REPUBLIC OF KENYA

MINISTRY OF FINANCE

ANNUAL
PUBLIC DEBT MANAGEMENT REPORT

JULY 2009 – JUNE 2010

MAY 2011

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Foreword

Over the last three years, public debt has risen by 60% from Ksh 870 billion in June 2008 to Ksh 1,400 billion in April 2011. In nominal terms, public debt to GDP increased from 42% of GDP to 50% during the three year period. Much of this increase was necessary in view of the global financial crisis, severe drought and the post election violence. The Government policy is to bring the public debt level from the current level of 50% to 45% in the medium term. I hasten to add that the Debt Sustainability studies done by the IMF/World Bank show that the public debt is still sustainable.

The fact that the bulk of the much needed funding was raised domestically is a pointer to the depth and resilience of the domestic debt market. This is a result of consistent reforms that have been undertaken by the Government in the last few years. I wish to commend all the stakeholders including the Ministry of Finance, the Capital Markets Authority, Central Bank of Kenya, Nairobi Stock Exchange, Market Leaders Forum and our development partners who have made this possible. I look forward to this reform momentum being maintained to make the domestic market comparable to those of emerging markets.

Public borrowing has been consistent with the overall fiscal framework aimed at ensuring macro-economic stability. It is anchored on the projections in the official documents including Budget Policy Statement and Budget Outlook Paper. The borrowing is further informed by a formal *Medium Term Debt Strategy* (MTDS) which is tabled in Parliament during the presentation of the Budget Estimates. The MTDS tool evaluates cost and risks of various scenarios to reach an optimal strategy that is implemented in the course of the year. The 2010 MTDS has guided the borrowing in the current financial year while the 2011 MTDS is being prepared for tabling in Parliament in June 2011 to guide borrowing in the financial year 2011/12. Measures are being taken to simplify and disseminate the document to ensure it is well understood.

As we embark on implementing the new constitution, it is of paramount importance to ensure prudent borrowing. The constitution provides that the County Governments can borrow only with the Central Government guarantee. The Public Finance Management Legislation Act which is under preparation will come up with provisions and guidelines of how this will be achieved.

HON. UHURU KENYATTA, EGH, MP
DEPUTY PRIME MINISTER AND MINISTER FOR FINANCE
MAY 2011

Acknowledgement

Prudent public debt management is critical for all economies and more so for developing countries where strong institutions are often lacking. In 2003, Kenya faced challenges relating to debt management which made the Government embark on a five year reform program to strengthen Debt Management. This has borne fruit since we now have a Debt Management Department in the Ministry of Finance which is the focal point of all matters on public debt management. The department provides the policy guidance to the Central Bank of Kenya in its role as agent of the Government in borrowing in the domestic market as well as externalization of payments for external loans; guides the External Resources Department (ERD) in cost and risks in the mobilization of external loan resources; and liaises with the Department of Government Investments and Public Enterprises (DGIPE) on on-lending and contingent liabilities for State Owned Enterprises. The production of an Annual Public Debt Management Report is one of the deliverables of the department and is aimed at disseminating information on public debt during the relevant period. This Report for 2009/10 is the fourth since its preparation was revived in 2006.

As part of the reforms to establish the Debt Management Department, capacity building has been an overriding priority. The department has a core team that has been trained in relevant skills. For instance, at the initial stages, the *Medium Term Debt Management Strategy* (MTDS) was being prepared by the World Bank and the IMF staff but now the core team is able to prepare the document with the World Bank and the IMF providing quality assurance. To ensure the retention of staff with such requisite technical skills, preparation of an appropriate Scheme of Service is in progress.

The implementation of the new constitution will necessitate review of institutional framework and Debt Management Department will be affected. Building on what has been achieved so far changes will be made so that the department is able to deliver on the expanded mandate of ensuring prudent borrowing by both the Central and County Governments.

I wish to recognize the role played by the Debt Management Department, Ministry of Finance who coordinated the production of this Report. My sincere gratitude is to the core team involved in its production, namely: John Murugu (Director), Haron Sirima (Deputy Director), Charles Kairu, Felister Kivisi, Livingstone Bumbe, Dunstone Ulwodi, Stella Osoro, Racheal Njoroge, Bernard Gibet, Simon Odum, and Faith Njau, all from the Debt Management Department; Joseph Kiarie from DGIPE and Leornard Thotho from the Central Bank of Kenya.

JOSEPH K. KINYUA, CBS
PERMANENT SECRETARY/TREASURY
MAY 2011

List of Abbreviations

ADB	African Development Bank
ADF	African Development Fund
A-I-A	Appropriation in Aid
ATM	Average Time to Maturity
BoP	Balance of Payments
BIS	Bank for International Settlement
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CCN	City Council of Nairobi
COMSEC	Commonwealth Secretariat
CPIA	Country Policy and Institutional Assessment
CRR	Cash Ratio Requirement
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DGIPE	Department of Government Investment and Public Enterprises
DMD	Debt Management Department
DSA	Debt Sustainability Analysis
DX	Domestic Currency
ECB	European Central Bank
EEC	European Economic Commission
EIB	European Investment Bank
ERD	External Resources Department
EUROSTAT	European Union Statistical Agency
FLSTAP	Financial and Legal Sector Technical Assistance Project
FX	Foreign Currency
FXD	Fixed Discounted Treasury Bonds
GDP	Gross Domestic Product
GoK	Government of Kenya
GSMM	Government Securities Market Makers
HIPC	Highly Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFB	Infrastructure Bond
IMF	International Monetary Fund
JPY	Japanese Yen
KACC	Kenya Anti-Corruption Commission
KBC	Kenya Broadcasting Corporation
KenGen	Kenya Electricity Generating Company
MODM	Monetary Operations and Debt Management Department
MOF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
NBFI	Non Bank Financial Institution
NPV	Net Present Value
NSE	Nairobi Stock Exchange
NSSF	National Social Security Fund
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OTC	Over The Counter
PA	Payment Advice
PFMB	Public Financial Management Bill
PMG	Pay Master General
PPG	Public and Publicly Guaranteed
PV	Present Value
PwC	PricewaterhouseCoopers
QEBR	Quarterly Economic and Budgetary Review
SDR	Special Drawing Rights
SFX	Restructuring Treasury Bonds
TDS	Total Debt Service
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TDS	Total Debt Service
TARDA	Tana and Athi River Development Authority
TEDS	Total External Debt Service
UK	United Kingdom
UNCTAD	United Nations Conference on Trade & Development
USA	United States of America
USD	US Dollar
WB	World Bank
ZC	Zero Coupon Rate Bonds

Executive Summary

The overall objective of the Government debt management policy is to meet the central Government's financing needs at the lowest possible long term borrowing cost with a prudent degree of risk. Additionally, it aims at facilitating Government's access to financial markets as well as supporting development of a well functioning vibrant domestic market.

The Government is committed to the pursuit of prudent debt management strategies to ensure that public debt remains within sustainability thresholds. In the medium term, the Government plans to lower the level of public and publicly guaranteed debt to 45 percent of GDP. This will require reduction in the overall fiscal deficit from over 6 percent to below 5 percent, as well as adherence to prudent debt management. The Government debt management strategy is outlined in the 2010 Medium Term Debt Strategy (MTDS) launched in June 2010. The MTDS is subject to annual updates.

Public and publicly guaranteed debt increased from Ksh 1,055,910 million or 45.8 percent of GDP in June 2008/09 to Ksh 1,225,720 million or 50.9 percent of GDP in June 2009/10. External debt rose from Ksh 537,403 million or 23.3 percent of GDP to Ksh 565,452 million or 23.5 percent of GDP over the period under review. Similarly, domestic debt rose from 518,507 million in 2008/09 to Ksh 660,268 million in 2009/10. As a percentage of GDP, domestic debt increased from 22.5 percent to 27.4 percent. This sharp rise in nominal domestic debt stock is attributed largely to a deliberate strategy to increase domestic borrowing to finance the budget deficit.

During the period under review, the share of domestic debt increased by 4.8 percentage points from 49.1 percent to 53.9 percent while external debt declined from 50.9 percent to 46.1 percent of total debt. The external portfolio indicates that the debt is mainly owed to multilateral and bilateral creditors at 62 percent and 35 percent, respectively. On domestic debt, the ratio of Treasury Bonds to Treasury Bills was 74:26.

The overall debt service increased by 20 percent from Ksh 67,594 million (14.8 percent of ordinary revenue) in 2008/09 to Ksh 80,992 million (16 percent of total revenue) in 2009/10. During the period, interest payments on domestic debt increased sharply by 25 percent to Ksh 57,381 million while external debt service increased marginally by 9 percent to Ksh 23,611 million. The sharp increase in domestic debt service was attributed to the rapid growth of domestic debt stock.

The Government external debt strategy remained unchanged: new external loans are contracted on highly concessional terms to minimise interest rate cost. The average interest rate and grace period on the external loan portfolio was 1.3 percent and 7.2 years, respectively. This profile, together with the long maturity of 31.7 years yields an average grant element of 53.3 percent for existing external loans. On the other hand, reflecting on the success of lengthening the maturity of domestic debt to minimise refinancing risk, the average maturity profile of outstanding domestic debt increased from 3.8 years to 4.6 years over the period under review.

Total disbursement of external loan funds and budget support decreased from Ksh 44,030 million in June 2009 to Ksh 39,781 million in June 2010. The amount disbursed under project loans remained below the annual target of Ksh 66,490 million at end June 2010. The dismal performance in disbursement of funds under project loans is due to low absorption capacity of project funds. To enhance the absorption capacity, the Ministry of Finance in liaison with development partners is formulating strategies and an action plan to improve aid and development effectiveness for consideration and implementation by the stakeholders. The Ministry has also adopted a computerized system, Electronic Project Management Information System (e-Promis) for monitoring the implementation of all development projects and taking quick remedial actions.

Over the period under review, average interest rates on Government securities significantly declined. The 91-day Treasury Bill rate fell by 433 basis points from 7.332 percent in June 2009 to 2.998 percent in June 2010. Likewise, average interest rate for the 182-day Treasury Bill dropped by 541 basis points to 2.856 percent during the period. The 364-day Treasury Bill which is issued bi-monthly also declined by 457 basis points from 8.712 percent in August 2009 to 4.138 percent in June 2010. Market yield rates on benchmark Treasury Bonds also fell, with the 2-year bond bearing a coupon rate of 7.108 percent declining by 373 basis points to register a market yield of 3.383 percent while the 20-year Treasury Bond with a coupon rate of 11.25 percent declined by 184 basis points to register a 10.066 percent market yield. The decline in interest rates is attributed to Central Bank of Kenya monetary policy stance. The Monetary Policy Committee reduced the Central Bank Rate (CBR) from 8 percent to 6 percent while the Cash Ratio Requirement (CRR) was reduced from 5 percent to 4.5 percent over the same period.

Efficient management of Government on-lending to state-owned enterprises has been recognized as an integral part of public debt management function. Significant arrears or defaults in the on-lent portfolio can severely constrain efficient debt management, and would ultimately impact on fiscal sustainability. Establishing better institutional processes and ensuring transparency in on-lending operations and contingent liabilities monitoring are expected to contribute positively towards the management of both cost and risk in government debt portfolio. In this regard, the Ministry of Finance is making efforts to ensure on-lent loans and contingent liabilities are well managed.

The outlook in the medium term indicates that gross public debt is projected to increase in nominal terms from Ksh 1,225,720 million in June 2010 to Ksh 1,691,724 million in June 2014. Real GDP is projected to grow at an average rate of 6.3 percent while debt to GDP ratio is expected to decline from 50.9 percent to 43.6 percent over the medium term.

Although overall debt service in nominal terms is projected to increase by almost 87 percent in the medium term, the debt burden indicators will remain within sustainable levels. Total debt service is projected to increase from Ksh 80,992 million (15.9 percent of revenue) in 2009/10 to Ksh 105,818 million (17.4 percent of revenue) in 2010/11 and to Ksh 151,324 million (16.7 percent of revenue) in 2013/14. Nearly 70 percent of the increase in debt service is attributed to domestic interest.

Information on public debt is available on the Treasury website www.treasury.go.ke, which hosts the *Annual Public Debt Management Report, the Monthly Debt Bulletin*, the *Quarterly Economic and Budgetary Review (QEBR,)* and the *Annual Appropriation Accounts* tabled in Parliament. The Central Bank's website www.centralbank.go.ke hosts the *Monthly Economic Review* and *Weekly Bulletin*.

Introduction

The Fiscal Year ***2009/10 Annual Public Debt Management Report*** presents the major developments in Kenya's public debt management activities during the financial year ended June 2010. The Report is organised under the following chapters:

1. Financing of Budget Deficit
2. External Debt
3. Domestic Debt
4. Publicly Guaranteed Debt
5. On-Lent Loans and Contingent Liabilities
6. Disputed External Commercial Debt
7. Debt Strategy and Debt Sustainability
8. Public Debt Reports and Statistics in Kenya
9. Reforms in Public Debt Management
10. Outlook for the Medium Term

1. FINANCING OF BUDGET DEFICIT

1.1 Financing of the Deficit

The 2009/10 Central Government budget deficit (including grants) of Ksh 168.2 billion or 6.8 percent of GDP was to be financed partly through net foreign financing of Ksh 50.2 billion (2.1 percent of GDP). The remaining Ksh 118 billion was to be financed through privatisation proceeds estimated at Ksh 8.5 billion (0.4 percent of GDP); and net domestic borrowing of Ksh 109.5 billion (4.3 percent of GDP) comprising of Ksh 77 billion net domestic borrowing and long-term domestic Infrastructure Bonds amounting to Ksh 32.5 billion.

A review of the actual budget outturn resulted in a revised budget deficit of Ksh 156.4 billion. This deficit was 6.5 percent of GDP and was financed through net foreign financing of Ksh 22.9 billion (1.0 percent of GDP), and net domestic borrowing of Ksh 133.5 billion (5.5 percent of GDP) out of which Ksh 32.9 billion (1.4 percent of GDP) were proceeds from the domestic Infrastructure Bonds.

1.2 Total Public Debt

Kenya's public and publicly guaranteed debt increased from Ksh 1,055,910 million or 45.8 percent of GDP in June 2009 to Ksh 1,225,720 million or 50.9 percent of GDP in June 2010 as indicated in Table 1.1. Domestic debt rose significantly from Ksh 518,507 million or 22.5 percent of GDP to Ksh 660,268 million or 27.4 percent of GDP over the period under review. Similarly, external debt rose from Ksh 537,403 million in 2009 to Ksh 565,452 million in 2010. As a percentage of GDP, external debt increased marginally from 23.3 percent to 23.5 percent over the period. The significant rise in domestic debt stock is attributed largely to a deliberate strategy to increase domestic financing from 4.3 percent to 5.5 percent of GDP partly due to reduced foreign financing and non-realisation of privatization proceeds.

