

International Monetary Fund

[Kenya](#) and the IMF

Kenya: Letter of Intent, and Updated Technical Memorandum of Understanding

Press Release:

[IMF Executive Board
Completes Fifth
Review Under the
ECF Arrangement for
Kenya and Approves
US\\$108.5 Million
Disbursement](#)

April 16, 2013

March 28, 2013

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LETTER OF INTENT

Nairobi Kenya
March 28, 2013

Mrs. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mrs. Lagarde,

1. Our economy continued to grow at a satisfactory pace in 2012. Stagnating demand for our exports in traditional export markets was offset by better than expected rains, which contributed to good harvests and hydropower generation, and increased demand for our goods in new markets. A tightening of monetary policy helped bring inflation under control and led to an accumulation of higher foreign exchange reserves. This success has provided scope for easing of monetary policy conditions, which should benefit economic activity in 2013.
2. Performance under the economic program supported by the arrangement under the IMF's Extended Credit Facility was in line with its objectives. We have met all the quantitative performance criteria for end-December 2012, except for the continuous performance criterion on external payment arrears for which we have taken corrective measures, such as strengthening the staffing, and for which we are requesting a waiver for its temporary non-observance. The indicative target on priority social spending, which was not met for end-December, was fully made up in January. On the structural front, we are finalizing the regulations necessary to implement the 2012 PFM Act and are establishing the Treasury Single Account that will become operational in FY 2013/14. The new VAT bill will be resubmitted for debate to the new National Assembly as soon as it convenes, following the March 4 general elections.
3. This Letter of Intent describes the policies that we intend to implement for the remainder of 2012/13 and in 2013/14. Policies in the near term will aim at strengthening revenues, rationalizing the wage bill in the context of devolution, and re-orienting expenditures towards development priorities. Monetary policy will continue to aim at a low and stable price environment, consistent with a sustained pace of private-sector credit expansion. We will further bolster our foreign exchange reserves as we undertake policies to strengthen the external position. We stay firmly

committed to our reform program aimed at achieving higher and equitable growth consistent with our long-term Development Strategy - of Vision 2030.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

4. Economic growth was satisfactory in 2012, despite the impact of the European crisis on exports, including tourism. The return of normal rains provided for strong harvests of our main crops and increased generation of hydro-power, which in turn served to limit costly diesel power generated by imported oil. As a result, the underlying external current account—after excluding capital imports that have surged because of oil exploration—narrowed. Under challenging circumstances, including wage demands and revenue shortfalls, we continued to maintain fiscal discipline, which helped to further lower the public debt-to-GDP ratio.

5. The tightening of monetary policy in the first half of 2012 helped entrench low inflationary expectations. Since then, the central bank has eased its monetary policy stance, by reducing its policy rate by a cumulative 850 basis points, as inflation fell to well below the government's medium-term target. Meanwhile, lending rates remain sticky at high rates and as such private sector credit expansion has slowed down helping domestic demand to grow more in line with supply, consistent with both macroeconomic and financial stability. The financial sector has remained vibrant and well-capitalized throughout the high interest rate environment as structural reforms take root and new financial instruments stimulate investment.

6. The exchange rate reversed the nominal depreciation that took place in 2011, but in the presence of still high inflation it appreciated in real effective terms for most of 2012. Recently, the stable exchange rate and low inflation has helped reverse this appreciation. This will allow for an improvement in the current account deficit throughout 2013 and continued build up of foreign exchange reserves by the CBK.

7. We expect economic growth to accelerate in 2013 supported by continued favorable weather, a healthy pace of private sector credit expansion as the recent easing of monetary policy takes effect, an increase in foreign direct investment, and further integration of regional markets. Continued fiscal discipline will allow for a slight reduction in the primary deficit and a further improvement in our public debt to GDP ratios. At the same time we will protect investments in infrastructure and the social sectors, while allocating sufficient resources to facilitate the transition to a devolved system of government.

8. From the external side, risks to the outlook stem mainly from a protracted period of slower European growth (larger than expected deleveraging, or negative surprise in potential growth) that

would further undermine tourism earnings, and from global oil shock triggered by geopolitical events. On the domestic side risks include challenges in setting up of the new devolved system of government and vulnerability to drought. Should these risks materialize we will take appropriate actions to safeguard macroeconomic stability.

