KENYA | MACROECONOMIC UPDATE | POLICY ANALYSIS | INSIGHTS

FUNDAMENTALS

KENYA'S IMF PROGRAMME: THORNS AMIDST ROSES

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IN BRIEF

- The IMF disbursed a combined USD 684.7mn following its Executive Board's conclusion of the sixth review under the Extended Fund Facility/Extended Credit Facility (EFF/ECF) and the first review under the Resilience and Sustainability Facility (RSF).

- The Fund also accepted Kenyan authorities' request for augmentation of access by approving additional USD 941.5mn under the EFF/ECF financing, which has been frontloaded in FY24 and has triggered exceptional access financing. Understandably, the urgency to secure multilateral financing amidst tighter financing conditions ahead of KENINT 2024 maturity in June triggered the request for augmentation of access. Although the IMF provided a window for member countries to increase their quotas by 50.0%, the tighter fiscal space ties the authorities' hands to exercise that option in the near term, in our view.

- We flagged some "tug-of-war" in the IMF's prognosis of FX trajectory. Throughout the programme, the IMF has been unequivocal on exchange rate flexibility. From the latest review, the IMF has thrown its weight behind a continued tightened monetary policy bias which on face value, we infer as "KES strengthening" stance. We side with Camp exchange rate flexibility, on the back of FX rollover risk from the Government-to-Government oil credit importation deal coupled with the expected deterioration in banks' net foreign asset by year-end.

- Unsurprisingly, the IMF emphasized revenue mobilization, more so the recently published Medium Term Revenue Strategy (MTRS) for the first phase FY25 – FY27 period. The IMF cited a tabling of amendment tax laws in the National Assembly in mid-December to raise additional 0.4% of GDP in FY24, but we note that this was during the long parliamentary recess period and the piece of legislation is yet to be publicized. From our analysis of the National Treasury projections, the expected 5.0% increase in the metric to c. 20.0% by FY27 will entail an additional KES 665.4bn in the outlier budget year, from the current baseline.

Hands-on-deck KENINT 2024 maturity smoothing options triggers IMF's exceptional access

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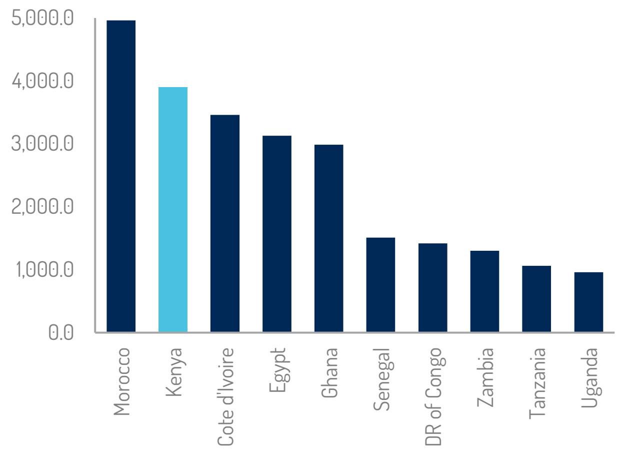
10 LARGEST IMF PROGRAMME SIZES* IN AFRICA



SOURCE: IMF, ICAMMU ESTIMATES

*Mark-to-Market of current IMF programmes, excluding RSF financing, using SDRUSD rate as at 19th Jan

Unlike the July 2023 augmentation that was spread across FY24-FY25 fiscal years, the latest augmentation has been frontloaded in the current FY24 budget. With the tight financing conditions, Kenyan authorities have increasingly baked in higher multilateral financing to help smooth out the maturity risk of the USD 2.0bn KENINT 2024 in June. Nevertheless, this is expected to upsize both the annual limit of the EFF (tapped under the General Resource Access window) and the cumulative access of the combined EFF/ECF above the quota thresholds of 200.0% and 600.0%, respectively, by the start of next year triggering exceptional access for the IMF financing.