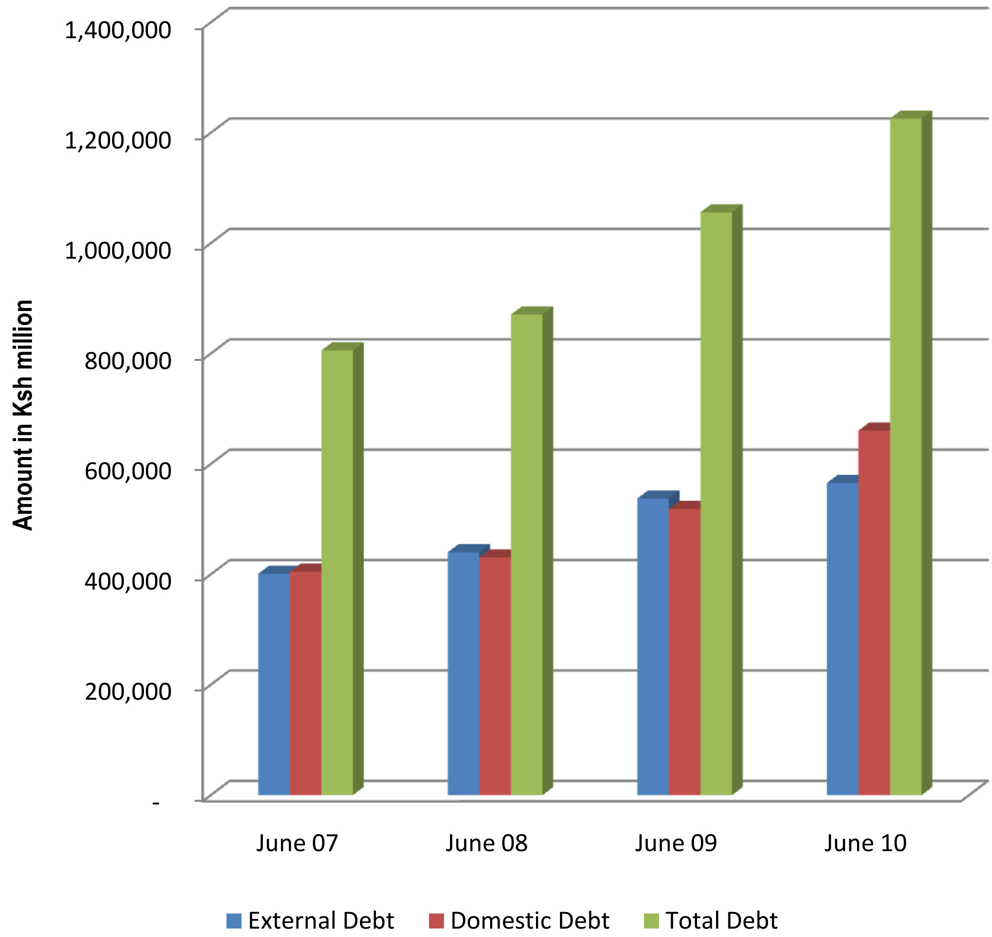
During the period under review, the share of domestic debt increased by 4.8 percent from 49.1 percent to 53.9 percent as shown in Table 1.1 while external debt declined from 50.9 percent to 46.1 percent of total debt. This is consistent with the Government strategy of financing the Government budget deficit through domestic sources. The external portfolio indicates that the debt is mainly owed to multilateral and bilateral creditors at 62 percent and 35 percent respectively. On domestic debt, the ratio of Treasury Bonds to Treasury Bills was 74:26.

Table 1.1: Public and Publicly Guaranteed Debt, Ksh Million

	Jun- 07	Jun-08	Jun-09	Jun-10	Change 2009/10
EXTERNAL					
Central Government					
Bilateral	118,512	127,786	152,985	159,687	6,702
Multilateral	240,259	268,223	327,633	348,647	21,014
Commercial Banks	574	0	0	0	0
Commercial Creditors	18,427	18,543	23,837	20,458	(3,379)
Sub-Total	377,772	414,552	504,455	528,792	24,337
Guaranteed					
Bilateral	23,194	25,415	32,948	36,660	3,712
Total External	**400,966**	**439,967**	**537,403**	**565,452**	**28,049**
As a % of GDP	*21.7*	*21.1*	*23.3*	*23.5*	*0.2*
(As a % of total debt)	*49.8*	*50.5*	*50.9*	*46.1*	*(4.8)*
DOMESTIC (Gross)					
Banks	**224,076**	**228,482**	**290,778**	**401,794**	**111,016**
Central Bank	36,182	35,548	40,061	50,215	10,154
Commercial Banks	187,894	192,934	250,717	351,579	100,862
Non-banks	**180,614**	**202,130**	**227,729**	**258,474**	**30,745**
Non-bank Financial Institutions	1,084	11,177	3,651	2,956	(695)
Other Non-bank Sources	179,530	190,953	224,078	255,518	31,440
Total Domestic	**404,690**	**430,612**	**518,507**	**660,268**	**141,761**
As a % of GDP	*21.9*	*20.7*	*22.5*	*27.4*	*4.9*
As a % of total debt	*50.2*	*49.5*	*49.1*	*53.9*	*4.8*
GRAND TOTAL	**805,686**	**870,579**	**1,055,910**	**1,225,720**	**169,810**
As a % of GDP	*43.6*	*41.8*	*45.8*	*50.9*	*5.1*
Memorandum item					
GDP	1,847,700	2,085,152	2,307,700	2,409,600	101,900

Source: Treasury and Central Bank of Kenya

Chart 1.1: Trend in Public and Publicly Guaranteed Debt Stock, Ksh Million



1.3 Debt Service

Total debt service on Kenya's Central Government debt increased by 20 percent from Ksh 67,594 million in 2008/09 to Ksh 80,992 million in 2009/10 as shown in Table 1.2. Interest payments on domestic debt increased substantially from Ksh 45,949 million to Ksh 57,381 million while external debt service increased marginally from Ksh 21,645 million to Ksh 23,611 million. The substantial increase in domestic debt service was attributed to the rise in domestic debt stock.

The structure of Central Government debt service remained relatively unchanged with a large share being domestic debt as illustrated in Chart 1.2. External debt service as proportion of total debt service decreased by 2.8 percent from 32.0 percent in 2008/09 to 29.2 percent in 2009/10 while domestic interest payments increased by the same margin from 68.0 percent to 70.8 percent. Total debt service as a percentage of revenue increased from 14.8 percent in June 2009 to 16.0 percent (see Table 1.2) in June 2010 largely due to increased domestic borrowing. External debt service as a percentage of export earnings declined from 6.7 percent to 5.9 percent over the same period which is attributed to both higher export earnings and improved concessionality of external debt.

1.4 Cost/Risk Characteristics of Public Debt

Arising from the Government external debt strategy of contracting external loans on highly concessional terms to minimise interest rate cost, the average interest rate and grace period on the external loan portfolio as at end June 2010 was 1.3 percent and 7.2 years, respectively. This profile, together with the long maturity of 31.7 years yields an average grant element of 53.3 percent in the external debt portfolio.

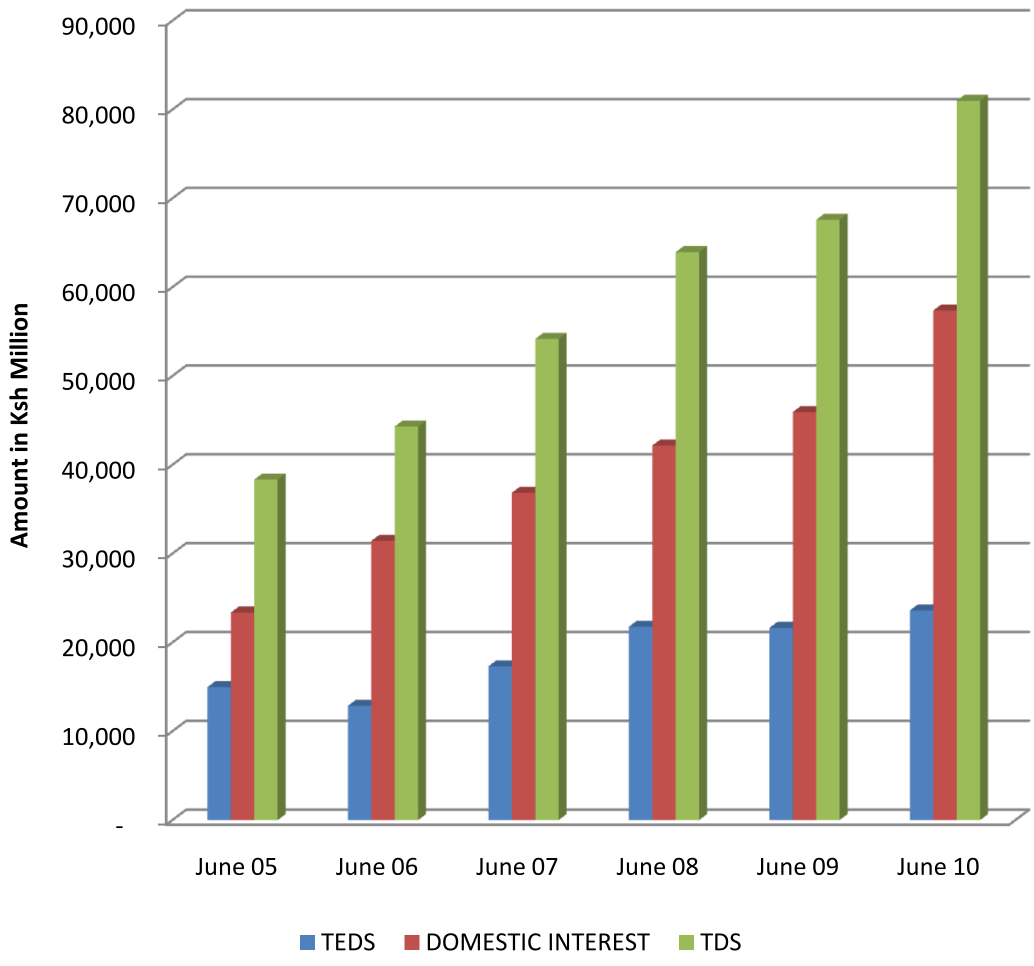
On the other hand, reflecting on the success of lengthening the maturity of domestic debt to minimise refinancing risk, the average maturity profile of outstanding Government domestic debt has increased from 3.8 years in June 2009 to 4.6 years in June 2010.

Table 1.2: Debt Service on Kenya's Central Government Debt, Ksh Million

	Jun-05	**Jun-06**	**Jun-07**	**Jun-08**	**Jun-09**	**Jun-10**	**Change 2009-10**
External Principal	10,544	9,230	13,884	15,815	16,013	17,373	1,360
External Interest	4,427	3,645	4,433	5,961	5,632	6,238	606
TEDS	**14,971**	**12,875**	**18,317**	**21,776**	**21,645**	**23,611**	**1,966**
TEDS as a % of TDS	*39.0*	*29.1*	*33.2*	*34.0*	*32.0*	*29.2*	*(2.8)*
Domestic Interest	**23,375**	**31,445**	**36,860**	**42,181**	**45,949**	**57,381**	**11,432**
Dom Interest as a % of TDS	*61.0*	*70.9*	*66.8*	*66.0*	*68.0*	*70.8*	*2.8*
TDS	**38,346**	**44,320**	**55,177**	**63,957**	**67,594**	**80,992**	**13,398**
Ordinary Revenue	265,912	291,064	338,509	396,489	456,000	507,500	51,500
Export Earnings (goods only)	209,918	228,181	261,626	298,239	322,660	400,123	77,463
TDS as a % of Revenue	*14.4*	*15.2*	*16.3*	*16.1*	*14.8*	*16.0*	*1.2*
TEDS as a % of Exports	*7.1*	*5.6*	*7.0*	*7.3*	*6.7*	*5.9*	*(0.8)*

Source: Treasury and Central Bank of Kenya

Chart 1.2: Kenya's Central Government Debt Service, Ksh Million



Source: Treasury and Central Bank of Kenya

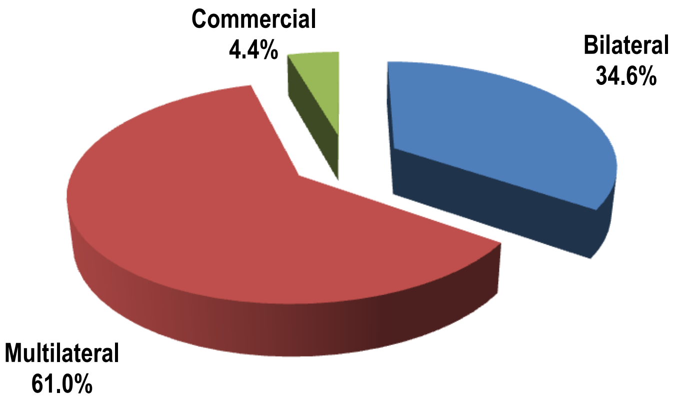
2. EXTERNAL DEBT

2.1 Total External Debt

As shown in Table 1.1, the total external debt increased from Ksh 537,403 million in June 2009 to Ksh 565,452 million in June 2010 due to both depreciation of the Kenya Shilling and increase in net loan disbursements. In US Dollar terms, external debt decreased by USD 62.2 million to USD 6,902.8 million at end June 2010 as shown in Appendix 1(b). Expressed as a percentage of GDP, external debt increased by 0.2 percent to 23.5 percent, reflecting a marginal increase in external debt burden.

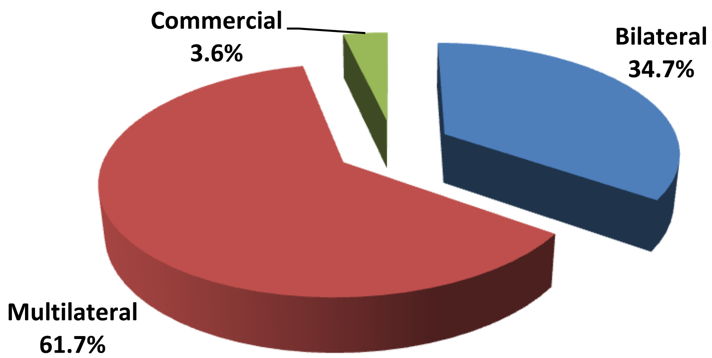
At the beginning of the financial year 2009/10, Kenya's external debt portfolio shows that the debt is mainly owed to multilateral (61.0 percent) and bilateral (34.6 percent) creditors with a small proportion owed to commercial creditors (4.4 percent) as shown in Chart 2.1(a). This structure remained relatively unchanged over the period under review as demonstrated in Chart 2.1(b) as multilateral and bilateral debt increased marginally to 61.7 percent and 34.7 percent respectively. Commercial debt decreased marginally from 4.4 percent to 3.6 percent on account of exchange rate movement.

Chart 2.1(a): External Debt stock by Broad Creditors, June 2009



Source: Treasury

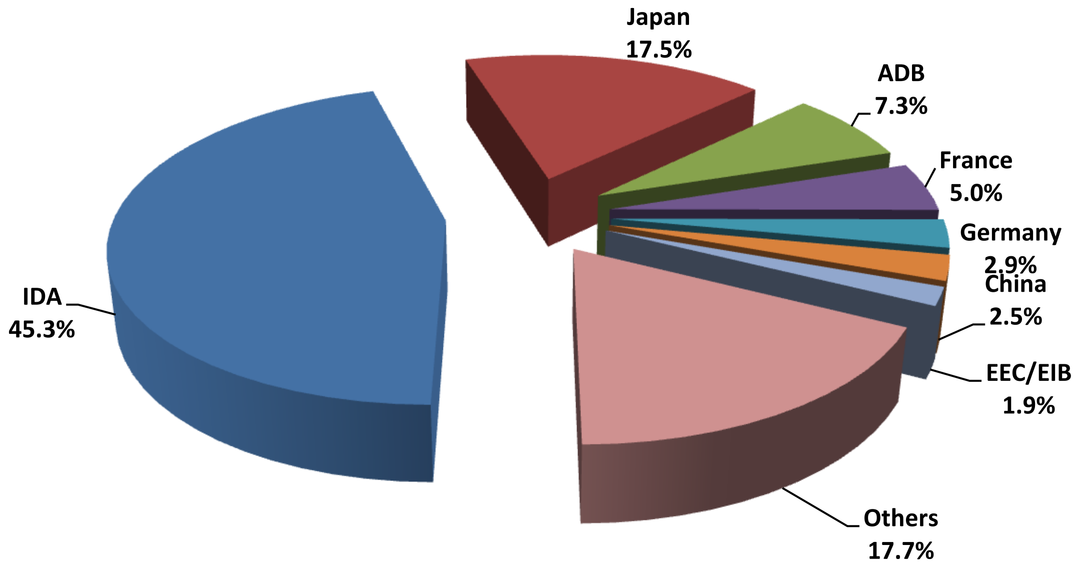
Chart 2.1(b): External Debt Stock by Broad Creditors, June 2010



Source: Treasury

Further examination of the external debt portfolio reveals that the World Bank (IDA) is the leading creditor (45.3 percent of total external debt), followed by Japan (17.5 percent) and African Development Bank Group (7.3 percent). Other notable creditors to Kenya are France, Germany, China and the European Union/European Investment Bank as shown in Chart 2.2.

Chart 2.2: External Debt by Major Creditors, June 2010

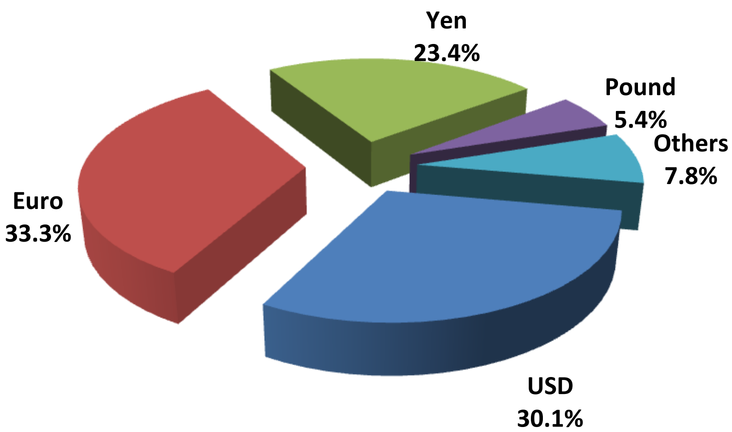


Source: Treasury

2.2 Currency Structure of External Debt

Chart 2.3 shows that external debt is mainly denominated in Euro, US Dollar and Yen. Although a diverse currency structure mitigates against exchange rate risk on the country's external debt, the currency mix is not as a result of a deliberate debt management strategy but more a reflection of source of external loans.