THE ECONOMIC PROGRAM FOR 2013

A. Fiscal Policy

9. We will continue to maintain fiscal discipline while pursuing our long-term development strategy as outlined in the draft Second Medium-Term Plan of Vision 2030. We note that the recent wage bill increase has placed an excessive burden on our limited domestic revenue resources. Hence, we will take steps to contain the wage bill, supported by the ongoing work of the Salaries and Remuneration Commission, which will advise on a new salary scheme for civil servants. Mobilizing additional revenue will be another key priority. In this regard, we will take the following steps: a) strengthen VAT audit functions which should lead to enhanced compliance by large tax payers--fifty of the 100 largest VAT tax payers will have been audited by end-June 2013; b) enforce measures towards improving tax collection from rental and real estate activities; c) implement an automated excise tax management system to eliminate possibilities of mis-declaration of excisable tax products in FY 2013/14; and d) make the excise tax on mobile financial transfers operational, which was already approved by the National Assembly in January 2013. In addition we plan to seek approval of the new VAT Bill as soon as the new National Assembly convenes.

10. The Supplementary Budget for FY 2012/13 that was approved by Parliament in January 2013 remains consistent with an improvement in the primary budget balance. We have accommodated wage increases for doctors, nurses, teachers, and lecturers, while reprioritizing expenditures and preserving the expanded coverage of the social safety nets. We plan to submit an updated budget to Parliament in March/April 2013, when the new administration is in place following the general elections. The updated budget will remain consistent with the fiscal program, with revenue shortfalls being offset by a reduction in non-priority expenditures such as travel budgets and allowances for civil servants, and budgets for some of the Constitutionally-mandated commissions, as well as postponement of domestically financed capital outlays such as government built housing and administration buildings.

11. In addition, we will continue to lower non-priority spending through improved expenditure control, supported by broadened coverage of IFMIS. We will ensure an orderly transition to devolved government, while maintaining fiscal sustainability. The new PFM law provides a sound

regulatory framework for fiscal decentralization including transparent budget formulation, execution and reporting a major step to increase accountability in the management of public resources.

12. Building on recent successes, we will continue making progress on our structural reform agenda. We will undertake a comprehensive review of the Income Tax Act and the Customs and Excise Act. We will revamp our natural resource taxation framework to bring it in line with international best practices as our country is poised to become a significant producer of oil, gas and minerals. Following the enactment of the new PFM law, we will finalize its implementing regulations, and operationalize the Treasury Single Account at both national and county level.

13. The Salaries and Remuneration Commission has presented its recommendations, regarding the remuneration of State Officers. They will be finalized following discussions with stakeholders before being published in the National Register and implemented. This will be followed by a comprehensive review of the remuneration for civil servants, which will ensure that the fiscal sustainability of the wage bill in line with the PFM law and limit the scope for one-off wage increases. The pension reform, which replaces a defined-benefit pension scheme with a defined-contribution scheme for civil servants, is set to start on July 1, 2013. It will reduce contingent liabilities by half over the medium term. Any excess transitional costs of pension reform will be offset by lower non-priority spending.

14. We will be updating our Medium-Term Debt Management Strategy that ensures public debt sustainability. The ongoing reorganization of the institutional framework of the National Treasury will lead to an improvement in the monitoring of contingent liabilities from state owned enterprises, semi-autonomous government agencies, and the newly created counties. Our priority remains to attract concessional loans for key energy and infrastructure projects and to strictly limit borrowing on commercial terms to those viable projects that can generate a cash-flow sufficient to finance the loan repayments. We plan to issue a sovereign bond in 2013/14 to repay the syndicated loan we contracted in May 2012. In the short term, through effective CBK-Treasury coordination, we will ensure that redemptions and new government domestic borrowing requirements are fully met in the market through the sale of government securities.

B. Monetary Policy

15. Monetary policy has succeeded in curbing inflationary pressures and cementing low inflation expectations. Moreover, the tight monetary policy reduced the demand for imports and attracted portfolio inflows, allowing the CBK to build up foreign exchange reserves during the second half of 2012. At the same time, the exchange rate has remained generally stable.

16. The rapid decline in inflation, combined with deceleration in credit growth, has allowed the CBK to ease its monetary policy stance. We expect this stance to be maintained, helped by normal weather conditions and stable oil prices. However, the CBK will remain vigilant, giving more weight to monitoring inflation expectations and anticipating possible price shocks.