With the mid-December approval of 50.0% quota increase by the IMF to member countries, this should give Kenya wiggle room to resume normal access of IMF financing in the event it increases its quota limit. However, we do not view this option as palatable amidst a strained fiscus environment as the exercise entails additional contributions to the Fund. Nevertheless, we believe the expected increase in financing from syndicated loans (USD 500.0mn) and World Bank Development Policy Operation (c. USD 1.0-1.5bn) by end 1Q2024 are the deal breakers in unlocking the exceptional access.

EXCEPTIONAL ACCESS UNDER KENYA'S EFF/ECF PROGRAMME

		SDR, Mn's					Quota (SDR 542.8Mn = 100%)		
		Amount Drawn			Amount Repaid	Cumulative Exposure	Amount Drawn		Cumulative Exposure
YEAR		EFF	ECF	Total			EFF	ECF	
	Exposure as at end 2019					**260.80**			48.0%
2020	RCF disbursement			542.80	(97.70)	**705.90**			130.0%
2021	EFF/ECF Disbursement (Initial, 1st and 2nd reviews)	474.95	211.69	686.64	(91.14)	**1,301.40**	87.5%	39.0%	239.8%
2022	EFF/ECF Disbursement (3rd & 4th reviews)	276.83	238.84	515.67	(50.37)	**1,766.70**	51.0%	44.0%	325.5%
2023	EFF/ECF Disbursement (5th reviews)	229.06	77.62	306.68	(21.58)	**2,051.80**	42.2%	14.3%	378.0%
2024	EFF/ECF Disbursement (6th, 7th & 8th reviews)	1086.14	215.21	1301.35	-	**3,353.15**	200.1%	39.6%	617.8%
2025	EFF/ECF Disbursement (Final 9th review)	78.71	43.68	122.39	(82.55)	**3,392.99**	14.5%	8.0%	625.1%

SOURCE: IMF, ICAMMU

IMF 2023 growth estimate laden with downside surprise

Our overall take from the sixth review is that IMF held a more sanguine assessment. Notably, the structural benchmarks to be adhered within the review were implemented with lags. Tax revenue outturn in FY23 budget missed the target by KES 148.0bn; a blight in the quantitative performance criteria. With a lack of market access in the immediate term to smooth out the upcoming maturity risk, it is a fair conclusion that pragmatism prevailed with the sixth review.

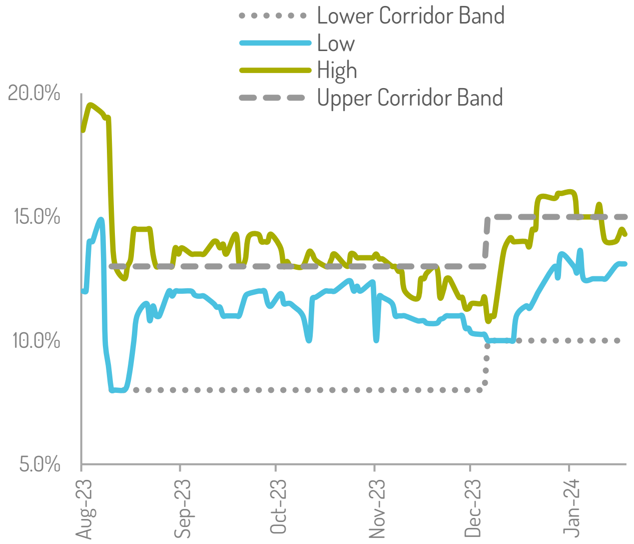
The IMF's estimated 5.1% real GDP growth for 2023 suggests a more bearish tone of growth and below our nowcasted real growth of 5.5%. With growth averaging 5.6% in the first 3 quarters of last year, the multilateral lender is telegraphing a weaker-than-consensus growth of 3.6% in 4Q2023. With a rebound in agriculture and resilient services, we anticipate the IMF may revise upwards 2023 GDP in its upcoming January 2024 update. We also think the IMF's estimated 2023 current account deficit-to-GDP (-4.0%) on a 12-month rolling basis may be recalibrated lower to a more realistic -3.5% levels, amidst demand compression and a dearth in export competitiveness albeit a weaker local currency.