Chart 2.3: External Debt by Currency, June 2010

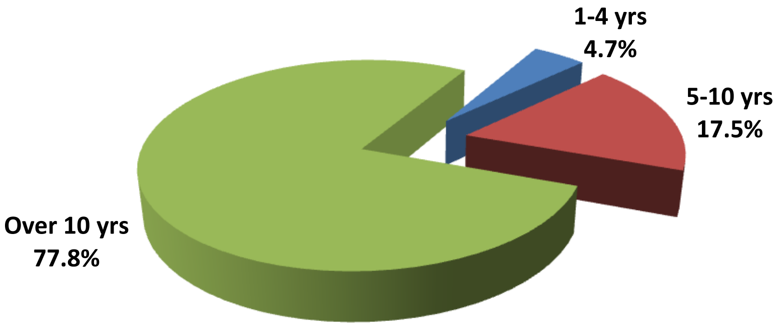


Source: Treasury

2.3 Maturity Structure

Overall, the country's external debt is long term. As at the end of June 2010, the proportion of external debt with remaining maturities of more than 10 years was 77.8 percent. Only 4.7 percent of the debt had maturity of less than 4 years: a reflection of negligible default risk (Chart 2.4). This profile shows that a large stock of external debt is scheduled for full retirement in the distant future.

Chart 2.4: External Debt by Remaining Maturity, June 2010



Source: Treasury

2.4 Average Terms of New External Loan Commitments

Arising from the Government external debt strategy of contracting external loans from both multilateral and bilateral sources on concessional or "soft" terms, average interest rate and grace period on new external loan commitment as at the end of June 2010 was 1.3 percent and 7.2 years respectively. This profile, together with the long maturity of 31.7 years yields an average grant element of 53.3 percent. Table 2.1 shows that during the period under review, there was a hardening of borrowing terms with the grant element declining by 3.6 percentage points at end June 2010.

Table 2.1: Average Terms of Loan Commitments

	June 2009	June 2010
Average Maturity (yrs)	33.1	31.7
Grace Period (yrs)	7.8	7.2
Average Interest Rate (%)	1.1	1.3
Grant Element (%)	56.9	53.3

Source: Treasury

2.5 External Debt Service

Total external debt service on Central Government debt increased marginally from Ksh 21,645 million in 2008/09 to Ksh 23,611 million in 2009/10 as shown in Table 2.2. Principal repayments increased from Ksh 16,013 million in June 2009 to Ksh 17,373 in June 2010 million while interest payments increased from Ksh 5,632 million to Ksh 6,238 million during the period. In the year under review, external debt service was split equally to multilateral and bilateral creditors. No commercial debt was repaid during the year as the entire category of this debt relates to disputed suppliers' credit.

Table 2.2: External Debt Service on Central Government Debt by Creditor, Ksh Million

Payments	Multilateral		Bilateral		Commercial		Total	
	Jun-09	Jun-10	Jun-09	Jun-10	Jun-09	Jun-10	Jun-09	Jun-10
Principal	8,112	8,976	7,901	8,397	-	-	16,013	17,373
Interest	2,567	2,872	3,065	3,366	-	-	5,632	6,238
Total	**10,679**	**11,848**	**10,966**	**11,763**	**-**	**-**	**21,645**	**23,611**

Source: Treasury

2.6 Disbursements of External Loan Funds

Total disbursement of external loan funds and budget support decreased from Ksh 44,030 million in June 2009 to Ksh 39,781 million in June 2010 as shown in Table 2.3. The amount disbursed under project loans remained below the annual target of Ksh 66,490 million at end June 2010. The dismal performance in disbursement of funds is due to low absorption capacity of project funds. To enhance the absorption capacity, the Ministry of Finance in liaison with development partners is formulating strategies and an action plan on how to improve aid and development effectiveness for consideration and implementation by the stakeholders. The Ministry is also implementing a computerized system, Electronic Project Management Information System (e-Promis) for monitoring the implementation of all development projects and taking quick remedial actions.

Table 2.3: External Loans Disbursements, Ksh Million

	Jun-09		Jun-10	
	Amount	**%**	**Amount**	**%**
Project Cash Loans	10,434	*23.7*	10,354	*25.7*
Programme Loans	*Nil*	*Nil*	*Nil*	*Nil*
Project A-I-A	17,343	*39.4*	29,427	*74.3*
Sub-total	**27,777**	***63.1***	**39,781**	***100.0***
BoP Support	**16,253**	***36.9***	**Nil**	***Nil***
Total	**44,030**	***100.0***	**39,781**	***100.0***

Source: Treasury

3. DOMESTIC DEBT

3.1 Total Domestic Debt

Government domestic debt consists of stock of Government securities which comprises Treasury Bills and Treasury Bonds, Long-Term Stocks, Government Overdraft at Central Bank of Kenya and Pre-1997 Government Debt. During the Financial year 2009/10, the Government raised Ksh 133.5 billion through borrowing from the domestic market by sale of Treasury Bills, Treasury Bonds and Infrastructure Bonds. Under the Government borrowing plan, the level of Government Overdraft was to be maintained at zero by end June 2010. As shown in Table 3.1, on a net basis, the outstanding stock of domestic debt rose by Ksh 141,761 million (27.3 percent growth) in 2009/10 to stand at Ksh 660,268 million in June 2010 compared to Ksh 518,507 million in June 2009. This increase was attributed to increases in the stock of Treasury Bonds (Ksh 87,871 million), Treasury Bills (Ksh 41,700 million) and the Government Overdraft at Central Bank of Kenya (Ksh 12,525 million) respectively. The increase in domestic debt was partly offset by the repayment of Ksh 1,110 million of the Pre-1997 Government Debt and Ksh 2 million redemption of long-term stocks.

Table 3.1: Domestic Debt Stock, Ksh Million

Instrument	June 2009		June 2010		Change
	Amount	%	Amount	%	
Total Stock of Domestic Debt (A+B)	**518,507**	***100***	**660,268**	***100.0***	**141,761**
A. Government Securities(1-4)	**511,621**	***98.7***	**640,080**	***96.9***	**128,459**
1.Treasury Bills (excluding Repo bills)	**116,794**	***22.5***	**158,494**	***24.0***	**41,700**
Banking Institutions	74,630	*14.4*	133,797	*20.3*	59,167
Others	42,164	*8.1*	24,697	*3.7*	(17,467)
2.Treasury Bonds	**360,744**	***69.6***	**448,615**	***67.9***	**87,871**
Banking Institutions	182,058	*35.1*	217,562	*32.9*	35,504
Others	178,686	*34.5*	231,053	*35.0*	52,367
3. Long Term Stocks	**755**	***0.1***	**753**	***0.1***	**(2.0)**
Banking Institutions	0	*0.0*	0.0	*0.0*	0.0
Others	755	*0.1*	753	*0.1*	(2.0)
4. Pre-1997 Government Debt	**33,328**	***6.4***	**32,218**	***4.9***	**(1,110)**
B. Others:*	**6,886**	*1.3*	**20,188**	***3.1***	**13,302**
Of which CBK Overdraft	5,124	*1.0*	17,649	*2.7*	12,525

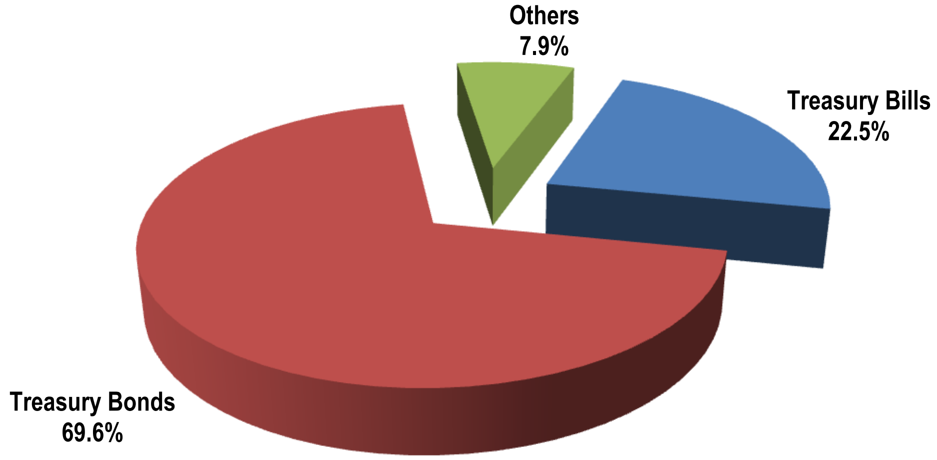
Others consist of CBK Overdraft to GoK, clearing items awaiting transfer to PMG, commercial bank advances and Tax Reserve Certificates.
Source: Central Bank of Kenya

3.2 Domestic Debt by Instrument

The stock of outstanding Treasury Bonds increased by 24.3 percent from Ksh 360,744 million in June 2009 to Ksh 448,615 million in June 2010 while Treasury Bills increased by 35.7 percent from Ksh 116,794 million to Ksh 158,494 million over the same period as shown in Table 3.1. Consequently, the proportion of Treasury Bonds in total domestic debt declined from 69.6 percent to 67.9 percent while Treasury Bills rose from 22.5

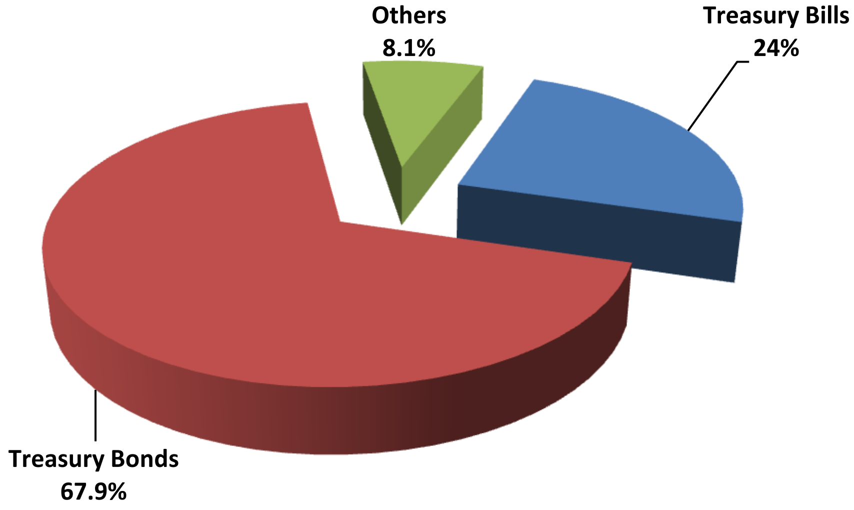
percent to 24.0 percent during the period as shown in Charts 3.1(a) and 3.1(b). Under the domestic debt borrowing strategy, the Government sought to achieve and maintain the ratio of Treasury Bills and Treasury Bonds at 25:75. Government Long Term Stocks also decreased to stand at Ksh 753 million or 0.1 percent of the total domestic debt as there was redemptions of the instrument during the year. The proportion of Pre-1997 CBK advances to Government dropped from 6.4 percent to 4.9 percent due to a net repayment of Ksh 1,110 million made during the fiscal year 2009/10.

Chart 3.1(a): Domestic Debt by Instrument, June 2009



Source: Treasury and Central Bank of Kenya

Chart 3.1(b): Domestic Debt by Instrument, June 2010



Source: Treasury and Central Bank of Kenya

The programme of issuance and reopening of benchmark bonds begun by Government in September 2007 to address illiquidity in the domestic bond market continued in the financial year 2009/10. The programme is aimed at strengthening the Government securities market by promoting secondary trading and improving liquidity around specific benchmark bonds. The program also sought to lengthen maturity of domestic debt in order to minimize rollover risk. In the period under review, the ratio of Treasury Bonds to Treasury Bills was 74:26 which is in line with the debt management strategy of lengthening the average time to maturity of domestic debt. Reflecting on the success of lengthening the maturity of domestic debt, the average maturity profile of outstanding Government securities increased from 0.5 years in June 2001 to 4.6 years in June 2010.

As a reflection of improved liquidity in the secondary bonds market, turnover at the Nairobi Stock Exchange (NSE) rose threefold from Ksh 109,476 million in 2008/09 to Ksh 337,300 million in 2009/10. In addition, the corporate bonds market recorded increased activity with seven (7) new corporate bonds listed at the NSE, two (2) each from CFC Ltd, Shelter Afrique, and Safaricom respectively and one (1) from KenGen. The entry of these bonds increased the number of listed corporate bonds at the NSE to sixteen (16) by June 2010.

3.3 Domestic Debt by Holder

Table 3.2 shows that commercial banks continue to hold the largest share of domestic debt at 53.2 percent up from 48.4 percent in June 2009. In the same period, the share of domestic debt held by non-bank investors declined from 43.2 percent in June 2009 to 38.7 percent in June 2010.

Table 3.2: Domestic Debt by Holder, Ksh Million

Holder	Jun-09		Jun-10		Change
	Amount	%	Amount	%	
Banks of which:	**290,778**	***56.1***	**401,794**	***60.8***	**111,016**
o/w Central Bank	40,061	*7.7*	50,215	*7.6*	10,154
Commercial Banks	250,717	*48.4*	351,579	*53.2*	100,862
Non-Banks of which:	**227,729**	***43.9***	**258,474**	***39.2***	**30,745**
o/w Non-Bank Financial Institutions	3,651	*0.7*	2,956	*0.5*	(695)
Other Non-Bank Sources	224,078	*43.2*	255,518	*38.7*	31,440
Total	**518,507**	***100***	**660,268**	***100***	**141,761**

Source: Central Bank of Kenya

3.4 Treasury Bills and Bonds by Tenor

Treasury Bills accounted for 26.1 percent of outstanding Government securities held as at end June 2010, from 24.4 percent as at end June 2009 (Table 3.3). The trend in Treasury Bills holdings indicates investor preference for 182- and 364-day paper. The 364-day Treasury Bill was introduced in August 2009 and is issued bi-monthly.

Outstanding Treasury Bonds with a maturity range of 1 year to 5 years amounted to Ksh 138,323 million (22.8 percent) of total Government securities while those with a maturity range of between 6 and 9 years stood at Ksh 114,820 million (18.9 percent). Treasury Bonds with a maturity profile of 10 years and above amounted to Ksh 195,472 million (32.2 percent). This maturity distribution along the yield curve indicates a large concentration of Government securities holding at the short end. However, there has been a gradual shift as the proportion of Treasury Bonds holding in the 10 - 25 year tenors increased to 32.2 percent in June 2010 from 27.0 percent in June 2009 while the 1–9 year category decreased to 41.7 percent from 48.6 percent during the same period. This development has contributed to the successful establishment of a stable yield curve for Government securities. The success is largely attributed to the implementation of the benchmark bonds programme that began in September 2007.

Table 3.3 shows that the benchmark Treasury Bonds (2, 5, 10, 15, 20, and 25 year) accounts for the largest share of outstanding Treasury Bonds (65 percent as at end June 2010) reflecting the success of the benchmark bond programme.

