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

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Blurred lines on expected disbursement

IMF staff and the Kenyan authorities reached a staff-level agreement on economic policies and reforms as it concluded the protracted seventh review of the Extended Credit Facility/Extended Fund Facility (ECF/EFF) programme and the second review under the Resilience and Sustainability Facility (RSF). Not surprisingly, the programme size has been scaled down by USD 288.6mn following the buyback transaction that was conducted in February this year. Nonetheless, the statement remained vague on the actual disbursement following the seventh review, highlighting the rough patches in the unusually lengthy review have not been ironed out. The completion of the second review under the RSF is expected to unlock USD 120.0mn, from the earlier targeted USD 179.0mn at the point of first review, suggesting some reform(s) have been pushed to subsequent third and/or fourth reviews.

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

- The total programme size under the EFF/ECF has been scaled down by USD 288.6mn, with the buyback of KENINT 2024 in February 2024 using the proceeds from KENINT 2031 easing the need for an outsized disbursement upon completion of the seventh review.
- The second review of the RSF that unlocks USD 120.0mn, lower than the targeted USD 179.0mn at the point of first review, suggests lingering reforms. Specifically, the January 2024 report had flagged a likelihood of delay in passage of carbon pricing legislation, which was one of the three reforms under the second review. Nevertheless, the Climate Change (Carbon Markets) Regulations 2024 were gazetted in late May 2024, giving a shot in the arm towards structured framework for implementing carbon projects in Kenya.
- The press release struck a less bullish tone on FY24 tax revenue and primary fiscal balance, suggesting the likelihood of a modification and/or non-observance of those two performance criteria for June 2024. As such, the IMF has backed the tax proposals in the Finance Bill 2024 for fiscal adjustment in FY25 budget year.
- The IMF also backed the tight monetary policy stance adopted by the Central Bank of Kenya that has anchored inflation expectations. The IMF also acknowledged the effort by the CBK to rebuild its FX reserves, which will be boosted near-term by the disbursement of the recently approved USD 1.2bn World Bank Development Policy Operation (DPO).

Our views:

Downscaling of IMF programme size takes Kenya from exceptional access and back to normal access

- Kenya's outstanding IMF purchases and loans stood at SDR 2.5bn (USD 3.3bn) as of 31st March 2024, representing 464.4% of its current quota of SDR 542.8mn (USD 716.1mn). These comprise of the Rapid Credit Facility (RCF) disbursement made in May 2020 at the onset of COVID-19 that was equivalent to 100.0% of Kenya's quota, coupled with the first six disbursements of the ongoing EFF/ECF programme (364.4% quota). At the end of the sixth review, the remaining disbursements of SDR 954.5mn (USD 1.3bn) with the last three reviews implied a cumulative disbursement of 640.3%, or an increase of 175.8% on the outstanding balance at the end of 1Q2024. From the latest Staff Level Agreement, the combined last reviews are now amounting to SDR 735.8mn (USD 970.7mn), an increase of 135.6% to bring the outstanding purchases and loans (in addition to the 464.4% as of end 1Q2024) to the upper limit of 600.0% under normal access.
- Unlike the urgency to mobilize multilateral financing to reduce refinancing risks that had been attached to KENINT 2024, the February 2024 buyback of USD 1.5bn of KENINT 2024 from proceeds of KENINT 2031 has lowered the need for an outsized disbursement at the completion of the seventh review of the IMF programme. Based on authorities' guidance along the sidelines of AfDB annual meetings, we estimate that Kenya will receive USD 256.9mn upon the IMF Board approval of the completion of the seventh review, down from USD 936.3mn previously programmed at the sixth review. We also expect the disbursement to be made in July 2024, a month later than previously expected disbursement of June 2024.
- The IMF has further rephased the remaining three disbursements towards the zero-interest Extended Credit Facility (ECF) from SDR 150.1mn (USD 198.0mn) at the sixth review, to SDR 267.7mn (USD 353.2mn) in the latest press release. This implies that the Extended Fund Facility (EFF), at concessional interest terms will amount to SDR 468.1mn (USD 617.6mn)

High likelihood of modification of June 2024 fiscal targets on lower-than-targeted outturn

- Although the seventh review focused on December 2023 (1H24) fiscal targets, focus now shifts to June 2024 (end FY24) quantitative performance criteria for tax revenue and primary budget balance. The authorities have already penciled in a KES 250.0bn downward revision in FY24 tax revenue collection, which points to a downward revision in the performance criteria. Following the assent of Supplementary Appropriations Bill 2024 into law by President Ruto on Monday, FY24 budget has been recalibrated to KES 3.87tn from the initial budget estimate of KES 3.74tn. This has led to a sharp overshoot in the primary balance from a surplus of KES 58.8bn (0.4% of GDP) to a deficit of KES 88.4bn (-0.5% of GDP).
- This notwithstanding, the authorities have penciled in a much lower overall fiscal deficit of 2.9% in FY25, from 5.8% in FY24. We think this aggressiveness with the overall fiscal deficit is the authorities' showing commitment to stick to the IMF programme despite the challenges of revenue mobilization. The Finance Bill 2024 is at the tail end of public participation and there are key sticky issues that generated wide debate such as the proposed introduction of motor vehicle circulation tax within the income tax segment, 16.0% VAT on bread, and the proposed introduction of the eco levy under miscellaneous fees and levy. With a much lower base on account of the KES 250.0bn downward revision in tax revenue collection this FY24, we opine that the expected KES 2.9tn revenue target in FY25 is highly ambitious.

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