sector, including cyber challenges.

V. Structural Reforms

14. To complement ongoing efforts that strengthen PFM, our authorities will implement fiscal structural reforms to address challenges in state-owned enterprises (SOEs) and to advance governance reforms. The ongoing pandemic has aggravated some underlying challenges in some SOEs. To address those characterized by overlapping mandates, low profitability, weak governance and poor value for money, the authorities are taking a systematic approach to evaluate, monitor, and manage the financial challenges facing SOEs. An immediate action has been the evaluation of the financial health and fiscal needs of nine SOEs with the largest fiscal risks to the FY20/21 budget. This will be followed by an in-depth analysis of the financial vulnerabilities of the largest and most exposed firms in the sector and development of a strategy to address fiscal risks from the SOEs, including a framework to guide interventions. Overall, the reforms will aim to strengthen corporate governance and enhance oversight to limit the risk of contingent liabilities.

15. On governance, the reforms comprise four priorities that will seek to enhance the anti-corruption framework. First, the authorities plan to ensure that comprehensive information on public tenders, including beneficial ownership information of the awarded entities, are publicly available on the government procurement information portal. Second, operationalizing the Access to Information Act. Third, review of the current legal framework for asset declarations of senior public officials and conflict of interest rules. The ongoing review is expected to establish a uniform disclosure regime, strengthen sanctions on misreporting, and improving accessibility of the asset declarations. Fourth, the authorities are undertaking a national risk assessment on money laundering and terrorism financing that will help Kenya develop a national AML/CFT strategy as well as an Action Plan to address the deficiencies identified. At the same time, they are supporting the Financial Reporting Centre (FRC) work on encouraging and strengthening the use of financial intelligence to trace proceeds of corruption by sharing relevant financial intelligence with law enforcement agencies.

16. Our authorities also place a high premium on efforts to strengthen the business environment. Building on past reforms, they will continue to remove any impediments to facilitate investment-led inclusive growth, including reducing the number of days to register a business. At the same time, they are taking measures to boost productivity in the agriculture sector and to reduce gender inequality.

VI. Program Modalities

17. Given the huge uncertainty brought about by the pandemic, our authorities appreciate the program's design which focuses on indicative targets and quarterly reviews. However, they note that key variables in the macroeconomic framework that underpin a program are subject to rapid changes, and they emphasize the need for utmost care in interpreting the results. For instance, the WEO global growth projections used in the assessment of the debt carrying capacity have been superseded in the rapidly changing environment and the projection itself remains highly uncertain (DSA, ¶11).

VII. Conclusion

18. Our authorities reiterate their commitment to further strengthening macroeconomic stability and enhancing the resilience of the economy. In this connection, they will pursue a multi-year fiscal consolidation that should bring public debt on a downward trajectory while preserving space for growth friendly public investment, including in The Big Four. They look forward to Executive Directors' support for approval of the EFF and ECF arrangements to complement their efforts to contain the impact of the pandemic and reignite durable and sustainable growth. Our authorities expect that Fund financing will catalyze additional grant and concessional financing from development partners to augment ongoing efforts and support recovery.