Table 3.3: Outstanding Treasury Bills and Bonds by Tenor, Ksh Million

	Jun-09			Jun-10			Change
Security Type	**Amount**	**Cum. amount**	***Cum (%)***	**Amount**	**Cum. amount**	***Cum. (%)***	
Treasury Bills (Days)							
91	23,523	23,523	*4.9*	23,663	23,663	*3.9*	140
182	93,271	116,794	*24.4*	85,337	109,000	*17.9*	(7,934)
364	-	-	-	49,494	158,494	*26.1*	49,494
Treasury Bonds (Years)							
1	14,789	14,789	*3.1*	0	0	*0.0*	0.0
2	45,206	59,995	*12.6*	46,577	46,577	*7.7*	1,371
3	12,798	72,793	*15.2*	1,781	48,358	*8.0*	(11,017)
4	12,914	85,707	*17.9*	3,384	51,742	*8.5*	(9,530)
5	52,787	138,494	*29.0*	86,582	138,323	*22.8*	33,795
6	38,769	38,769	*8.1*	48,986	48,986	*8.1*	10,217
7	24,153	62,922	*13.2*	21,353	70,339	*11.6*	(2,800)
8	17,944	80,866	*16.9*	26,721	97,060	*16.0*	8,777
9	12,615	93,481	*19.6*	17,760	114,820	*18.9*	5,145
10	44,415	44,415	*9.3*	69,090	69,090	*11.4*	24,675
11	4,031	48,446	*10.1*	4,031	73,122	*12.0*	0.0
12	28,494	76,940	*16.1*	33,051	106,173	*17.5*	4,557
15	42,303	119,243	*25.0*	61,929	168,102	*27.7*	19,626
20	9,526	128,769	27.0	20,361	188,463	31.0	10,835
25	0	0		7,008	195,472	32.2	7,008
Total	**477,538**			**607,109**			**129,571**

Source: Central Bank of Kenya

3.5 Treasury Bills by holder

The stock of Treasury Bills rose by 35.7 percent from Ksh 116,794 million in June 2009 to Ksh 158,494 million in June 2010 (Table 3.4). The proportion held by Commercial Banks increased from Ksh 74,630 million (63.9 percent) in June 2009 to Ksh 137,497 million (86.8 percent) in June 2010. Insurance companies, Parastatals and Pension funds scaled down their holdings to 5.5 percent, 1.2 percent and 2.9 percent respectively during the period under review.

Table 3.4: Outstanding Treasury Bills, Ksh Million

Holders	June 2009		June 2010	
	Amount	%	Amount	%
Commercial Banks	74,630	*63.9*	137,497	*86.8*
NBFIs	200	*0.2*	212	*0.2*
Insurance companies	17,041	*14.6*	8,757	*5.5*
Parastatals	2,329	*2.0*	1,961	*1.2*
Pensions Funds (including NSSF)	6,955	*6.0*	4,647	*2.9*
Others	15,639	*13.4*	5,420	*3.4*
Total *	**116,794**	***100***	**158,494**	***100***

***Excludes repurchase order (Repo) bills for monetary policy**

***Source: Central Bank of Kenya*.**

3.6 Treasury Bonds by holder

Outstanding Treasury Bonds increased from Ksh 360,744 million in June 2009 to Ksh 448,615 million in June 2010 as shown in Table 3.5. Commercial Banks continue to hold the highest share of Treasury Bonds. However holdings by Parastatals, Insurance companies, and Pension Funds recorded the highest increase while the share of Commercial Banks declined. Holdings in the 'others' category which includes individual investors recorded a decline from 4.7 percent to 1.3 percent during the period under review.

Table 3.5: Outstanding Treasury Bonds, Ksh Million

Holders	June 2009		June 2010	
	Amount	%	Amount	%
Commercial Banks	180,691	*50.1*	217,562	*48.5*
NBFIs	8,564	*2.4*	9,832	*2.2*
Insurance Companies	38,097	*10.6*	54,642	*12.2*
Parastatals	2,685	*0.7*	17,123	*3.8*
Pensions Funds (including NSSF)	113,825	*31.6*	143,799	*32.0*
Others	16,882	*4.7*	5,657	*1.3*
Total	**360,744**	***100.0***	**448,615**	***100***

Source: Central Bank of Kenya

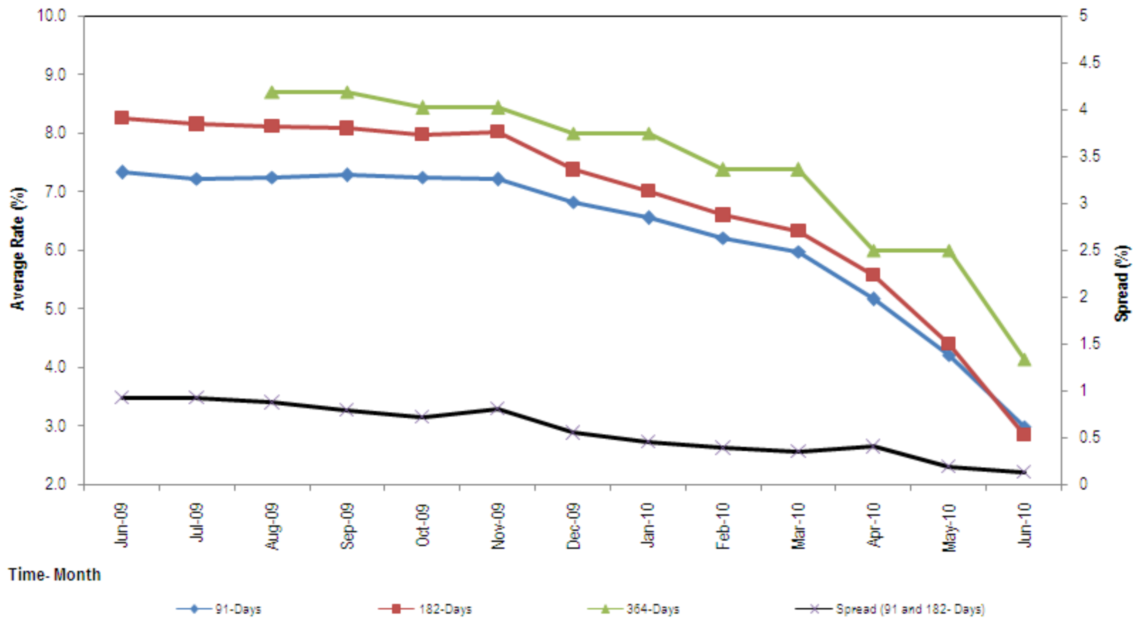
3.7 Average Interest Rates on Government Securities

Average interest rates for Treasury Bills declined during the period under review. The 91-day Treasury Bill rate fell by 433 basis points from 7.332 percent in June 2009 to 2.998 percent in June 2010. Likewise, average interest rate for the 182-day Treasury Bill dropped by 541 basis points to 2.856 percent during the period (Chart 3.2). The 364-day Treasury bill which is issued bi-monthly also declined by 457 basis points from 8.712 percent in August 2009 to 4.138 percent in June 2010.

Market yield rates on benchmark bonds also declined. The 2-year bond with a coupon rate of 7.108 percent declined by 373 basis points to register a market yield of 3.383 percent while the 20-year bond with a coupon rate of 11.25 percent declined by 184 basis points to register a 10.066 percent market yield. The decline in interest rates is attributed to decline in inflation rate and the Central Bank of Kenya monetary policy stance. The Monetary Policy Committee reduced the Central Bank Rate (CBR) from 8 percent to 6 percent while the Cash Ratio Requirement (CRR) was reduced from 5 percent to 4.5 percent over the same period.

Average interest rates on the 91-day and 182-day Treasury Bills continue to act as benchmark rates in the money markets. Changes to these rates cause adjustments to both commercial banks' deposit and lending rates, pricing of tradable debt securities and structure of investment portfolio.

Chart 3.2: Interest Rates Trend on Treasury Bills, July 2009 - June 2010



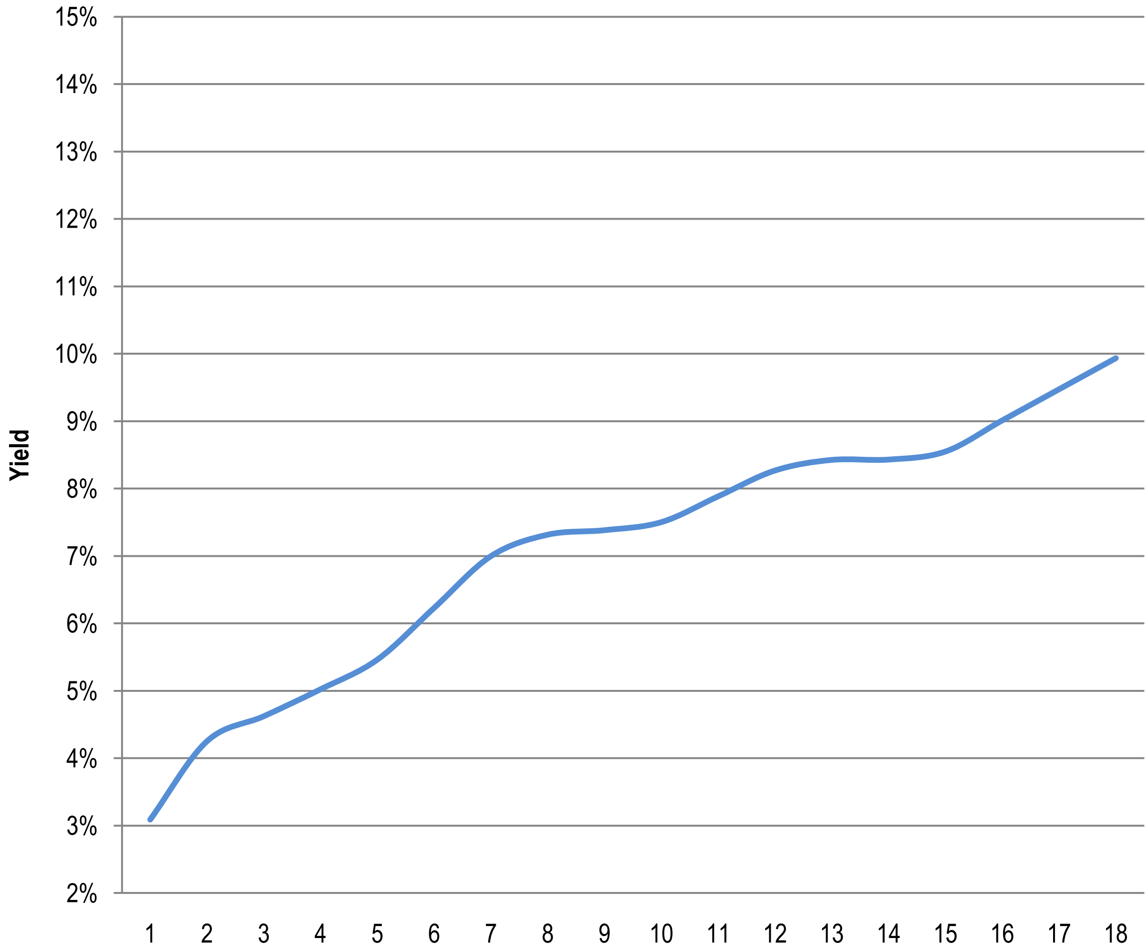
Note: Scale for the spread (91 and 182 days) is on the right hand side while the scale for average rates is on the left hand side of the graph.
Source: Central Bank of Kenya

3.8 Government Securities Yield Curve

As shown in Chart 3.3, the Government securities trading yield curve shows a normal ascending shape indicating that the yields rise as maturity lengthens. The yield curve reflects the risk premium associated with the uncertainty about the future rate of inflation and the risk this poses to the future value of cash flows. Investors price these risks into the yield curve by demanding higher yields for maturities further into the future.

The successful development of the yield curve has been boosted by implementation of a predictable Government domestic borrowing programme, introduction and reopening of benchmark bonds, and enhanced liquidity in the secondary market for Government Bonds. In addition, continued domestic borrowing mainly through issuance of Treasury Bonds of varying features has helped firm up the mid to long end of the yield curve as well as lower rollover risk associated with short term debt. Short term debt held in Treasury Bills is associated with frequent rollovers that could trigger sudden increases in interest rates.

Chart 3.3: Government of Kenya Securities Yield Curve, June 2010



Source: Central Bank of Kenya

3.9 Domestic Interest Payments

As shown in Table 3.6, Government expenditure on interest and other charges on domestic debt during the fiscal year 2009/10 amounted to Ksh 57,381 million, a 25 percent increase from 2008/09. As a proportion of revenue, expenditure and GDP, domestic interest increased over the period largely due to increased domestic borrowing. Interest payments on Treasury Bills declined by 9.5 percent to Ksh 8,156 million, while a significant increase of 38.6 percent was observed in interest payments on Treasury Bonds, which is consistent with the increase in bond holdings.

Table 3.6: Domestic Interest Payments and Ratios

Type of Debt	**Interest (Ksh Million)**		**Percentage Change**
	2008/09	**2009/10**	
Treasury Bills	9,041	8,156	(9.5)
Treasury Bonds	32,416	44,934	38.6
CBK Commission	3,000	3,000	0
Pre - 1997 Debt	1,025	993	(3.1)
Others	467	298	(36.1)
Total	**45,949**	**57,381**	**24.9**
Ratios (%)			
Domestic Interest/Revenue	9.8	11.3	1.5
Domestic Interest/Expenditure	6.8	7.9	1.1
Domestic Interest/GDP	2.0	2.4	0.4
Domestic Interest/Total Interest	89.1	90.2	1.1

Source: Treasury and Central Bank of Kenya

4. PUBLICLY GUARANTEED DEBT

4.1 Legal Framework

Publicly guaranteed debt refers to the debt owed by the country's public entities to both foreign and local creditors but guaranteed by Central Government. The debts may be denominated in domestic or foreign currency.

The Guarantee (Loans) Act, Laws of Kenya Cap 461 provides the legal framework for issuance of Government loan guarantees to public entities. The current ceiling for guaranteed debt under the Act is Ksh 80 billion which is subject to review by Parliament through a Sessional Paper by the Minister for Finance. To minimize contingent liabilities to the central government and ensure prudent borrowing, public enterprises are required to seek prior approval from their parent ministries, respective management boards and the Ministry of Finance before contracting any direct or guaranteed loans.

Table 4.1: Publicly Guaranteed Debts, Ksh Million

Organization	Year Loan Contracted	Purpose of Loan	Creditor	Loan Balance	
				June 09	June 10
City Council of Nairobi	1985	Umoja II Housing Project	USA	393.5	348.20
Kenya Broadcasting Corporation	1989	KBC Modernization Project	Japan	6,075.6	6,268.6
Telkom Kenya Ltd	1990	Purchase of Microwave Telephone System	Canada	370.4	376.8
Tana and Athi River Development Authority	1990	Tana Delta Irrigation Project	Japan	2,607.4	2,717.4
East African Portland Cement	1990	Cement Plant Rehabilitation Project	Japan	3,241.3	3,378.00
KenGen Ltd	1995	Mombasa Diesel Generating Power Project	Japan	5,488.8	5,899.10
	1997	Sondu Miriu Hydropower Project	Japan	5,046.4	5,472.50
	2004	Sondu Miriu Hydropower Project II	Japan	8,509.8	9,758.9
	2007	Sondu Miriu Hydropower Project – Sang'oro Power Plant	Japan	892	1,620.7
Kenya Ports Authority	2007	Mombasa Port Modernization Project	Japan	322.3	819.5
Kenya Farmers Association	2005	Revival of KFA	Local banks	Unutilized	Unutilized
National Cereals & Produce Board (GSM-102)*	2009	Importation of maize under GSM-102	USA	Unutilized	Unutilized
TOTAL				**32,947.5**	**36,659.7**

Source: Treasury

****GSM-102: USA Export Credit Guarantee Programme***

4.2: Stock of Guaranteed Debt

As shown in Table 4.1, outstanding Government guaranteed debt increased by Ksh 3,712.2 million to Ksh 36,659.7 million in June 2010 from Ksh 32,947.5 million in June 2009. The increase was attributed to new disbursements for KenGen – Sondu Miriu Hydropower Project, Kenya Ports Authority - Mombasa Port Modernization Project and partly due to depreciation of the Kenya Shilling against the Japanese Yen in which the bulk of the guaranteed debt is denominated.

Table 4.2: Payments by the Government on Guaranteed Debt in 2009/2010, Ksh Million

Borrower	Quarter 1		Quarter II		Quarter III		Quarter IV		Cumulative June 2010	
	Projected	Actual	Projected	Actual	Projected	Actual	Projected	Actual	Projected	Actual
NCC	38.64	35.65	-	-	36.65	-	-	35.72	75.29	71.37
TARDA	161.41	158.91	-	-	159.46	-	-	157.44	320.87	316.35
KBC	405.37	392.35	-	-	-	391.34	401.32	-	806.69	783.69
TOTAL	**605.42**	**586.91**	**-**	**-**	**196.11**	**391.34**	**401.32**	**193.16**	**1,202.85**	**1,171.41**

Source: Treasury

4.3: Payments by the Government on Publicly Guaranteed Debt

During the period under review, the Government as a guarantor spent Ksh 1,171.41 million to service guaranteed debts owed by public enterprises in financial distress. As shown in Table 4.2, these public enterprises included City Council of Nairobi, Kenya Broadcasting Corporation and Tana and Athi River Development Authority. Due to delays in internal payment processes in the fourth quarter of 2009/10, the projected amount of Ksh 401.32 million remained outstanding as at end June 2010 but was eventually paid in July 2010 after the end of the 2009/10 Financial year.