You can't have your cake and eat it

Despite inflation's comforting direction of travel, risks lurk in the form of supply chain disruptions and spillovers from continued FX weakness. We flagged some "tug-of-war" in IMF's prognosis of FX trajectory. Throughout the programme, the IMF has been unequivocal on exchange rate flexibility. From the latest review, the IMF has thrown its weight behind a continued tightened monetary policy bias which on face value, we infer as "KES strengthening" stance. Specifically, the MPC delivered an out-of-consensus 200bps hike in the policy rate in its December 2023 MPC meeting to 12.5%, resulting in cumulative rate hikes of 550bps in the current tightening cycle, with a secondary aim of supporting KES. With our view that inflation will trend to 5.5% in June 2024 on further food inflation as we fade off El Nino risk, we assess the policy stance at the current 12.5% as 'restrictive'.

Sticking our neck out as we return to this tug of war, we side with Camp exchange rate flexibility. Despite the recent rejig of the FX interbank market, KES has started on a wrong footing (-3.1% YTD) on the back of the -21.3% adjustment last year. This has heightened rollover risks in the government-to-government (G2G) oil credit importation deal that runs until December 2024, in the absence of appropriate FX hedging tools in the intervening period of supply initiation and settlement of credit payment. With the authorities committing to the IMF that settlements will be executed at market rates, we think the fuel pump pricing may continue underweighting FX risk component. Furthermore, the National Treasury pushed back against news flow late last week that suggested a premature cancellation of the ongoing G2G deal.

RANGE OF DAILY INTERBANK RATE



SOURCE: CENTRAL BANK OF KENYA

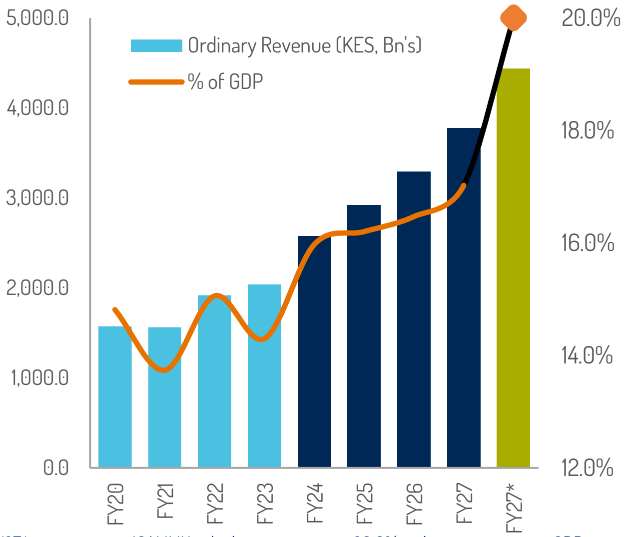
That as it may, our assessment of projected outturn of banks' net foreign asset position point to a volatile swing from a position of USD 1.3bn net foreign assets in September 2023 to net foreign liabilities of c. USD 644.4mn in December 2024, exacerbating the FX liquidity concerns. To reiterate, we thus expect KES weakness in the near-term despite the tightening bias in monetary policy. However, we expect rate cuts in the latter half of the year that will result in a policy rate of 11.0% at year-end. We further like the current MPC's intent to anchor the CBR to the interbank rate as announced in the August 2023 MPC meeting. However, the occasional breaches in executed interbank rates outside the corridor reinforces the need to strengthen the horizontal repo market. Worryingly, the chaperoning towards an interbank corridor has led to increased usage of the discount window with 20 banks, who account for 62.0% of banking sector assets, accessing last resort lending. Furthermore, we have noted that the Open Market Operations have been biased towards liquidity injections via reverse repo since the second half of 2023. In light of this, it was surprising that the IMF report did not give a concrete update on the horizontal repo market, while the timeline for its revival remains open-ended for now.