17. The framework for monetary operations has been effective, establishing the CBR as the pivot rate for the transmission of rates in the banking system. In particular, money market rates have declined in tandem with the policy rate. Monetary operations will remain geared at managing liquidity effectively, leading to further convergence between interbank rates and the central bank policy rate.

18. We will maintain our international reserves coverage in line with the program, while using open market operations to sterilize any excess liquidity and reduce volatility in the interbank market. We remain fully committed to our floating exchange rate regime and we will only intervene in the foreign exchange market to accumulate international reserves and to smooth out temporary excessive exchange rate volatility.

C. Financial Policy

19. With the return of macroeconomic stability our financial sector has recovered its dynamism, as reflected by the strong performance of the stock exchange, buoyed by foreign investor interest. We are currently in the final stages of demutualizing and listing the stock exchange in order to further diversify the investor base. In addition, our stock exchange has developed a new growth enterprise market segment (GEMS), which will allow small and medium-sized companies to access financial markets.

20. Continued financial innovation has allowed a rapid increase in access to banking services. Over the last six months we have seen a one third increase in M-Pesa transactions and witnessed the development of a new mobile-based savings and loan product (M-Shwari) geared toward the unbanked part of the population.

21. Our efforts to deepen the financial sector will intensify with the expected approval of a real-estate investment trust (REIT) by the Capital Markets Authority. New prudential guidelines are under implementation in our banking system, which will help promote financial stability in an environment of financial expansion. We are starting to coordinate with stakeholders to move ahead with plans to establish a futures market and a commodity exchange.

22. We have also made substantial progress on the AML-CFT front, by addressing the concerns of the Financial Action Task Force (FATF). The Prevention of Terrorism Act 2012 and the Proceeds of Crime and Anti-Money Laundering (Amendment) Act 2012 were enacted in 2012. The CBK has issued a revised Guideline on the Proceeds of Crime and Money Laundering (Prevention) and Combating the Financing of Terrorism, which take into account the revised FATF recommendations. The Financial Reporting Centre (FRC), Kenya's financial intelligence unit, has become operational and has begun receiving suspicious transaction reports from financial institutions that fall under the purview of the CBK. Arrangements are at an advanced stage to get other reporting entities outside the banking sector, particularly those in the capital markets and insurance sectors, to commence submitting suspicious transaction reports to the Centre.

PROGRAM ISSUES

23. Program monitoring. Our program will be monitored using the definitions, data sources and frequency of monitoring set out in the accompanying-revised TMU. The government will make available to Fund staff all data appropriately reconciled and on a timely basis, as specified in the TMU. Table 1 shows the quantitative performance criteria and indicative targets to be used in monitoring performance in the remainder of 2012/13 and first half of 2013/14. Fiscal performance criteria will cover the budgetary central government for the remainder of 2012/13. The sixth review under the ECF arrangement, assessing end-June 2013 performance criteria, is expected to be completed by November 15, 2013.

24. Given our strong program implementation, we request completion of the fifth review of the ECF-supported program, approved on January 31, 2011 and augmented on December 9, 2011 and the associated disbursement of SDR 71.921 million. We reiterate that our program is on track with regard to quantitative performance criteria, except for the temporary non-observance of the continuous performance criterion on the non-accumulation of external payment arrears and the indicative target for end-December 2012. We request modification of the end-June 2013 performance criteria for net international reserves, net domestic assets, the primary budget balance of the central government, and the continuous ceiling for non-concessional external debt. We request a waiver for the temporary non-observance of the continuous performance criterion on the non-accumulation of external payment arrears.

25. We will maintain a close policy dialogue with the Fund and stand ready to take additional measures as appropriate to ensure the achievement of the government's economic and social objective under the ECF-supported program. We will also maintain a close policy dialogue with the

Fund on the adoption of measures, and in advance of revisions of the policies contained in this Letter of Intent, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/

Robinson Njeru Githae
Minister for Finance

/s/

Njuguna Ndung'u
Governor, Central Bank of Kenya

Attachments: Updated Technical Memorandum of Understanding

Appendix Table 1. Kenya: Revised and New Performance Criteria for the 2011/2014 ECF Arrangement

(In billions of Kenyan shillings; unless otherwise indicated)