4.4: Cumulative GoK Payments of Guaranteed Debt

As shown in Table 4.3, the net cumulative repayments of guaranteed debt by the Government on behalf of public enterprises between 1991 and June 2010 stood at Ksh 20,901.6 million. The top net debtors to the Central Government under publicly guaranteed debt are Kenya Broadcasting Corporation (Ksh 6,474.1 million), Nzoia Sugar Company (Ksh 6,127.8 million), City Council of Nairobi (Ksh 3,773.5 million) and Tana and Athi River Development Authority (Ksh 2,288.2 million), all four accounting for 90 percent of un-reimbursed balances.

Payments of Ksh. 1,028 million paid on behalf of Telkom Kenya Ltd and reflected in 2008/2009 has been offset as a result of Telkom restructuring in 2009 when the corporation relinquished its Safaricom shares to the Government.

Table 4.3: Cumulative Central Government Payments of Guaranteed Debt, Ksh Million, 1991-2009/10

	Parastatals	Principal	Interest	Total	Reimbursement to GoK by Parastatals	Balance
1	KenGen	1,487.4	1,156.5	2,643.9	2,609.7	34.2
2	Tana and Athi River Development Authority(TARDA)	1,383.6	904.9	2,288.5	0.3	2,288.2
3	Tana and Athi River Development Company (TRDC)	1,001.3	1,154.3	2,155.6	2,148.4	7.2
4	Kenya Posts and Telecommunication Corporation	675.8	691.5	1,367.3	1,080.7	286.6
5	Kenya Railways	1,151.0	203.9	1,354.9	715.1	639.8
6	Nzoia Sugar Company	4,605.8	1,523.5	6,129.3	1.5	6,127.8
7	City Council of Nairobi	1,758.3	2,139.9	3,898.2	124.7	3,773.5
8	National Housing Corporation	9.2	42.4	51.6	31.9	19.7
9	East Africa Sugar Industries Muhoroni	226.7	75.8	302.5	-	302.5
10	Kenya Broadcasting Corporation	3,790.7	2,727.4	6,518.1	44.0	6,474.1
11	Development Finance Company of Kenya	92.4	39.9	132.3	45.0	87.3
12	Industrial and Commercial Development Corporation	484.9	181.4	666.3	-	666.3
13	Kenya Fiber Corporation	0.0	14.7	14.7	-	14.7
14	Agricultural Development Corporation	106.7	72.9	179.6	-	179.6
15	Telkom Kenya Limited	931.9	96.1	1,028.0	1,028.0	-
	TOTAL	**17,696.7**	**11,158.0**	**28,854.7**	**8,840.3**	**20,901.6**

Source: Treasury

5. ON-LENT LOANS AND CONTINGENT LIABILITIES

5.1 Background

Government on-lending is an arrangement where Central Government normally through the Ministry of Finance contracts loans from either external or domestic sources and lends it to a state owned enterprise or institution. In certain circumstances, Central Government may use tax revenue as a source of loan funds. The rationale for this lending arrangement is two-fold:

1. The state-owned enterprise or institution does not have a strong balance sheet to attract funding from external or domestic sources on competitive terms;
2. The project to be financed is a social welfare enhancing investment that would efficiently be executed by a state-owned enterprise or institution on behalf of the Government.

Depending on the source of borrowing, the Central Government would record a debt (liability) and a corresponding domestic claim (asset) in its portfolio. Borrowing by state-owned entities with or without Government guarantees constitutes potential contingent liability to the Government. In the event of default on on-lent loans and guaranteed or non-guaranteed loans, Central Government will bear the cost of the debt.

Effective Government on-lending is now recognized as an important debt management function. Significant arrears or defaults in the on-lent portfolio can severely constrain efficient debt management, and would ultimately impact on fiscal sustainability. Establishing better institutional processes and ensuring transparency in on-lending operations and monitoring of contingent liabilities are expected to contribute positively towards the management of costs and risks in government debt.

In an attempt to automate loan records, the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) data base was installed in 1988 in the Department of Government Investments and Public Enterprises (DGIPE) in the Ministry of Finance. CS-DRMS is basically an external and domestic debt management package but has been adopted to manage both on-lent and direct loans. DGIPE has designed a customized manual ledger for capturing the loan accounts. To date, the manual ledgers and CS-DRMS exist side by side.

5.2 On-Lent Loan Portfolio

Table 5.1 shows that the total on-lent loan portfolio amounted to Ksh 90,813.7 million as at June 2010, out of which outstanding loans, arrears and accrued interest stood at Ksh 42,876.1 million, Ksh 14,522.2 million and Ksh 33,415.4 million, respectively. Over 90 percent of the loan portfolio is non-performing due to poor financial performance of borrowers.

Table 5.1: Status of On-Lent Loans Portfolio as at June 2010, Ksh Million

Ministry/Sector	June 2009 (Ksh Million) Outstanding loans	June 2010 (Ksh Million) Outstanding loans	Principal Arrears	Accrued interest	Total
Local Government	7,635.0	7,635.0	4,843.8	10,715.6	23,194.4
Transport	2,967.9	5,636.4	2,405.7	13,029.6	21,071.7
Energy	12,923.5	12,268.3	3,354.8	4,192.9	19,816.0
Agriculture	5,473.3	5,635.5	3,197.3	3,636.2	12,459.0
Water and Irrigation	2,290.5	9,070.9	-	1,255.9	10,326.8
Trade	1,196.2	1,096.2	128.8	3.9	1,228.9
Environment & Natural Resources	593.0	593.0	399.9	1.1	994.0
Finance	477.9	411.2	34.5	5.5	451.2
Others*	530.5	529.6	157.4	584.7	1,271.7
Total	**34,087.8**	**42,876.1**	**14,522.2**	**33,415.4**	**90,813.7**

**Others include: - Tourism, Education and Land*

Source: Treasury

During the period under review, the outstanding on-lent loans excluding arrears and interest increased by Kshs 8,788.3 million from Ksh 34,087.8 million to Ksh 42,876.1 million. This increase is attributed to new loans on-lent to the water, transport and agriculture sectors.

5.3 Receipts From On-Lent and Direct Loans

As shown in Table 5.2, principal receipts by GoK amounted to Ksh 907.6 million during 2009/10 against a projection of Ksh 1.5 billion. Over the same period, Ksh 681.3 million was collected as interest receipts against a projection of Ksh 1.3 billion. Total collections therefore translates to only 57 percent performance of the portfolio

Table 5.2 Principal and Loan Interest Receipts, 2009/10, Ksh Million

Organization	Principal Receipts	Interest Receipts	Total
KenGen	655.2	460.4	1,115.6
Agro Chemical & Food Co. Ltd	-	150.0	150.0
Uchumi Supermarkets	100.0	-	100.0
Nyeri Water and Sewerage	50.4	14.2	64.6
Cooperative Bank of Kenya	33.5	9.4	42.9
K -Rep Bank	33.3	6.2	39.5
Kenya Airports Authority	-	23.4	23.4
Nzoia Sugar Co.	20.0	-	20.0
New KCC	11.0	1.7	12.7
ICDC	-	10.0	10.0
Agricultural Finance Corporation	3.2	1.8	5.0
Sony Sugar Co.	-	3.0	3.0
Agricultural Settlement Fund	0.9	1.2	2.1
Agricultural Society of Kenya	0.2	-	0.2
Total	**907.7**	**681.3**	**1,589.0**

Source: Treasury

5.4 Contingent Liabilities

Potentially large and unreported contingent liabilities have been identified as posing additional risk to the sustainability of public debt. In this regard, a comprehensive financial review/study was commissioned in 2007 by the Government to establish the extent of contingent liabilities in twenty five (25) state corporations. The review established that the identified corporations have actual liabilities adding up to Ksh 63.8 billion and contingent liabilities estimated at Ksh 22.1 billion. Subsequently, this review would be extended to other state corporations. With the implementation of a devolved system of government the extent of contingent liabilities is expected to increase as liabilities of county governments are taken into account.

6. DISPUTED EXTERNAL COMMERCIAL DEBT

6.1 Background

Kenya's external commercial debt estimated at Kshs 20,458 million or 1.7 percent of total public debt at end June 2010 is in arrears. In August 2004, the Government suspended payments pending verification of the amount due on each of the eleven (11) suppliers' credit contracts which constitute external commercial debt. Soon after the suspension, the Controller and Auditor General undertook a special audit on eighteen (18) suppliers' credit contracts as follows:

1. Eleven (11) contracts that are in dispute.
2. Three (3) contracts though fully paid by the Government, relate to projects in dispute as under (1) above.
3. Four (4) contracts in which the creditors voluntarily returned all funds paid by the Government.

In four (4) of the eleven (11) suppliers' credit contracts in dispute, the creditors sought legal re-dress in courts or arbitrations in UK, The Hague and Switzerland for breach of contract. In response, the Government engaged reputable and experienced international law firms to represent its interest.

In February 2005, the Kenya Anti-Corruption Authority (KACC) began investigations on these contracts. Although some progress has been made, the pace has been slowed down by court orders that have prohibited KACC from carrying out investigations in some areas.

6.2 Audits on External Commercial Debts

The Controller and Auditor General's Special Audit Report was tabled in Parliament in May 2006. The findings indicated that procurement laws and regulations were violated in the contracting process, that the projects were overpriced and in most cases, no credit was extended by the creditors. The Report recommended that professional valuation of works, goods and services be carried out to determine value for money.

In January 2007, the Ministry of Finance contracted PricewaterhouseCoopers (PwC) to conduct forensic audit and valuation. PwC submitted the forensic audit and valuation report on 31st July 2007. The PwC Report established that those contracts were procured in an irregular manner and that the pricing, financing, and other terms of the contract do not reflect terms obtained on arms length commercial transactions.

Specifically, the PwC Report cited:

- Significant overpricing
- Financing charged in excess of the financing that was needed
- Under-delivery of supplies provided under the contracts
- Serious contraventions of Kenya public expenditure law

- Circumstantial evidence that these contracts were corruptly procured

As a precautionary measure, the Government sought to eliminate financial risk exposure on Promissory Notes issued under seven (7) contracts. The Minister for Finance, in consultation with the Attorney General, issued a Caveat Emptor in December 2007 informing all parties that the underlying contracts were fraudulent and hence the Promissory Notes were illegal and the Government would not honour them. The Caveat Emptor was circulated to banks worldwide through SWIFT and placed in the local dailies.

6.3 Government Position on Existing Commercial Debts

The Government is committed to resolving the dispute on the outstanding external commercial debts on the basis of fair value received by the Government on each contract as determined by independent valuers and based on legal advice. On the other hand, the Government will take legal measures to recover from the suppliers any payments over and above the fair value received. One of the 11 projects in dispute, Project Nexus has been successfully resolved and negotiations are on-going in one other project. Two Cabinet Memoranda are awaiting submission to the Cabinet to seek approval on resolution of the remaining projects.

6.4 Lessons Learnt from External Commercial Debt

Some key lessons have been learnt on this matter referred to by the media as the “Anglo Leasing” scandal. First, weak institutional arrangement of public debt management undermined accountability and transparency in the contracting, disbursement and payment processing of external loans. To address this weakness, the Government embarked on a comprehensive public debt management reform program to set up a fully functional Debt Management Department at the Ministry of Finance responsible for all matters relating to public debt. Second, inadequate public financial management system weakens budget formulation and implementation. This partly explains payment of suppliers’ credit contracts against under-deliveries. Public Financial Management Reforms have been undertaken to strengthen the budget, accounting and control systems in Central Government. Third, weak legal framework on public procurement that permitted single sourcing on account of national security concerns. Whereas restricted tendering system or single sourcing is not wrong per se, it can be subject to abuse in absence of robust framework of checks and balances. This matter has to a large extent been addressed in the Public Procurement and Disposal Act 2005.

Finally, lack of formal debt policy and strategy that guides debt management operations created fiscal risk through high cost borrowing to finance non-priority expenditures. As a remedial measure, the Government has prepared a Medium Term Debt Strategy (MTDS) that indicates the sources, amount and loans of preferred borrowing to finance the budget deficit taking into account both cost, risk and debt sustainability. Specifically, external commercial borrowing will be contracted transparently from reputable financial institutions or through issuance of international sovereign Bond.

7. DEBT STRATEGY AND DEBT SUSTAINABILITY

7.1 Background

The Government through the technical assistance of World Bank/IMF/ComSec has developed a Medium Term Debt Strategy (MTDS 2010), a second of its kind that explicitly enhanced transparency of the Government debt management decisions. This plan, like its predecessor (MTDS 2009) seeks to balance cost and risk of both existing public debt portfolio and alternative borrowing mix. In addition, the strategy incorporates initiatives to develop a vibrant domestic debt market. Before the advent of MTDS, the government's debt management objectives were achieved through ad hoc strategies. These strategies were neither entrenched in the institutional or legal framework. To institutionalize the production of the MTDS, its publication will be provided for in regulations to operationalize the Public Financial Management Act (PFMA) under the new Constitution.

The MTDS provides a guide to achieving the broad objective of Debt Management in Kenya of closing the financing gap at least cost with a prudent degree of risk. Over the years, the Government has sought to maximize concessional external borrowing while taking cognizance of interest cost and rollover risk of accumulating domestic debt. More recently, external concessional borrowing has been difficult to obtain with creditors lending on hardened terms. In view of this, the Government explored options that enabled it achieve its objectives. Due to high demand for infrastructure financing, the Government increased domestic borrowing to supplement the external financing which also went towards achieving the objective of deepening the domestic market.

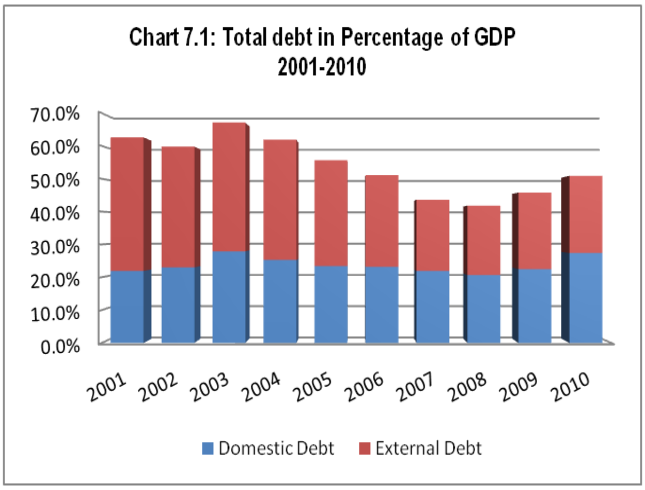
7.2 Cost and Risk Characteristic of Existing Debt Portfolio

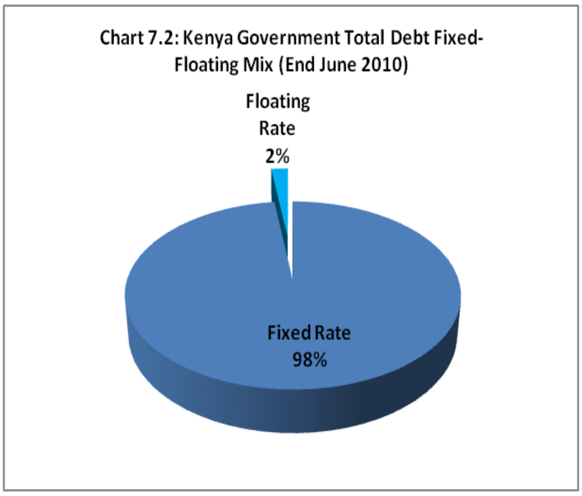
The 2010 MTDS envisaged growth of public debt stock as at June 2010 to reach 42 percent of GDP in nominal terms. In addition, the structure of the debt portfolio was expected to change reflecting the higher proportion of domestic debt to foreign debt. Table 7.1 and Chart 7.1 show the proportion of domestic and foreign debt as at end June 2010. This reflects the desire of the Government to reduce reliance on external sources in light of their volatility.

Table 7.1: External and Domestic Debt, End June 2010

	Percent of GDP	Percent Share of Total Debt	Weighted Average Interest Rate
External Debt	22	46	1.2
Domestic Debt	26	54	10.4
Total Debt	48	100	6.2

Source: Treasury and Central Bank of Kenya





For the first time since 2007, domestic debt has surpassed foreign debt constituting 54 percent of total debt as at end June 2010. This indicates a significant exposure of the debt portfolio to interest cost and refinancing risk associated with domestic debt. To mitigate against refinancing risk, the Government has made a deliberate effort to lengthen the maturity profile of domestic debt. On the other hand, the external debt portfolio consists of a range of instruments denominated in four major currencies (Euro, US dollar, Sterling Pound and Yen).

