FUNDAMENTALS

KENYA IMF UPDATE: SCOPE FOR A SUCCESSOR PROGRAMME

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IN BRIEF

- On Wednesday 30 October 2024, the IMF Executive Board approved the combined 7th and 8th reviews under the Extended Fund Facility/Extended Credit Facility (EFF/ECF) and the Resilience and Sustainability Facility (RSF), allowing the disbursement of a cumulative USD 606.1mn.
- As telegraphed by the June 2024 Staff Level agreement (our thoughts here), the cumulative disbursement under the current programme reverts to normal access following the KENINT 2024 partial buyback in February 2024 that lowered the necessity for accessing IMF financing under exceptional access.
- We estimate end-2024 inflation at 2.5%, at the lower end of the target band (5.0% ± 2.5%), and an average of 2.65% implies that the authorities may avoid triggering Monetary Policy Consultation Clause upon expiry of the IMF programme.
- With the impact of the shelving of the Finance Bill 2024, there has been a revision in the fiscal target from tax revenue to ordinary revenue, tax revenue plus ordinary revenue, for the December 2024 monitor date.
- The proposed Tax Laws (Amendment) Bill 2024 and Tax Procedures (Amendment) Bill 2024 are aimed to bring back the progressive aspects off the shelved Finance Bill 2024 and are likely to be tabled in the National Assembly early this week.
- Notably, the primary balance is projected to grow from 1.4% of GDP in FY25 to 2.5% of GDP in FY29, way past the completion of the current IMF programme. We opine that the successor programme will be a non-financed one, considering Kenya's cumulative access will be at the maximum allowable 600.0% quota at the end of the current programme.

Completion of the protracted seventh review and combined with the eighth review

On Wednesday 30 October 2024, the IMF Executive Board approved the combined 7th and 8th reviews under the Extended Fund Facility/Extended Credit Facility (EFF/ECF) and the Resilience and Sustainability Facility (RSF), allowing the disbursement of a cumulative USD 606.1mn. Of this amount, USD 216.5mn has been earmarked for balance of payment, with the balance of USD 389.6mn for budget support. The disbursement fell short of the expected USD 876.6mn under the National Treasury's planned disbursement in the FY25 Annual Borrowing Plan, largely on the lower-than-targeted disbursement under the RSF. Coincidentally, the approval by the IMF Executive Board came a day after the Supreme Court had lifted the unconstitutionality of the Finance Act 2023.

As telegraphed by the June 2024 Staff Level agreement (our thoughts here), the cumulative disbursement under the current programme reverts to normal access following the KENINT 2024 partial buyback in February 2024 that lowered the necessity for accessing IMF financing under exceptional access. Furthermore, the IMF financing is 1:2 split between the ECF and EFF, respectively, compared to 27:73 split at the time of the sixth review in January 2024. The latest approval by the Executive Board implies a higher-than-anticipated disbursement of c. USD 853.5 under the EFF/ECF and RSF when the IMF programme concludes successfully in March 2025.

	Disbursements, USD Mn's	
	EFF/ECF	RSF
Immediate	307.95	
First	407.10	
Second	258.09	
Third	235.61	
Fourth	447.39	
Fifth	415.35	
Sixth	624.46	60.20
Seventh	242.84	120.31
Eighth	242.84	-
Ninth	492.61	360.86
	3,674.24	541.37

SOURCE: IMF STAFF REPORTS, IC INSIIGHTS

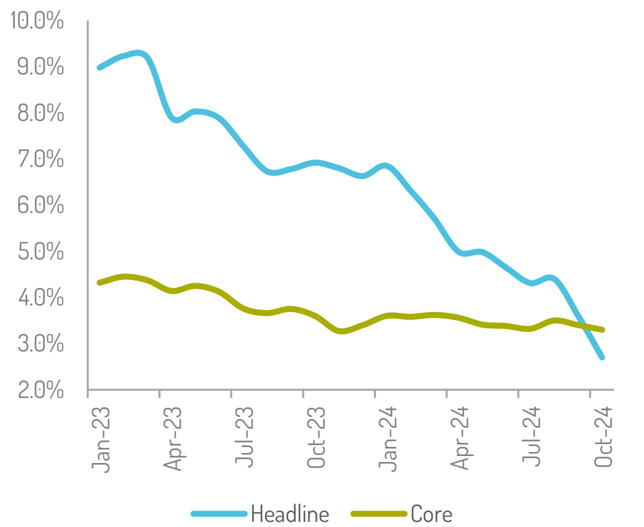
IMF exercises leniency on slow implementation of structural benchmarks

With the events leading to the shelving of the Finance Bill 2024 completely exogenous and out of the authorities' intervention scope, we are unimpressed that some of the structural benchmarks (SBs) as at the sixth review were not completed on schedule. Of the ten SBs, the authorities were able to fulfil just one; establishment of the Steering Committee at the National Treasury to strengthen the governance and process of the Medium-Term Revenue Strategy. Six SBs were not met, of which two have been rescheduled, while three SBs were implemented with delays. The conclusion of the latest combined reviews with the slow pace in implementing the SBs speaks of leniency on the IMF's part amidst a protracted seventh review process.