	2012			2013			
	Performance Criteria			Indicative Targets	Performance Criteria	Indicative Targets	Indicative Targets
	End-Dec.		met/not met	End-March	End-June	End-Sept.	End-Dec.
	Program	Actual		Program	Program	Proposed	Proposed
Quantitative performance criteria							
Fiscal targets							
Primary budget balance of the central government (=deficit, floor) ^{1,2,3}	-64.0	-60.7	met	-62.0	-40.0	-15	-35
Monetary targets ^{4,5}							
Stock of central bank net international reserves (floor, in millions of US\$) ^{6,7}	4,460	4,530	met	4,150	4,250	4,350	4,450
Stock of net domestic assets of the central bank (ceiling)	-50	-81	met	-40	-35	-35	-10
Public debt targets							
Contracting or guaranteeing of medium- and long-term nonconcessional by the central government (ceiling; millions of US\$) ^{8,9}	1,500	1,130	met	1,500	2,500	2,500	2,500
New central government and central government guaranteed external payment arrears (ceiling, millions of US\$) ¹⁰	0	2.47	not met	0	0	0	0
Indicative targets							
Priority Social Expenditures of the central government(floor) ^{2,3}	15.0	11.9	not met	21.0	28.3	8	16

¹ The primary budget balance of the central government is defined as overall balance including grants, minus concessional project loans, plus interest payments.

² Targets for end-September 2012, end-December 2012, end-March 2013, and end-June 2013 are cumulative flow from July 1, 2012 (beginning of the 2012/13 fiscal year).

³ Targets for end-September 2013 and end-December 2013 are cumulative flow from July 1, 2013 (beginning of the 2013/14 fiscal year).

⁴ For program monitoring, the daily average for the month when testing dates are due.

⁵ The NIR floor will be adjusted upward (downward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative to the programmed amounts. The NDA ceiling will be adjusted downward (upward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative to the programmed amounts.

⁶ Excludes encumbered reserves.

⁷ First review targets at September 1, 2010 exchange rates. Second review targets at April 29, 2011 exchange rate.

⁸ Cumulative flow of contracted debt, from January 1, 2011.

⁹ The targets on the ceiling of non-concessional external debt combine nonconcessional project loans, syndicated loan and sovereign bond.

¹⁰ Continuous.

Appendix Table 2. Kenya: Structural Benchmarks for the ECF Arrangement

Item	Measure	Time Frame	Status
	Tax measures		
	Submit Value Added Tax (VAT) legislation to help improve administration and compliance. <i>Macro criticality: The VAT reform will allow for higher mobilization of revenue which will reduce the fiscal imbalance.</i>	Second Review	Completed. To be discussed by the National Assembly.
	VAT Audits of the 50 largest taxpayers. <i>Macro criticality: Restore compliance with VAT by large taxpayers following the phasing out of withholding requirements.</i>	Sixth Review	
	Expenditure control		
	Submit Public Finance Management legislation to the Commission of Implementation of the Constitution, to help accelerate reforms in public financial management. <i>Macro criticality: PFM management legislation is crucial for increasing both spending efficiency and improving the fiscal management.</i>	Third Review	Completed.
	Adopt a Single Treasury Account to strengthen cash management and improve resource management. <i>Macro criticality: Single Treasury Account (STA) adoption will improve both liquidity management and expenditure control.</i>	Fourth Review	Completed.
	Banking supervision		
	Amend the Banking Act to reinforce prompt corrective action by the banking supervision authority. <i>Macro criticality: Reinforcing the banking supervision authority is crucial to reducing the risk of macroeconomic instability.</i>	First Review	Completed on December 24, 2010 (2010 Finance Act).
	Capital markets		
	Introduce legislation to allow the demutualization of the Nairobi Stock Exchange, to remove the conflict of interest from the governing body of the exchange and to strengthen capital markets. <i>Macro criticality: Demutualization of the Nairobi Stock Exchange is essential for the both development of deeper financial markets that will enhance financial stability, and attracting capital inflows to reduce the balance of payments financing need.</i>	First Review	Completed in January 2011 (guidelines were introduced Attorney General ruled that a new law was not needed).

Attachment. Updated Technical Memorandum of Understanding

1. This memorandum sets out the understandings between the Kenyan authorities and the IMF regarding the definitions of quantitative performance criteria and indicative targets, their adjusters and data reporting requirements for the three-year Extended Credit Facility (ECF) arrangement.

I. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

2. Quantitative performance criteria are proposed for December 31, 2011; June 30, 2012; and December 31, 2012; and June 30, 2013 with respect to:

- the primary balance of the budgetary central government including grants, excluding external concessional project loans, cash basis (**floor**);
- the net official international reserves (NIR) of the Central Bank of Kenya (CBK) (**floor**);
- the net domestic assets (NDA) of the CBK (**ceiling**);
- nonconcessional medium- and long-term external debt contracted or guaranteed by the central government or by local and municipal governments without central government guarantee (**ceiling**); and
- medium- and long-term external public debt arrears (**continuous ceiling**).

3. The program sets indicative targets for March 31, 2012, September 30, 2012, and March 2013 with respect to:

- priority social spending of the budgetary central government (**floor**).

II. PERFORMANCE CRITERION ON THE PRIMARY BALANCE INCLUDING GRANTS OF THE BUDGETARY CENTRAL GOVERNMENT

4. **The budgetary central government primary balance excluding external concessional project loans** on cash basis is defined as budgetary central government revenues and grants minus expenditures and net lending, plus due interest payments and investment expenditure financed through external concessional project loans, adjusted for cash basis.

5. For program purposes, the **budgetary central government primary balance excluding external concessional project loans** on cash basis is cumulative from July 1, 2011 and will be measured from the financing side as the sum of the following: (a) the negative of **net domestic financing** of the budgetary central government; (b) the negative of **net external financing of the budgetary central government, excluding external concessional project loans**; and (c) **domestic and external interest payments** of the budgetary central government. For the December 31, 2012 and June 30, 2013 test date, the budgetary central government primary balance including grants excluding external concessional loans will be measured cumulative from July 1, 2012.

The above items are defined as follows:

- **Net domestic financing** of the budgetary central government is defined as the sum of:
 - net domestic bank financing;
 - net domestic nonbank financing;
 - change in the stock of domestic arrears of the budgetary central government; and
 - proceeds from privatization.
- **Net external financing excluding external concessional project loans** is defined as the sum of:
 - disbursements of **external nonconcessional project loans**, including securitization;
 - disbursements of **budget support loans**;
 - principal repayments on all **external loans**;
 - net proceeds from issuance of external debt;
 - any exceptional financing (including rescheduled principal and interest);
 - net changes in the stock of short-term external debt; and
 - any change in external arrears including interest payments.
- **External concessional project loans** of the budgetary central government are defined as **external project loans** contracted by the budgetary central government, which are considered concessional according to the definition in paragraph 11. All other **external project loans** are deemed **nonconcessional external project loans**.

- **Domestic and external interest payments** of the budgetary central government are defined as the due interest charges on domestic and external central government debt.

6. **The budgetary central government primary balance excluding concessional project loans** will be adjusted downward by the amount of the shortfall of program grants, which are expected as refunds for Kenya's participation in African Union Mission in Somalia (AMISOM).

III. PERFORMANCE CRITERION ON THE NET INTERNATIONAL RESERVES (NIR) OF THE CENTRAL BANK OF KENYA

7. **The net official international reserves** (stock) of the CBK will be calculated as the difference between total gross official international reserves and official reserve liabilities.

- **Gross official international reserves** are defined as the sum of:
 - the CBK's holdings of monetary gold (excluding amounts pledged as collateral);
 - holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General allocation and the September 9, 2009 Special allocation;
 - CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments).
- **Gross official international reserves** exclude:
 - the reserve position in the IMF;
 - pledged, swapped, or any encumbered reserve assets, including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities;
 - deposits with Crown agents; and
 - precious metals other than gold, assets in nonconvertible currencies and illiquid foreign assets.
- **Official reserve liabilities** are defined as:

- the total outstanding liabilities of the CBK to the IMF except those arising from the August 28, 2009 SDR general allocation and the September 9, 2009 SDR special allocation;
 - convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year;
 - commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).
- The following **adjustors** will apply to the target for NIR:
 - If budgetary support (external grants and loans) and external commercial debt exceed the programmed amounts, the target for NIR will be adjusted upward by the difference, for up to US\$100 million.
 - If budgetary support (external grants and loans) and external commercial debt fall short of the programmed amounts, the target for NIR will be adjusted downward by the difference, for up to US\$100 million.

8. **NIR are monitored in U.S. dollars**, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar equivalent values, using the exchange rates as specified in Table 1, and net international reserves will be computed as the daily average for the month when the testing date is due.