Like in 2009 MTDS, the 2010 MTDS recommends a shift in the composition of debt towards long term domestic debt over the medium term to minimize both cost/risk in the debt portfolio. Therefore, the relevant considerations arising from the current debt portfolio (as summarized in Table 7.2) that influence the 2010 MTDS is based on seeking to reduce exchange rate exposure, and reduce refinancing exposure in the domestic market, while containing the cost of debt.

Table 7.2: Cost and Risk Considerations of Debt Portfolio, End June 2010

Characteristics of Existing Portfolio	Ex-ante Risks	Ex-ante Cost
Currency Composition (FX = 46%; DX=54%)		
External, mostly concessional	Exchange rate risk	Low
Domestic	No exchange rate risk	High
Maturity Profile (ATM = 8.9 years)		
External, mostly concessional (ATM =11.8 years)	Low refinancing risk	Low
Domestic (ATM = 5.5 years)	Medium refinancing risk	High
Interest Rate Composition		
(Fixed=98%; Floating=2%)	Low interest rate risk	

Source: 2010 MTDS

7.3 Sources of finance

7.3.1 External Sources of Financing

Official Sources

IDA, ADB/AfDB and EEC/EIB are the main multilateral creditors. They account for on average over 90 percent of the outstanding multilateral debt as at end June 2010. IDA is the single biggest source of external resources, accounting for over 70 percent of the outstanding multilateral debt. The multilateral share of total external debt increased due to a disbursement of Ksh 16.3 billion (USD 209 million) from the International Monetary Fund (IMF) under the Exogenous Shock Facility (ESF) for Balance of Payments (BoP) support. In terms of bilateral creditors, Japan, France, Germany and China are the main creditors accounting for 75 percent of the bilateral debt. Japan is the largest bilateral donor, accounting for over 49 percent of the bilateral debt.

Commercial Sources

Kenya's Commercial debt constitutes 4 percent of total public external debt. All Commercial debt is in dispute. The Government potential to access international capital market remains, particularly given the general recovery in international market conditions and Kenya's promising economic growth.

7.3.2 Domestic Sources of Financing

Since 2003, the Government has been implementing a domestic borrowing strategy to raise resources while promoting the development of the domestic debt market. The 2010 MTDS sought to promote the benchmark bonds to stimulate secondary trading, enhance liquidity, lower the costs of borrowing and facilitate the establishment of a reliable yield curve for Government securities.

In June 2010, the Government successfully issued the longest Treasury bond (25 years) of Ksh 12 billion as part of the effort to strengthen the bond programme.

The investor base remains dominated by the domestic banking sector, which represent about 50 percent of the investor base. Pension funds and insurance companies are the next most significant investor group.

7.4 Baseline Assumptions for 2010 MTDS

7.4.1 Macroeconomic Assumptions

- Growth in real GDP has continued to improve with output expanding faster that projected. In 2009/10, real GDP growth rate was 3.6 percent and is expected to gradually grow attaining 6.8 percent in 2013. With improvement of the global economic growth, the public deficit and external balance are expected to improve.

- Inflation is expected to remain at around 5 percent, in line with the CBK objectives, and the exchange rate to remain stable. Balance of payments is expected to return to surplus from FY2010/11 due to an increase in remittances and FDI compared to 2009.

- Gross international reserves are assumed to reach the EAC target of 4 months of imports by FY2013/14.

7.4.2 External Borrowing Assumptions

The following pricing assumptions for different external sources of financing underlie the *2010 MTDS*.

- Concessional external loans are priced at a fixed rate of 0.75 percent, with a 40-year tenor and a 10-year grace period. These loans are assumed to be denominated in SDRs.

- Semi-concessional loans are assumed to be contracted from official creditors or export credit agencies. These loans have a fixed interest rate of 2.5 percent, a maturity of 30 years including a 10-year grace period. These loans are denominated in Euros and US. Dollars.

- Accessing the international capital market is priced off the assumed effective yield curve, which is based on the underlying forward US Treasury curves plus an assumed credit spread. The analysis assumes that international capital markets could be accessed if concessional resources fall below target. Alternatively, domestic borrowing could increase. The international sovereign bond would have a maturity of 10 years, with a bullet repayment.

- The credit spread is set at 450 basis points. A 5-year bond is expected to have a spread of 410 basis points.

- The net external borrowing for financial year 2010/11 is 3.0 percent of GDP and expected to decline to 1.8 percent of GDP in the financial year 2012/13.

7.4.3 Domestic Borrowing Assumptions

- Domestic borrowing will be undertaken through issuance of Treasury Bills and Treasury Bonds at the ratio of 30:70 and ensuring that the maturity structure of the existing portfolio is lengthened to minimize refinancing risk.

- Domestic borrowing is about 75 percent of total net borrowing in financial year 2010/11.
- Net domestic borrowing for financial year 2010/11 is 3.8 percent of GDP and is expected to fall to 1.8 percent of GDP in the financial year 2012/13.

7.4.4 2010 Optimal Strategy

The 2010 optimal strategy entails:

- 75 percent net domestic financing and 25 percent external financing.
- The domestic borrowing will be medium and long term with issuance of benchmark bonds in the tenor of 2, 5, 10, 15 and 20 years.
- External borrowing will comprise of 17 percent on concessional terms while 8 percent will be on semi-concessional terms.
- Issuance of Eurobond will be held in abeyance as developments in the International market are monitored.

7.5 Debt Sustainability

The 2010 Debt Sustainability Analysis carried out under the joint World Bank-IMF debt sustainability framework concluded that Kenya faces low risk of external debt distress (see Appendices 7 and 8). Total public debt, however shows greater risk of unfavorable debt developments, especially under a shock to GDP growth, unchanged fiscal policy, or materialization of some contingent liabilities. Debt sustainability is assessed in relation to policy-dependent debt burden thresholds. Kenya is classified as a "*Medium Performer*" in terms of quality of its policies and institutions as measured by a three year average of Kenya's score on the World Bank's Country Policy and Institutional Assessment (CPIA) index.

In Table 7.2, a **worst case scenario** is simulated where a "borrowing shock" is applied by assuming a Government borrowing (or materialization of contingent liabilities) equivalent to 10 percent of GDP in 2010. The results indicate that in the medium term (by 2013); the debt burden indicators will breach one debt sustainability benchmark, the net present value of debt as a percentage of GDP.

Table 7.2: Sensitivity Analysis for Key indicators of public debt

	Benchmark for 'Medium Performer'	Actual 2009	Estimate 2010	***Impact of 10% of GDP increase in borrowing*** *(or materialization of contingent liabilities)* ***in 2010*** **Debt indicators in 2013**
NPV of debt as % of:				
GDP	40	38	42	48
Revenue (Incl. grants)	240	162	165	179
Debt service as % of Revenue	30	27	25	26

Source: Treasury

In the financial year 2010/11, borrowing limit is set at 4.8 percent of GDP and increase to 5.0 percent of GDP in 2011/12.

7.6 Implementing the 2010 MTDS

To support the development of a MTDS, reforms to improve the enabling environment will be implemented in the following areas:

- The Government will determine a borrowing plan to accompany the *2010 MTDS* and meet the financing requirement for the coming fiscal year. The Government will communicate the plan to the market participants.

- If the risk parameters in 2010 MTDS result in a significant deviation from the outturn, the strategy will be reviewed and possibly revised.

- To support the debt management strategy, the Government will develop a robust legal framework.

- The Government will increasingly monitor the contingent liabilities as they have implication on debt sustainability.

- Continued collaboration with partners, such as the US Treasury, the World Bank and the IFC will be encouraged in developing the Government and corporate bond markets and capacity building in debt management.

In conclusion, the 2010 MTDS complements the debt sustainability framework which is concerned with long-term sustainability of debt. It provides a systematic approach to decision making on the appropriate composition of external and domestic borrowing to finance the budget in the financial year 2010/11, taking into account both cost and risk.

Whereas Kenya’s current debt level is sustainable, long-term debt sustainability depends on a number of factors such as real GDP growth, sound macro-economic policy mix, including prudent debt management strategy.

8. PUBLIC DEBT REPORTS AND STATISTICS IN KENYA

8.1 Introduction

The buildup of public and publicly guaranteed debt since independence has compelled the Government of Kenya to put in place a Computer Based Debt Management System (CBDMS). The CBDMS of choice for Kenya is the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS). According to best practice, all debt management activities should be supported by an accurate and comprehensive debt management system. Apart from enhancing efficiency by ensuring proper management of debt data and timely debt service payment, the system improves transparency in government financial accounts and quality of budgetary and debt reporting.

8.2 Prerequisites for Reporting

While it is important to have a debt recording and management system, the importance of maintaining accurate and timely data cannot be gainsaid. Towards this end, Kenya migrated its validated external debt data from CS-DRMS version 7.2 to the CS-DRMS 2000+ in June 2006. This was in line with the recommendations of the Joint IMF/World Bank mission that had undertaken an evaluation of the debt management activities in Kenya in 2003/2004. Establishment of a comprehensive debt database at the Ministry of Finance and Central Bank of Kenya on a common platform was identified as a key reform in addressing the structural weaknesses in public debt management in Kenya. Inaccurate debt data would lead to wrong policy decisions with attendant dire consequences. The Back Office of the DMD therefore keenly updates and validates data to ensure accuracy, timeliness, periodicity and consistency, which are key factors in data quality.

Accurate debt data is also a prerequisite in formulation of medium term scenarios (MTS) and debt ratios. MTS are numerical evaluations that take account of expectations of the behavior of economic variables to determine conditions under which debt and other indicators would stabilize at reasonable levels. Debt ratios include: debt to exports, debt to GDP, debt service to exports, debt service to fiscal revenue, and reserves to short-term debt. MTS and debt ratios are used to analyze the debt burden of a country and its sustainability.

8.3 Debt Data Reporting Initiatives

In the aftermath of the 1994/95 international financial crises, there was increased recognition that reliable, timely, comprehensive, and accessible data could facilitate formulation and implementation of sound economic policies and investment decisions, which in turn reduce turbulence in the financial markets. This realization increased recognition of the challenges that globalization implies for data producers. In today's globalised village, it is good practice for countries to regularly report on debt statistics to a common database. Below are debt data reporting initiatives by international finance institutions to which Kenya is currently reporting.

8.3.1 IMF Initiatives

In recognition of the "**public good**" features of data and as a service to its membership, the IMF's governing body called for data standards in April 1995. In March 1996, the Special Data Dissemination Standard (SDDS) was approved as a guide for countries having, or seeking access to international capital markets. In December 1997, the General Data Dissemination System (GDDS) was approved as a guide for all member countries. Kenya currently reports under the GDDS and QEDS.

i. SDDS Reporting

SDDS is a standard that identifies best practices in the dissemination of economic and financial data for countries that subscribe to specific, internationally agreed data dissemination practices. Subscription to the SDDS is voluntary but **observance is an obligation**. Annual observance reports by countries are prepared since 2007.

ii. GDDS Reporting

GDDS provides a framework for participating countries to develop a strategy for strengthening their statistical systems. It fosters the application of sound methodology, the adaptation of good compilation and dissemination practices and the observance of procedures ensuring professionalism.

GDDS encourages reporting of gross external debt position and future external debt service payments. It covers public and publicly-guaranteed external debt which is disaggregated by maturity - short and long term. Periodicity for the GDDS is biannual for four quarters and two semesters where timeliness is set at one to two quarters lag. Though many countries do not track it, the IMF strongly encourages reporting of non-guaranteed private sector external debt.

8.3.2 World Bank Initiatives

i. Debtor Reporting System

The World Bank Debtor Reporting System (DRS) has been in existence since 1951. Using standardized forms, the database captures detailed information at loan level for external borrowing of reporting countries. The World Bank has always recognized the importance of reliable and timely information on external debt. Since its inauguration, each member country that has received either a World Bank loan or an International Development Association (IDA) credit has consented in the loan or credit agreement to provide information on external debt. Compliance is critical and if a recent debt report is not in possession of the Bank when a loan is being negotiated, the borrowing country is requested to furnish it.

The data reported under DRS is published annually in summary form in the ***Global Development Finance****.* The detailed data is used by Bank staff in assessing the ability of countries to service outstanding debt and to support future foreign borrowing, in making economic projections and, in general, in the analysis of a country's overall economic position.

The timely receipt of complete and accurate reports from countries participating in the DRS is extremely important, not only to the borrower and to the Bank but also to many other users of the data, especially governments, international institutions, commercial banks, and other private lenders. The data is used extensively by those interested in world economic development; the United Nations, other international organizations, the academic community, industrial and commercial enterprises, and economic and financial publications. Data is sent to the World Bank annually with an end of March reporting deadline for the preceding calendar year.

ii. QEDS Reporting

Kenya was among twenty seven (27) countries invited to participate in the newly introduced GDDS/QEDS reporting project in August 2007. The invited countries were all Low Income Countries (LICS) who were likely to meet the minimum requirement of the project. The QEDS (Quarterly External Debt Statistics), reporting project focuses on the public and publicly-guaranteed external debt stock data. Debt data is reported quarterly to the World Bank using prescribed tables. The data is placed in an international database, which helps researchers and other interested parties carry out various studies including comparison of the financial situation of the participating countries.

iii. Public Sector Debt Reporting

The Public Sector Debt Reporting is a new initiative begun in 2010 to which 133 countries including Kenya have been invited to participate. Public sector debt covers domestic and external debt of the general government, public nonfinancial corporations, and public financial corporations. The World Bank and the International Monetary Fund are joining efforts to present public sector debt statistics in an online centralized database. It is designed to complement the existing Quarterly External Debt Statistics (QEDS) database.

The main purpose of this database is to facilitate timely dissemination of debt data of the public sector of members of the IMF's General Data Dissemination System (GDDS) and, over time, the Special Data Dissemination Standard (SDDS). By presenting such data (and related metadata) in a central location, the database will support macroeconomic analysis and cross-country comparisons.

The classifications and definitions are harmonized with those used in other statistical manuals, such as the *System of National Accounts 2008 (SNA2008)*, *Government Finance Statistics Manual 2001 (GFSM2001)*, and *Balance of Payments and International Investment Position Manual (BPM6)*. The participation of countries is voluntary and the minimal requirement is reporting of central government debt by instrument.

Countries are encouraged to provide tables for other sectors and additional breakdowns are also encouraged if these data are available or can be produced. The database frequency is quarterly, but if some components are only available annually, those data would also be acceptable.

8.3.3 OECD Handbook of African Public Debt

In 2007 the OECD invited African countries to participate in debt data reporting project on a pilot basis. The data is published in an official Handbook of African Public Debt and Kenya is among the first batch of participating countries in this initiative.

Participation in all these initiatives has been made possible by the fact that Kenya now has a fairly comprehensive, accurate and timely debt database.

8.4 Task Force on Finance Statistics (TFFS)

To assist the reporting countries compile their statistics, the Inter Agency Task Force on Finance Statistics (TFFS) has published the *External Debt Statistics*: *Guide for Compilers and Users*. The publication was prepared to provide guidance on the following:-

- Concepts, definitions and classifications
- Sources and techniques for compilation
- Analytical use of external debt data.

The Guide provides common understanding of the issues involved in preparation and presentation of debt statistics and reports. It also provides standardization to enable all the countries report to a common database. The TFSS is chaired by the IMF and includes international agencies involved in public sector debt: the BIS, ComSec, ECB, Eurostat, OECD, Paris-Club Secretariat, UNCTAD and World Bank.

Active participation in debt reporting initiatives is an indication that Kenya's Debt Management is continually moving towards internationally accepted best practice.

9. REFORMS IN PUBLIC DEBT MANAGEMENT

9.1 Introduction

The Treasury and the Central Bank of Kenya (CBK) have been implementing reforms that seek to address structural weaknesses in public debt management. The reforms are being supported by two donor funded projects: Financial and Legal Sector Technical Assistance Project (FLSTAP) and the Public Financial Management Reforms (PFMR) project.

The objective is to transform the Debt Management Department (DMD) to a Debt Management Office (DMO) at the Ministry of Finance anchored on an effective staff retention framework to effectively perform public debt management functions in accordance with best practice. The CBK will spearhead reforms in the domestic debt markets to broaden the investor base, promote secondary trading and develop a yield curve for Government securities. Under the new institutional arrangement, debt management operations will be guided by both appropriate legal framework and Medium Term Debt Strategy (MTDS).