The restructuring of Kenya Airways, initially targeted by end of April 2024, has been rescheduled to end of this month. Longer-than-anticipated restructuring plan, exacerbated by collective bargaining agreement with pilots, and seeking strategic investor(s) delayed the completion of the SB. With the call-up of USD 150.0mn of FX-debt owned by local banks in August, the authorities have hinted an LCY-denominated security issuance to offset the called amount.

The authorities intend to submit to Parliament legal amendments to anchor the new State Corporations Ownership Policy and other State-Owned Enterprises (SOE) Blueprint measures in the law. Relatedly, there has been false starts with the privatization efforts with the High Court ruling the privatization of the initial eleven SOEs as unconstitutional in September 2024. Furthermore, the Cabinet had approved the divestment of five non-strategic commercial SOEs in February 2024 and a further six Government-held listed companies in June 2024. Of the latter plan, we note that the divestiture can realize a paltry USD 17.1mn at current exchange rates and share close prices, as it excludes other six blue-chip companies including Safaricom, Kenya Commercial Bank, and power utility companies KenGen and Kenya Power. If considered as part of the divestiture plan, these blue-chip companies could fetch USD 2.2bn when the government fully divests. We opine that their strategic influence in the local economy, and their rich dividend payments buttresses non-investment income, as a major contributor for their non-inclusion for divestment.

INFLATION TREND



SOURCE: KENYA NATIONAL BUREAU OF STATISTICS, CENTRAL BANK OF KENYA

Out of touch tighter monetary policy prescription

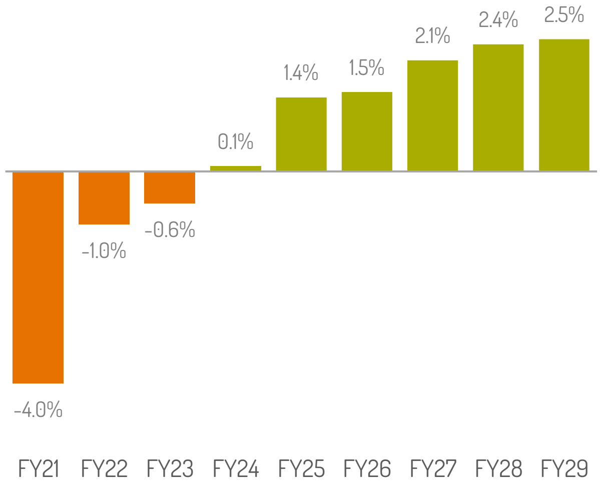
Notably, the IMF maintained its policy prescription for a tight monetary policy stance, largely on the sticky core inflation which has ranged between 3.3% - 3.6% while headline print has fallen by 415bps in the first ten months of this year. We estimate end-2024 inflation at 2.5%, at the lower end of the target band, and an average of 2.65% implies that the authorities may avoid triggering Monetary Policy Consultation Clause upon expiry of the IMF programme. The downside surprise to our base case should arise with a faster food disinflation in the November 2024 print and is likely to cement a more aggressive policy cut at the December 2024 MPC meeting. That said, although a tighter monetary policy stance was appropriate at the earlier duration of the IMF programme, the entrenched disinflation trend amidst a broader easing cycle should support a looser monetary policy stance.

Larger primary surpluses in outlier years suggests scope for successor programme

The IMF delivered a weaker assessment of FY24 tax revenue outturn, stemming from the comparison of the target as of sixth review of KES 2,428.0bn against the revised post-Supplementary II FY24 target of KES 2,188.6bn. Against the target of the sixth review, the performance fell short by KES 328.9bn (-2.1% of GDP) against the actual shortfall of KES 89.7bn (-0.6% of GDP) following the second Supplementary revisions to the FY24 budget. With the impact of the shelving of the Finance Bill 2024, and seemingly as the IMF's Executive Board awaited the decision on the constitutionality of the Finance Act 2023, there has been a revision in the fiscal target from tax revenue to ordinary revenue, tax revenue plus ordinary revenue, for the December 2024 monitor date. Refreshingly, the authorities had earlier identified an additional KES 69.3bn (0.4% of GDP) as non-tax revenue to be realized from tax amnesty extension, the KES 7/litre increase in the Road Maintenance Levy and dividends from the folding of forty-seven SOEs, and already baked in the FY25 fiscal framework.