IV. PERFORMANCE CRITERION ON THE NET DOMESTIC ASSETS (NDA) OF THE CENTRAL BANK OF KENYA

9. **Net domestic assets** are defined as reserve money minus NIR converted in shillings at the accounting exchange rate specified in Table 1, plus medium- and long-term liabilities (i.e., liabilities with a maturity of one year or more) of the CBK, including those arising from the August 28, 2009 SDR General allocation and the September 9, 2009 SDR Special allocation; minus the value in shillings of encumbered reserves converted at the accounting exchange rate specified in Table 1.

- NDA is composed of:
 - net CBK credit to the budgetary central government;
 - outstanding net credit to domestic banks by the CBK (including overdrafts); and
 - other items net.

 - Reserve money is defined as the sum of:
 - currency in circulation; and
 - required and excess reserves.

 - The following **adjustors** will apply to the target for NDA:
 - If budgetary support (external grants and loans) and external commercial debt exceed the programmed amounts, the target for NDA will be adjusted downward by the difference.
 - If budgetary support (external grants and loans) and external commercial debt fall short of the programmed amounts, the target for NDA will be adjusted upward by the difference.
10. **NDA are monitored in shillings, and will be computed as the daily average for the month when the testing date is due.**

V. PERFORMANCE CRITERION ON NONCONCESSIONAL EXTERNAL DEBT CONTRACTED OR GUARANTEED BY THE CENTRAL GOVERNMENT

11. The definitions of "debt" and "concessional borrowing" for the purposes of this memorandum of understanding are as set out in point 9 of Executive Board Decision No. 6230-(79/140), as subsequently amended, including by Executive Board Decision No. 14416-(09/91), effective December 1, 2009. This definition also includes the following:

- Debt is understood to mean a direct, that is, not contingent, liability, created under a contractual agreement through the provision of value in the form of assets (including currency) or services, which requires the obligor to make one or more payments in the form

of assets (including currency) or services at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- loans, that is, advances of money to the obligor by the lender made on the basis of a undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
 - suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and
 - leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains title to the property. For the purpose of this guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.
- Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.

12. Debt is considered concessional if, on the date on which the contract was signed, the ratio of the present value of the loan, based on the commercial interest reference rates (CIRRs), to the nominal value of the loan is less than 65 percent (that is, the grant element of the loan is at least equal to 35 percent of its nominal value). The present value of the loan will be calculated by discounting future payments of interest and principal using the CIRRs established by the

Organization for Economic Cooperation and Development (OECD). Specifically, the 10-year average of CRRs reported by the OECD will be used for loans with maturities longer than 15 years while the six-month average of CRRs will be used for loans with shorter maturities. To both the 10-year and 6-month averages of the reference rate, the margin for different repayment periods will be added, as established by the OECD (0.75 percent for repayment periods of less than 15 years; 1 percent for repayment periods of 15–19 years; 1.15 percent for repayment periods of 20–29 years; and 1.25 percent for repayment periods of 30 years or more).

13. The definition of **external debt**, for the purposes of the program, is any debt as defined in paragraph 9, which is denominated in foreign currency, i.e., currency other than Kenyan shillings (Ksh). Similarly, external borrowing is borrowing denominated in foreign currency.

14. The performance criterion on nonconcessional external debt is measured as a cumulative flow from January 1, 2011 and this includes: (i) nonconcessional external debt contracted or guaranteed by the budgetary central government; and (ii) nonconcessional external debt contracted by local and municipal authorities without central government guarantee. The authorities should consult with the Fund where public enterprises and other parastatals seek nonconcessional external borrowing without central government guarantee to limit the potential fiscal risk to the government. Medium- and long-term debt refers to debt with maturity of one year or longer.

15. The ceiling on nonconcessional external borrowing (see Table 1 in LOI) encompasses commercial loans, including the proceeds of syndicated loans and eventual proceeds from the issuance of a sovereign bond, and non-concessional project financing.

VI. PERFORMANCE CRITERION ON THE STOCK CENTRAL GOVERNMENT AND CENTRAL GOVERNMENT GUARANTEED EXTERNAL PAYMENT ARREARS TO OFFICIAL CREDITORS

16. Central government external payment arrears to official creditors are defined as overdue payments (principal or interest), which were not made by their contract due date nor during the applicable grace period thereafter, on debt contracted by the central government. Central government guaranteed external debt payment arrears (principal or interest) to official creditors are defined as overdue payments beyond 30 days after the original contract due date in order to allow

the central government sufficient time to process the due repayment after the original debtor has notified of its inability to pay. The definition excludes arrears relating to debt subject to renegotiation (dispute) or rescheduling.