9.2 Achievements

9.2.1 The Treasury

In line with FLSTAP Implementation Plan, the following reforms have been undertaken since 2004:

i. Consolidation of Debt Management functions
   - DMD Organization Structure set up with clearly defined functions. This will be complemented by the envisaged development of a Treasury Scheme of Service.
   - Staffing and staff training at DMD has been enhanced.
   - Annual DMD Work Plans developed, implemented, monitored and evaluated.
   - DMD Service Charter developed.

ii. Strengthening Back Office Operations
   - New CS-DRMS 2000+ software installed and upgraded periodically.
   - Updated and validated external debt data in the CS-DRMS database.
   - Use of CS-DRMS 2000+ in Back office operations, debt service forecasts for the annual Budget and other debt statistics.
   - Computerization of external debt service Payment Advice (PA) through an in-house developed system. This process was previously done manually, resulting to delays, inaccuracies and subsequent accumulation of arrears and resultant penalty payments.
   - Strengthened Back Office payment and settlement operations.
   - Developed Back Office operations manual.

- Activated the Fibre Optic link between the Treasury and CBK to facilitate electronic data transmission.

iii. Strengthening of Front and Middle Office Operations
   - Active participation in domestic and external borrowing strategy design and implementation.
   - Increased and accurate dissemination of debt information through Weekly Domestic Borrowing Bulletin, *Monthly Debt Bulletin, Quarterly Economic and Budget Review (QEBR), Annual Public Debt Management Report* and other ad hoc reports.
   - Developed Front and Middle Office operations manuals.
   - Increased staffing and training.

iv. Development of a MTDS
   - In June 2010, the Government published the second debt strategy, the *2010 Medium Term Debt Strategy* (MTDS).

9.2.2 Central Bank of Kenya

The Central Bank of Kenya as a fiscal agent of Government in liaison with MoF and other stakeholders in the market has undertaken a number of successful initiatives geared towards development of domestic debt markets as follows:

i. Legal framework - Amendment of the Internal Loans Act to allow for among other things, dematerialization of Government securities and extended definition of securities beyond the traditional Treasury Bills and Bonds.
ii. Lengthening of maturity profile of domestic debt – The aim of lengthening the maturity profile of domestic debt is to minimize refinancing risks associated with short term debt. From June 2001 to June 2010, the proportion of Treasury Bills to Bonds has been reversed from 70:30 to 24:76. This milestone has helped in the development of a more reliable yield curve. Consequently, the average maturity of domestic debt has improved from 0.5 years in June 2001 to 4.6 years as at June 2010.
iii. Product diversification and market development – In June 2010, the CBK successfully issued the first 25-year bond which recorded 361% subscription rate and was reopened in July 2010 registering a 105% subscription on the Ksh 15bn offered. This was a big milestone in lengthening maturity of debt and developing a reliable yield curve for pricing long term money and other financial assets. During the period under review, the Bank through the MLF adopted the issuance of market determined coupon bonds (as opposed to pre-set coupon), only for benchmark tenors up to 10 years, as a reflection of market maturity in price discovery and information processing. This strategy has generated significant cost savings in debt service both through low discount and interest payments. Product diversification also included packaging of bonds with different features or

incentives to both issuer and investors as well as design of savings products for the retail market to be launched in the next financial year.

iv. Roll out of Horizontal (Inter-bank) Repurchase Agreements (Repos) – The CBK rolled out this facility in September 2008 where commercial banks can make use of Treasury Bills or/and Bonds to manage liquidity requirements. This has improved liquidity distribution and has supplemented existing credit lines arrangements among banks. On average, about Ksh 2.5 – 4 billion is transacted every month under this arrangement.

v. Issuance of Infrastructure Bonds (IFBs) – The Government issued the first IFB in February 2009 which attracted huge market appetite owing to its attractive features and public confidence from ownership of development projects in the country. By June 2010, IFBs totalling Kshs 51.5 billion had been issued. Following the successful lead taken by Government, other public institutions like KenGen have followed suit and successfully tapped the huge potential in the local capital market to mobilize funds through project specific bonds.

vi. Investor Education and Public Awareness and effective market promotion of debt securities markets – CBK has undertaken this initiative through the mass media, its website, regular meetings/workshops with market stakeholders and general public. This milestone has greatly supported full subscriptions of government bonds and impressive take-up of new products.

vii. Successful implementation of the Benchmark Bonds programme – Following adoption of the programme in September 2007, the Bank has consistently issued only bond tenors of 2, 5, 10, 15 and 20 years identified in the programme and has continued to reopen the same to build adequate liquidity critical for robust secondary trading. Other strategies including bond switches/exchanges and conversions that are important in development of benchmark bonds and smoothening of future maturities are being explored. With the CBK implementing these initiatives, it is expected that under each tenor category, only one bond will show characteristics for benchmark status as reflected by holding and trading levels among other factors. This is critical for promoting faster growth of the bond market and development of a firm and reliable yield curve that is generally acceptable by the market.

viii. Reduced moratorium period for trading newly issued bonds – In liaison with NSE, CBK introduced the Automated Trading System (ATS) which has reduced the waiting time for trading newly issued Treasury Bonds from 7 days to 3 days in order to improve trading of new securities and enhance secondary market activity. Plans to put in place efficient modern systems at the primary market are at an advanced stage in order to reduce the settlement period to just a day which is important in boosting liquidity of bonds and increasing investor appetite.

ix. Introduced the 364-day Treasury bill that has consistently received positive uptake from the market. This paper is tradable Over The Counter (OTC) with settlement of cash and securities taking place at CBK.

9.3 Challenges in Implementation of Reforms

i. Resource constraint to support capacity building in debt management.
ii. Staffing constraints and staff retention (high staff turnover) at DMD.
iii. Delays in receiving technical assistance under donor funded programs.

9.4 Future Reforms

9.4.1 The Treasury

The Treasury through DMD plans to implement the following reforms to further strengthen public debt management:

i. Strengthen staffing and staff retention policy at DMD.
ii. Execute the Agency Agreement between the Treasury and CBK.
iii. Ensure sustainable capacity to design and implement Medium Term Debt Strategy.
iv. Prepare the Public Finance Management Legislation for enactment by Parliament in accordance with the new constitution.

9.4.2 Central Bank of Kenya

The CBK in liaison with other stakeholders will continue to undertake the following reforms:

i. Online bidding for Government securities and dissemination of auction results.
ii. In liaison with MOF and CMA, oversee the establishment of Over the Counter (OTC) trading for bonds.
iii. Continue implementation and firming up of the Benchmark Bonds programme.
iv. Fully Implement the Government Securities Market Makers (GSMM) programme as a first phase in the Primary Dealership (PD) framework.
v. Continue to implement remaining recommendations in the Crown Agents Consultancy Report under FLSTAP.

10. OUTLOOK FOR THE MEDIUM TERM

10.1 Public Debt Stock in the Medium Term

As shown in Table 10.1, overall public debt is projected to increase in nominal terms from Ksh 1,225,720 million in June 2010 to Ksh 1,277,964 million in June 2011 and rise to Ksh 1,691,724 million in June 2014. However, as a proportion of GDP, public debt in nominal terms is projected to decline from 50.9 percent of GDP in June 2010 to 47.1 percent of GDP in June 2011 and to decline further to 43.6 percent in June 2014.

External debt is projected to increase from Ksh 565,452 million in June 2010 (23.5. percent of GDP) to Ksh 618,632 million (22.8 percent) in June 2011 and to Ksh 818,701 million (21.1 percent) in June 2014. On the other hand, domestic debt is projected to increase from Ksh 660,268 million (27.4 percent of GDP) in June 2010 to Ksh 659,332 million (24.3 percent) in June 2011 and to Ksh 873,023 million (22.5 percent) in June 2014.

Table 10.1: Projected Public Debt Stock, Ksh Million

	2009/10	2010/11	2011/12	2012/13	2013/14
External Debt	565,452	618,632	676,434	741,210	818,701
% of GDP	*23.5*	*22.8*	*22.0*	*21.4*	*21.1*
Domestic Debt	660,268	659,332	765,600	817,410	873,023
% of GDP	*27.4*	*24.3*	*24.9*	*23.6*	*22.5*
Total Public Debt	**1,225,720**	**1,277,964**	**1,442,034**	**1,558,620**	**1,691,724**
% of GDP	*50.9*	*47.1*	*46.9*	*45.0*	*43.6*
Memoranda Items					
Nominal GDP	2,409,600	2,713,300	3,074,700	3,463,600	3,878,700
Ordinary Revenue	507,500	605,900	688,000	800,900	905,200

Source: Treasury

10.2 Debt Service in the Medium Term

Table 10.2 shows that although in nominal terms overall debt service is projected to increase by 87 percent in the medium term, as a ratio to GDP, the debt burden indicators will be within sustainable levels. Total debt service is projected to increase from 15.9 percent of revenue in 2009/10 to 17.4 percent of revenue in 2010/11 and decline to Ksh 16.7 percent of revenue in 2013/14. Nearly 70 percent of the increase in debt service is attributed to domestic interest.

Domestic interest is projected to increase from Ksh 57,381 million in 2009/10 to Ksh 75,972 million in 2010/11 and to Ksh 104,763 million in 2013/14. However, as a percentage of GDP, average domestic interest will remain at 12 percent of revenue in the medium term. On the other hand, interest on external debt is projected to increase from Ksh 6,238 million in 2009/10 to Ksh 8,140 million in 2010/11 and rise to Ksh 15,520 million in 2013/14, an average 1.5 percent of revenue over the period.

Annual principal repayments on external debt will increase from Ksh 17,373 million in 2009/10 to Ksh 21,706 million in 2010/11 and to Ksh 31,041 million in 2013/14 or an annual average of 3.4 percent of revenue.

Table 10.2: Central Government Projected Debt Service, Ksh million

	2009/10	2010/11	2011/12	2012/13	2013/14
Domestic Interest	57,381	75,972	83,017	93,517	104,763
% of Revenue	11.3	12.5	12.1	11.7	11.6
External Interest	6,238	8,140	9,224	13,854	15,520
% of Revenue	*1.2*	*1.3*	*1.3*	*1.7*	*1.7*
Total Interest	63,619	84,112	92,241	107,371	120,283
% of Revenue	*12.5*	*13.8*	*13.4*	*13.4*	*13.3*
External Principal Repayments	17,373	21,706	24,598	24,245	31,041
% of Revenue	***3.4***	***3.6***	***3.6***	***3.0***	***3.4***
Total Debt service	**80,992**	**105,818**	**116,839**	**131,616**	**151,324**
% of Revenue	***15.9***	***17.4***	***17.0***	***16.4***	***16.7***

Source: Treasury, BOPA 2009

10.3 Infrastructure Bonds

In financial year 2009/10, the Government issued Infrastructure Bonds (IFBs) amounting to Ksh 34.4 billion in December 2009 and March 2010 which were oversubscribed by over 130 percent. The proceeds of the bonds were used to finance projects in the roads, energy and water sectors. In financial year 2010/11 sector-specific IFBs worth Ksh 31.6 billion will be issued to finance various infrastructure projects across the country.

GLOSSARY

- **Concessionality**
  A measure of the softness of a credit reflecting the benefit to the borrower compared to a loan at market rate. Technically, it is calculated as the difference between the nominal value and the present value of the debt service as of the date of disbursement, calculated at a discount rate applicable to the currency of the transaction and expressed as a percentage of the nominal value.

- **Debt Relief**
  Agreements by creditors to lessen the debt burden of debtor countries by either rescheduling interest and principal payments falling due over a specified time period, sometimes on concessional basis, or by partially or fully cancelling debt service payments falling due in a specified period of time.

- **Debt Rescheduling**
  A form of debt re-organization in which payments of principal and/or interest previously due at a specified time are deferred for repayment on a new schedule following negotiations between the creditor and debtor.

- **Debt Service**
  The amount of funds necessary for or used in the payment of interest or amortization charges of a debt.

- **Debt Sustainability**
  Sustainable debt is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding accumulation of arrears, while allowing an acceptable level of economic growth.

- **Debt Sustainability Analysis**
  Conducted in the context of medium-term scenarios. These scenarios are numerical evaluations that take account of expectations of the behaviour of economic variables and other factors to determine the conditions under which debt and other indicators would stabilize at reasonable levels, the major risks to the economy, and the need and scope for policy adjustment. In these analysis, macroeconomic uncertainties, such as the outlook for the current account, and policy uncertainties, such as for fiscal policy, tend to dominate the medium term outlook.

- **Disbursement**
  The actual international transfer of financial resources or of goods or services by the lender to the borrower.

- **Domestic Borrowing**
  Government borrowing through issuance of Government securities and direct borrowing from the Central Bank.

- **Export Credit**
  Loans for the purpose of trade and which are not represented by a negotiable instrument. They may be extended by the official or the private sector. If extended by the private sector, they may be supported by official guarantees.

- **External Borrowing**
  Government borrowing from both official (Government or Government agencies) and private institutions domiciled outside the country.

- **Government Securities**
  Financial instruments used by the Government to raise funds from the primary market.

- **Grant Element**
  It measures the concessionality of a loan, in the form of the present value of an interest rate below the market rate over the life of a loan.

- **London Club**
  An international group of private commercial banks whose credits are not covered by government guarantees or insurance. The group is designed to provide a common approach to rescheduling of such debts owed by debtor countries.

- **Monetary Policy**
  The management of the money in an economy to achieve desired economic conditions such as the overall level of prices.

- **Present Value**
  The present value (PV) of debt is a measure that takes into account the degree of concessionality. It is defined as the sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the appropriate market rate. Whenever the interest rate on a loan is lower than the market rate, the resulting PV of debt is smaller than its face value.

- **Official Development Assistance**
  Loans from official development agencies to countries received by the public sector, for promotion of economic development and welfare as the main objective and, extended at concessional financial terms (with minimum grant element of 25 percent). Loans and credits for military purposes are excluded in this definition.

- **Paris Club**
  The Paris Club is an ad-hoc gathering of creditor Governments, chaired by high ranking official of the French Treasury, which meets for the purpose of rescheduling debts. The Paris Club is open to all creditor governments that are willing to adhere to its unwritten rules and practices and that have claims against a debtor country seeking rescheduling. Debtor countries must have strong adjustment programmes supported by the upper credit tranche IMF arrangements before being considered for debt relief.

- **Primary Market**
  A market in which initial issue of financial instruments is made.

- **Public Debt**
  Outstanding financial liabilities of the Government arising from past borrowing. It includes Government guaranteed debts to State Corporations and Local Authorities.

- **Public Domestic Debt**
  Part of the overall debt owed by the Government to creditors domiciled in the economy. The debt includes money owed to commercial banks, non-bank financial institutions and individuals.

- **Public External Debt**
  Part of the overall debt owed by the Government to creditors domiciled outside the economy. The debt includes money owed to private commercial banks, other governments, or international financial institutions such as the IMF and World Bank.

- **Secondary Market**
  A market for already issued financial instruments.

- **Suppliers' Credit**
  An arrangement under which a supplier or exporter agrees to allow the customer to defer payment under a sales contract.

- **Treasury Bills**
  Short term debt instruments currently with maturities of 91, 182 and 364 days issued by the Treasury. In Kenya, this instrument is issued by the Treasury through the CBK.

- **Treasury Bonds**
  Medium to long-term term debt instruments issued by the Treasury. In Kenya, this instrument is issued by the Treasury through the CBK.

- **Yield Curve**
  Relationship between the return an investor receives by holding a debt instrument to maturity and time value of money.