Furthermore, the Cabinet Secretary for the National Treasury put a public notice in local media pre-empting the publication of the Tax Laws (Amendment) Bill 2024 and the Tax Procedures (Amendment) Bill 2024. These two pieces of legislation are aimed to bring back the progressive aspects off the shelved Finance Bill 2024 and are likely to be tabled in the National Assembly early this week once the House resumes its legislative sessions upon the completion of the short recess on November 5, 2024. As per the IMF report, the authorities expect to raise an additional 0.9% of GDP, or an estimated KES 157.0bn, of additional revenue this FY25. A notable proposal is the introduction of 5.0% withholding tax on infrastructure bonds (currently 0.0% WHT) on a prospective basis, with the IMF report "striving for tax neutrality across all financing instruments". Given the optics of a 'sneaking back' of Finance Bill 2024 with the introduction of these two proposed Bills, the authorities will have to get the necessary buy-in from the public should it want to push through these revenue-raising measures.

PRIMARY BALANCE-TO-GDP



SOURCE: IMF, NATIONAL TREASURY

Notably, the primary balance is projected to grow from 1.4% of GDP in FY25 to 2.5% of GDP in FY29, way past the completion of the current IMF programme. We opine that the successor programme will be a non-financed one, considering Kenya's cumulative access will be at the maximum allowable 600.0% quota at the end of the current programme. The implementation of the successor programme should anchor the authorities' resolve to carry through implementation of this ambitious primary balance target. The authorities have telegraphed gradual implementation of the progressive aspects of the Medium-Term Revenue Strategy (MTRS), with the Steering Committee expected to adopt comprehensive Personal Income Tax (PIT), Corporate Income Tax (CIT), and Value Added Tax (VAT) reforms by end February 2025, ahead of tabling of Finance Bill 2025.

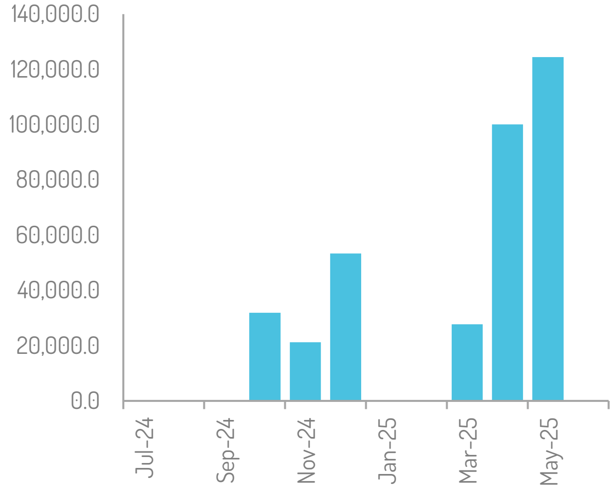
Higher-than-targeted external commercial financing implies lower net domestic financing requirements

Although the targeted commercial loan financing is KES 168.8bn or USD 1.3bn-equivalent during this FY25, the authorities have telegraphed close to USD 2.5bn financing in the pipeline. The National Treasury Cabinet Secretary reiterated that Kenya is seeking a 7-year USD 1.5bn loan from the United Arab Emirates (UAE) at an interest cost of 8.25%. With this UAE loan denominated in USD, we think that the authorities have the luxury of time to tap this loan at a slightly cheaper interest rate if the pricing is USD Secured Overnight Facility Rate (SOFR) plus premium. Furthermore, the authorities are seeking USD 500.0mn-equivalent Samurai bond guaranteed by Nippon Export and Investment Insurance (NEXI) and another USD 500.0mn-equivalent panda bond guaranteed by the Asian Infrastructure Investment Bank (AIIB), that seem to be project-specific.

Should these external financing materializes, we foresee a downward revision to the FY25 net domestic financing requirements to KES 413.1bn. The authorities recently introduced a tentative calendar for domestic debt issuance. Commendable was the bond switch auctions scheduled to be conducted in November 2024 and January 2024, respectively, to mitigate the huge T-Bond maturities in 2Q2025.

Nevertheless, the authorities shelved the bond switch that was planned to be conducted during this month, suggesting some flexibility with issuance. With domestic borrowing at KES 298.9bn, 72.4% run rate, the authorities are ahead of their FY25 issuance and lowers the urgency of resorting to switch auctions.

HIGH T-BONDS MATURITY, KES MN's, IN 2Q2025



SOURCE: NATIONAL TREASURY, CENTRAL BANK OF KENYA, NAIROBI SECURITIES EXCHANGE

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