MTRS through FY27 is baking in aggressive tax mobilization plan

Unsurprisingly, the IMF emphasized revenue mobilization, more so the recently published Medium Term Revenue Strategy (MTRS) for the first phase FY25 – FY27 period. In our view, the MTRS in its current format is threadbare on its granular view of the additional revenue of each of the proposed tax revenue policy measures. The IMF cited a tabling of amendment tax laws in the National Assembly in mid-December to raise additional 0.4% of GDP in FY24, but we note that this was during the long parliamentary recess period and the piece of legislation is yet to be publicized. While the IMF struck an optimistic tone on the execution of the MTRS through FY27, we would like to err towards cautious outlook as the authorities square the circle of subpar ordinary revenue-to-GDP ratio that trended lower to 14.3% in FY23. From our analysis of the National Treasury projections, the expected 5.0% increase in the metric to c. 20.0% by FY27 will entail an additional KES 665.4bn in the outlier budget year, from the current baseline.

With tax revenue outturn in 1H of FY24, that was released last Friday, coming in lower than the KES 1.06tn target, this will be a focus of the seventh review (to be completed in May 2024). This necessitated a preemptive waiver of non-observance of the IMF programme's quantitative performance criteria, and this cements our cautious outlook. Mindful that the next general elections will be held at the front-end of FY28, we dial upwards the likelihood of relaxation of some aggressive taxation measures by the Kenya Kwanza government as we approach FY27. We are also mindful of the debt anchor that is currently at 55.0% (± 5.0%) of public debt-to-GDP in Present Value terms by FY29. If we take a glass-is-half-full view on the implementation of the MTRS, this should fast-track the achievement of the mid-point debt anchor target by FY28. However, the authorities have committed to consolidate the entire public sector balance – State Owned Entities and County Governments – with the central government. This may bring to visibility additional debt that is not currently under close monitoring.

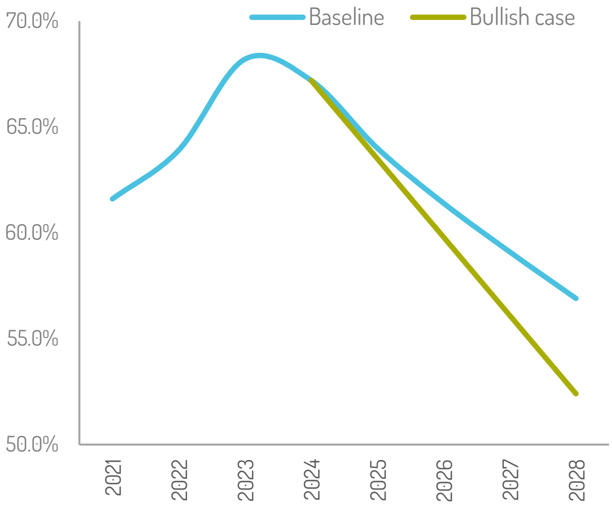
MTRS SIGNALS AGGRESSIVE REVENUE MOBILIZATION IN FY27 ...



FY27* estimates are ICAMMU calculations assuming 20.0% ordinary revenue-to-GDP

SOURCE: NATIONAL TREASURY, ICAMMU ESTIMATES

...FAST-TRACKING ACHIEVING OF THE MID-POINT DEBT ANCHOR BY FY28 IN THE BULLISH SCENARIO



SOURCE: NATIONAL TREASURY, ICAMMU ESTIMATES

Positive building blocks for SOE reforms

The National Treasury has baked in the tabling of a FY24 Supplementary Budget II Estimates by end of 1Q2024, targeting an improved primary surplus of 0.7% of GDP from the current 0.4% of GDP. Although the Auditor General published its special report on Supplementary Budget Expenditure spanning FY14 to FY23 period, we suspect that the long recess period by the National Assembly and the short-time frame before the tabling of the FY24 Supplementary Budget II Estimates may result in a looser application of the report's stringent recommendations. Encouragingly, several proposed structural benchmarks to be adhered to in the remainder of the programme dwell on SOE reforms. Of importance, options for Kenya Airways restructuring strategy are expected by end-April 2024, whereas the financial evaluation of 50 SOEs with the largest fiscal risks – and with a view towards potential privatization of some SOEs – is expected to be completed by end-June 2024. With the buildup in fuel subsidy arrears that totaled KES 27.0bn in FY23, we are also encouraged by the new structural benchmark of authorities' intent to enhance governance structure for the Petroleum Development Fund by end 1Q 2024.

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