17. The performance criterion on the stock of central government and central government guaranteed external payment arrears applies only to newly accumulated arrears on or after January 1, 2011.

VII. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

18. The program sets a floor on priority social spending of the central government. For the purposes of the program, priority social spending of the government is defined as the sum of:

- cash transfers to orphans and vulnerable children;
- cash transfers to elderly;
- anti-retroviral treatment expenditures;
- free primary education expenditure; and
- free secondary education expenditure.

VIII. COVERAGE

19. All the references to **central government** in the current TMU will be changed to **general government**, in order to include local governments whenever the fiscal decentralization takes place according to the new constitution.

TMU Table 1. Kenya: Program Exchange Rates

Kenya (Program) Exchange Rates for the ECF Arrangments
(Rates as of February 29, 2012)

Currency	Kenyan Shillings per currency unit	Dollars per currency unit
U.S. DOLLARS	82.85	1.0000
STG. POUNDS	131.99	1.5813
JAPANESE YEN	1.03	0.0124
CANADIAN DOLLARS	83.47	1.0000
EURO	111.57	1.3366
SWISS FRANCS	92.68	1.1102
SWEDISH KRONORS	12.66	0.1516
DANISH KRONORS	15.01	0.1798
S.D.R.	128.81	1.5432

TMU Table 2. Kenya: African Mission in Somalia (AMISOM) Grant Schedule
(Billions of Kenyan shillings)

	FY 2012/13			
	Q1	Q2	Q3	Q4
Program Amount (cumulative)	3.5	8.3	8.3	19.9
Received Amount (cumulative)	0	1.1	2.4	N/A

Source: Authorities' data

TMU Table 3. Kenya: Summary of Data to Be Reported

Information	Frequency	Reporting Deadline	Responsible Entity
1. Primary balance of the central government including grants			
Net domestic bank financing (including net commercial bank credit to the central government and net CBK credit to the central government)	Monthly	Within 15 days after the end of the month.	CBK
Net nonbank financing	Monthly	Within 15 days after the end of the month.	CBK
Central government arrears accumulation to domestic private parties and public enterprises outstanding for 60 days or longer	Monthly	Within 15 days after the end of the month.	Ministry of Finance (MoF)
Proceeds from privatization	Monthly	Within 15 days after the end of the month.	MoF
Interest paid on domestic debt	Monthly	Within 15 days after the end of the month.	CBK
Interest paid on external debt	Quarterly	Within 4 weeks after the end of the quarter.	CBK
Disbursements of external nonconcessional project loans, including securitization	Quarterly	Within 45 days after the end of the quarter.	MoF
Disbursements of budget support loans	Quarterly	Within 45 days after the end of the quarter.	MoF
Principal repayments on all external loans	Monthly	Within 15 days after the end of the month.	CBK
Net proceeds from issuance of external debt	Monthly	Within 15 days after the end of the month.	CBK
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 15 days after the end of the month.	MoF

Net changes in the stock of short-term external debt	Quarterly	Within 45 days after the end of the quarter.	MoF
Net change in external arrears, including interest	Quarterly	Within 45 days after the end of the quarter.	MoF
2. Gross official international reserves			
CBK's holding of monetary gold (excluding amounts pledged as collateral)	Monthly	Within 15 days after the end of the month.	CBK
Holdings of SDRs	Monthly	Within 15 days after the end of the month.	CBK
CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments)	Monthly	Within 15 days after the end of the month.	CBK
4. Net domestic assets			
Net CBK credit to the central government	Monthly	Within 15 days after the end of the month.	CBK
Outstanding net CBK credit to domestic banks (including overdrafts)	Monthly	Within 15 days after the end of the month.	CBK
5. Reserve money			
Currency in circulation	Monthly	Within 15 days after the end of the month.	CBK
Required and excess reserves	Monthly	Within 15 days after the end of the month.	CBK
Nonconcessional medium- and long-term external debt contracted or guaranteed by the central government	Quarterly	Within 45 days after the end of the quarter.	MoF
Accumulation of central government and central government guaranteed external payment arrears.	Quarterly	Within 45 days after the end of the quarter.	MoF
Social priority spending	Quarterly	Within 45 days after the end of the quarter.	MoF