IMF reaches staff-level agreement with Kenya following conclusion of sixth review

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IMF staff and the Kenyan authorities reached a staff-level agreement on economic policies and reforms as it concluded the sixth review of the Extended Credit Facility/Extended Fund Facility (ECF/EFF) programme and the first review under the Resilience and Sustainability Facility (RSF). As telegraphed by a senior Economic Advisor last week, the IMF programme was augmented by 130.3% of Kenya's quota size against an earlier expectation of 90.0% of the quota size. This brings the total size of the IMF programme, inclusive of RSF, to USD 4.4bn. The expected disbursement of USD 682.3mn following the latest review, to be realized in January 2024, will bring the cumulative disbursement to USD 2.7bn under the augmented ECF/EFF and RSF.

Highlights of the Staff-level agreement following the completion of the sixth review under EFF/ECF and first review under the RSF

- The staff-level agreement highlighted the tight global financing conditions facing Kenya's execution of FY24 budget. As penciled in the 2023 Budget Review and Outlook Paper, the authorities seemingly have dialed upwards multilateral and commercial financing to substitute a lack of market access
- IMF also noted the narrowing current account deficit, driven by a recovery in the tourism sector to pre COVID-19 levels, resilience in remittances, reduction in imports and a real exchange rate depreciation.
- On the fiscal side, the IMF Mission emphasized a prolonged expenditure rationalization, pegged on better targeted subsidies and transfers, addressing weakness in SOEs, and enhanced efficiency of public investments.
- The IMF team applauded the monetary authorities' progress in modernizing the monetary policy framework and an improvement in FX market functioning. Importantly, the staff-level agreement emphasized the need for greater exchange rate flexibility to reduce the large spreads and curb excess FX demand. Furthermore, the agreement flagged a waning momentum with the ongoing FX policy shift as a key downside risk.
- Notably, the reform measures under the RSF have kicked off positively. Specifically, under the latest review, the authorities managed to adopt the National Framework for Climate Services in October, with fast-tracking of the remainder of the reforms in subsequent reviews expected to unlock additional climate financing.

Our views:

Augmentation lowers FY24 domestic borrowing requirement, and supports USD 300.0mn partial buyback

- We revise lower the FY24 domestic borrowing by KES 47.2bn (0.3% of GDP) on the augmentation of the EFF/ECF program following the conclusion of the sixth review. With the augmentation, the immediate disbursement after the Executive Board approval in January 2024 will dial up to USD 682.4mn (KES 104.1bn) from the initial USD 372.8m (KES 56.9bn) as at the end of the fifth review. This will, in turn, lower FY24 domestic borrowing to KES 372.6b (2.3% of GDP) ceteris paribus, and anchor domestic interest rates lower in 1H2024.
- Furthermore, we believe that the augmentation (USD 309.6mn) will support GoK's plan of a partial buyback of a similar amount. Although the partial buyback in December 2023 will precede the expected IMF disbursement in January 2024, on balance, we are of the view that the additional IMF financing will offset the drawn down in FX reserves if a partial buyback is pursued next month.

More financing to follow, should the IMF quota be revised higher mid-December 2023

- The overall augmentation of SDR 707.3mn, that is roughly 130.3% of quota size over the duration of the ECF/EFF programme, implies that the cumulative quota will jerk up to 540.0% (or SDR 2,932.7m; USD 3.9bn). We estimate that this comprises 360.2% from the General Resources Account (GRA) and 179.8% from the Poverty Reduction and Growth Trust (PRGT). On expectation that the IMF Executive Board is expected to increase the quota by 50.0% across member countries, this will increase headroom for further augmentations during the 7th – 9th reviews over the FY25 budget year.
- Additionally, we think that the enhanced IMF financing over the programme's duration will unlock more multilateral financing, concessional, and commercial syndicated terms. We suspect that the World Bank's first "Kenya Fiscal and Sustainability and Resilient Growth" which is in the pipeline is a development financing programme and will realize USD 1.0bn – USD 1.5bn financing in FY24.

Economist,
Churchill Ogutu: +254 711 796739
For further information, please contact our Research Team. T: 233 308-250051| Email: insights@ic.africa