APPENDICES

Appendix 1(a): External Debt by Creditor, Ksh Million

CREDITOR	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
1. BILATERAL								
AUSTRIA	2,262	2,664	2,468	2,437	3,031	3,252	2,218	1,814
BELGIUM	2,255	5,693	5,188	5,247	4,625	4,750	7,078	6,774
CANADA	2,700	2,322	1,297	1,267	1,470	1,400	1,585	1,609
DENMARK	1,936	2,521	2,365	2,392	2,144	2,336	2,354	2,291
FINLAND	267	215	134	160	118	120	129	119
FRANCE	13,543	18,416	18,106	18,643	18,886	22,903	28,103	28,173
GERMANY	8,144	11,236	12,941	13,910	13,479	15,764	16,441	16,235
ITALY	8,744	9,129	7,182	8,741	7,151	6,344	5,750	4,347
JAPAN	79,433	85,353	84,469	79,464	66,167	72,845	90,840	98,847
NETHERLANDS	3,738	4,103	2,208	2,752	2,367	2,318	2,140	1,877
UK	2,655	2,863	2,818	2,705	2,628	2,458	2,354	2,128
USA	6,653	5,821	6,057	5,842	5,206	4,863	5,670	5,729
CHINA	2,182	2,306	2,486	2,398	3,132	4,024	11,821	20,597
OTHERS	8,083	10,273	9,949	8,918	11,300	9,824	9,452	5,806
TOTAL	**142,593**	**162,914**	**157,669**	**154,877**	**141,706**	**153,200**	**185,933**	**196,347**
2. MULTILATERAL								
ADB/ADF	23,845	25,366	**23,560**	25,837	23,630	30,135	32,651	41,000
EEC/EIB	8,566	10,178	8,468	13,335	10,248	11,235	11,063	10,498
IBRD	853	111	38	-	-	-	-	-
IDA	194,065	216,366	210,311	204,306	190,877	206,633	243,013	256,422
IMF	5,989	8,270	12,641	11,409	13,703	17,548	35,125	34,110
OTHERS	512	367	655	663	1,801	2,673	5,781	6,617
TOTAL	**233,829**	**260,658**	**255,764**	**255,550**	**240,259**	**268,223**	**327,633**	**348,647**
3.COMMERCIAL BANKS	**3,597**	**2,912**	**1,776**	**1,274**	**574**	**-**	**-**	**-**
4.EXPORT CREDIT	**27,034**	**16,674**	**19,244**	**19,536**	**18,427**	**18,543**	**23,837**	**20,458**
GRAND TOTAL	**407,053**	**443,157**	**434,453**	**431,237**	**400,966**	**439,967**	**537,403**	**565,452**

Source: Treasury

Appendix 1(b): External Debt by Creditor, USD Million

CREDITOR	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
1. BILATERAL								
AUSTRIA	30.5	33.5	32.4	33.0	45.6	50.3	28.7	22.1
BELGIUM	30.4	71.6	68.0	71.0	69.6	73.4	91.7	82.7
CANADA	36.4	29.2	17.0	17.2	22.2	16.3	20.6	19.6
DENMARK	26.1	31.7	31.0	32.4	32.3	36.1	30.5	28.0
FINLAND	3.6	2.7	1.8	2.2	1.8	1.9	1.7	1.5
FRANCE	182.6	231.6	237.3	252.3	277.8	354.0	364.2	343.9
GERMANY	109.8	141.3	169.6	188.3	198.1	243.7	213.1	198.2
ITALY	117.9	114.8	94.1	118.3	107.6	95.2	74.5	53.1
JAPAN	1,071.0	1,073.4	1,109.5	1,075.6	1,006.0	730.6	1,177.4	1,206.8
NETHERLANDS	50.4	51.6	28.9	37.3	35.6	35.8	27.7	22.9
UK	35.8	36.0	36.9	36.6	39.6	37.9	30.5	26.0
USA	89.7	73.2	79.4	79.1	70.9	68.9	73.5	69.9
CHINA	29.4	29.0	32.1	32.5	46.9	62.2	153.2	251.4
OTHERS	109.0	129.0	130.9	120.7	117.7	151.9	122.5	70.9
TOTAL	**1,922.6**	**2,048.9**	**2,069.0**	**2,096.3**	**2,071.5**	**1,958.3**	**2,409.8**	**2,397.0**
2. MULTILATERAL								
ADB/ADF	321.5	319.0	**310.0**	349.7	353.1	465.8	423.2	500.5
EEC/EIB	115.5	128.0	111.0	180.5	150.4	173.7	143.4	128.1
IBRD	11.5	1.4	0.5	-	-	-	-	-
IDA	2,516.6	2,721.0	2,757.0	2,765.4	2,867.7	3,133.9	3,083.9	3,130.4
IMF	80.8	104.0	165.7	154.4	206.9	271.2	455.2	416.4
OTHERS	6.9	4.8	6.0	9.0	32.7	41.3	140.5	80.8
TOTAL	**3,052.8**	**3,278.2**	**3,350.2**	**3,459.0**	**3,610.8**	**4,085.9**	**4,246.3**	**4,256.1**
3.COMMERCIAL BANKS	**48.5**	**36.6**	23.3	**17.2**	**4.3**	**-**	-	**-**
4.EXPORT CREDIT	**364.5**	**209.7**	**252.3**	**264.4**	**271.0**	**286.6**	**308.9**	**249.7**
GRAND TOTAL	**5,388.4**	**5,573.4**	**5,694.8**	**5,837.0**	**5,957.6**	**6,330.7**	**6,965.0**	**6,902.8**

Source: Treasury

Appendix 2: Outstanding Government Securities by Tenor, Ksh Million

Tenor	Jun-01	Jun-02	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
91-DAY	109,539	61,420	48,186	29,500	42,761	37,632	22,017	17,980	23,523	23,663
182-DAY	6,901	20,630	30,558	33,439	29,177	57,144	72,405	58,313	93,271	85,337
1-YEAR	20,197	15,258	14,593	9,343	30,953	1,000	8,728	13,191	14,789	-
1.5 YEAR	-	3,999	-	-	-	-	-	-	-	-
2-YEAR	9,952	33,117	44,214	28,237	24,686	39,738	37,652	31,747	45,206	46,577
3-YEAR	9,969	31,846	40,973	44,817	27,898	31,225	31,174	26,663	12,798	1,781
4-YEAR	-	9,800	20,187	26,520	26,160	26,287	19,281	16,539	12,914	3,384
5-YEAR	4,381	9,336	18,003	23,086	22,740	28,391	28,787	43,511	52,787	86,582
6-YEAR	-	2,982	11,800	17,909	20,434	33,105	48,333	47,589	38,769	48,986
7-YEAR	-		2,801	8,558	10,330	13,566	15,884	24,154	24,153	21,353
8-YEAR	-	-	3,907	11,969	11,969	15,287	17,944	17,944	17,944	2,671
9-YEAR	-	-	2,368	9,555	9,555	12,615	12,615	12,615	12,615	17,760
10-YEAR	-	-	2,705	8,634	8,634	17,113	22,113	34,415	44,415	69,090
11-YEAR	-	-	-	-	-	-	4,031	4,031	4,031	4,031
12-YEAR	-	-	-	-	-	-	8,766	8,766	28,494	33,051
15-YEAR	-	-	-	-	-	-	16,892	32,114	42,303	61,929
20-YEAR	-	-	-	-	-	-	-	1,912	9,526	20,361
25-YEAR	-	-	-	-	-	-	-	-	-	7,008
TOTAL	**160,939**	**188,388**	**240,295**	**251,567**	**265,297**	**313,103**	**366,622**	**391,484**	**477,538**	**607,109**

Source: Treasury and Central Bank of Kenya

Appendix 3: Treasury Bonds Issues, July 2009 - June 2010, Order by Issue Date

Issue no	Tenure (Years)	Amount at face (Ksh Million)	Amount at cost (Ksh Million)	Issue date	Maturity date
FXD 2/2008/1*	10	12,622,700,000.00	11,889,719,842.45	27/07/2009	16/07/2018
FXD 3/2008/5	5	10,548,350,000.00	10,007,558,283.00	24/08/2009	19/08/2013
FXD 3/2009/2	2	7,974,550,000.00	7,770,688,031.50	21/09/2009	19/09/2011
FXD 1/2009/5	5	3,452,800,000.00	3,244,273,664.50	21/09/2009	15/09/2014
FXD 1/2009/1	15	9,420,450,000.00	8,704,400,015.00	26/10/2009	07/10/2024
IFB 2/2009/1	6	9,193,700,000.00	8,951,439,359.00	07/12/2009	30/11/2015
IFB 2/2009/1	9	5,145,000,000.00	4,746,053,148.60	07/12/2009	26/11/2018
IFB 2/2009/1	12	4,558,950,000.00	4,702,177,296.00	07/12/2009	22/11/2021
FXD 1/2008/2*	20	10,834,800,000.00	10,878,059,346.00	28/12/2009	05/06/2028
FXD 1/2010/2	2	7,170,850,000.00	7,154,347,663.00	01/02/2010	30/11/2012
FXD1/2009/5	5	9,786,300,000.00	10,091,005,171.30	01/02/2010	15/09/2014
IFB 1/2010/8	8	8,776,471,185.00	8,850,654,261.00	01/03/2010	22/02/2016
IFB 1/2010/8	6	7,131,578,815.00	7,191,858,447.00	01/03/2010	19/02/2010
FXD 2/2010/2	2	6,157,300,000.00	6,176,747,452.00	29/03/2010	26/03/2012
FXD 1/2010/1	15	10,206,450,000.00	10,419,787,590.00	29/03/2010	10/03/2025
FXD 1/2010/1	10	12,052,600,000.00	12,178,301,620.00	26/04/2010	13/04/2020
FXD 1/2010/5	5	11,924,850,000.00	11,985,755,755.00	24/05/2010	18/05/2015
FXD 1/2010/2	25	7,008,150,000.00	7,497,638,186.50	28/06/2010	28/05/2035

Source: Central Bank of Kenya

***Reopened Bonds**

Appendix 4: Macro-Risks and Implications for the Medium Term Debt Strategy

Implications for Debt Strategy Preferences				
Macroeconomic Factors	**Impact**	**Target source**	**Currency**	**Other comments**
Balance of Payment Risks				
Terms of trade shock	Exchange rate	Domestic	DX	Improve market capacity
FDI/Private capital flow volatility	Exchange rate	Domestic	DX	Improve market capacity
Remittance dependence	Exchange rate	Domestic	DX	Improve market capacity
Tourism receipts dependence	Exchange rate	Domestic	DX	Improve market capacity
Low foreign exchange reserves	Exchange rate		FX	Diversify trading partners
Fiscal Risks				
Potential volatility (revenues)	Expenditure volatility	Market	DX/FX	Create fiscal space, prioritize expenditure and improve efficiency
Capital spending aid dependent	Growth volatility		DX/FX	Improve relationship with donors, improve absorptive capacity and implementation efficiency
Contingent liabilities	Debt level increase	Market	DX/FX	Create fiscal space and strengthen overall PFM framework
Monetary Risks				
High inflation	Impede market development, higher interest costs			
Negative real interest rate	Impact real money investors and deposit growth			Increase credibility of monetary policy, improve monetary operational framework and monetary transmission mechanism to reduce inflation premium
Natural Disasters				
Natural Disasters	Growth volatility	Market	DX/FX	Diversify economy and explore the possibility of commodity hedge

Source: 2010 MTDS

Appendix 5: Government Securities Market Yields for June 2010

Tenor		Current Market Yield (%)	Last issue average rate (%)	Dated	Last issue coupon rate (%)	Tenor Differential
91- days	0.25	2.620	2.620	21.06.10	-	-
182- days	0.5	3.273	3.273	14.06.10	-	0.653
364- days	1		2,962	16.08.10	-	0.801
1 year	1	3.0911	6.010	08.02.10	-	-0.182
2 year	2	4.254	6.936	29.03.10	7.108	4.254
3 year	3	4.624	9.696	25.09.06	8.250	0.371
4 year	4	5.024	9.438	26.02.07	11.000	0.400
5 year	5	5.465	9.592	01.02.10	9.500	0.440
6 year	6	6.232	11.288	30.04.07	11.500	0.768
7 year	7	7.000	10.325	26/.07.07	9.750	0.768
8 year	8	7.317	12.955	26.02.07	12.750	0.318
9 year	9	7.384	13.599	24.04.06	13.500	0.067
10 year	10	7.504	8.633	26.04.10	8.790	0.119
11 year	11	7.886	14.308	25.09.06	13.750	0.383
12 year	12	8.269	12.537	07.12.09	12.000	0.383
13 year	13	8.427	-	-	-	-
14 year	14	8.432	13.305	-	-	-
15 year	15	8.551	9.980	29.03.10	10.250	-
18 year	20	9.936	13.691	28.12.09	13.750	-

Source: Central Bank of Kenya

Appendix 6: Performance of Infrastructure Bonds (IFBs) At Primary Market Auctions

Issue No./Tenor	Date of Issue	Offer Amount (Ksh Mn)	Bids Received FV (Ksh Mn)	No. of Competitive Bids	No. of Non-Competitive Bids	Successful Bids (Ksh Mn)	Coupon Rate (%)
IFB 1/2009/12	23-02-09	18,500	26,884	950	593	18,568	12.500
IFB 2/2009/12	07-12-09	18,500	44,121	930	554	18,417	12.000
IFB 1/2010/8	01-03-10	14,500	35,273	398	372	16,264	9.750

Source: Central Bank of Kenya

Appendix 7: Kenya Public Sector Debt Sustainability Framework, Baseline Scenario 2007-2030
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate	Projections					2010-15 Average			2016-30 Average
	2007	2008	2009			2010	2011	2012	2013	2014	2015		2020	2030	
Public sector debt 1/	34.6	41.3	44.4			47.6	49.0	49.1	48.1	47.0	45.4		36.9	28.8	
o/w foreign-currency denominated	21.1	23.7	23.8			24.2	24.4	25.2	25.5	25.1	24.3		20.9	9.2	
Change in public sector debt	-3.5	6.7	3.1			3.2	1.4	0.1	-1.0	-1.1	-1.6		-1.1	-0.6	
Identified debt-creating flows	-5.6	2.5	1.0			2.5	0.1	-1.2	-1.4	-1.6	-2.1		-1.5	-1.2	
Primary deficit	0.5	2.0	3.1	-0.1	1.7	3.8	3.2	2.3	1.6	1.3	0.8	2.2	0.5	0.1	0.3
Revenues and grants	23.1	23.2	23.7			25.2	26.6	26.5	26.8	26.8	26.3		25.2	24.2	
of which: grants	1.1	1.1	0.9			1.0	1.2	1.3	1.3	1.3	0.9		0.6	0.2	
Primary (non-interest) expenditure	23.6	25.3	26.7			29.0	29.8	28.9	28.4	28.1	27.1		25.7	24.3	
Automatic debt – dynamics	-4.4	2.2	-2.1			-1.3	-3.1	-3.6	-2.9	-2.9	-2.9		-2.0	-1.3	
Contribution from interest - rate/growth differential	-1.8	-0.5	-0.3			-1.3	-2.1	-2.5	-2.2	-2.2	-2.2		-1.4	-1.0	
of which: contribution from average real interest rate	0.6	0.0	0.8			0.8	0.5	0.6	0.9	0.9	0.8		0.8	0.7	
of which: contribution from real GDP growth	-2.5	-0.5	-1.0			-2.1	-2.6	-3.0	-3.1	-3.1	-2.9		-2.2	-1.7	
Contribution from real exchange rate depreciation	-2.6	2.7	-1.8			0.0	-1.0	-1.1	-0.7	-0.7	-0.7		…	…	
Other identified debt-creating flows	-1.6	-1.8	0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-2.2	-1.8	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization	0.6	0.1	0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	2.1	4.2	2.1			0.7	1.2	1.3	0.4	0.5	0.5		0.4	0.6	
Other Sustainability indicators															
PV of public sector debt	13.5	17.7	38.2			41.7	42.7	43.1	42.2	41.4	40.0		32.2	26.5	
o/w foreign-currency denominated	0.0	0.0	17.6			18.2	18.2	19.3	19.6	19.4	18.9		16.2	6.9	
o/w external	…	…	17.6			18.2	18.2	19.3	19.6	19.4	18.9		16.2	6.9	
PV of contingent liabilities (not included in public sector debt)	…	…	…			…	…	…	…	…	…		…	…	
Gross financing need 2/	10.7	12.2	14.7			15.9	15.7	15.6	14.6	13.6	12.7		10.3	9.8	
PV of public sector debt-to-revenue and	58.3	76.0	161.5			165.0	160.8	162.5	157.1	154.6	152.3		127.8	109.6	

	Actual			Average	Standard Deviation	Estimate	Projections					2010-15 Average			2016-30 Average
	2007	2008	2009			2010	2011	2012	2013	2014	2015		2020	2030	
grants ratio (in percent)															
PV of public sector debt-to-revenue ratio (in percent)	61.3	79.7	167.8			172.1	168.5	170.5	165.2	162.4	157.6		130.9	110.7	
o/w external 3/	…	…	77.4			75.2	71.6	76.2	76.8	76.4	74.5		65.7	29.0	
Debt service-to-revenue and grants ratio (in percent) 4/	26.9	26.4	27.2			25.1	23.1	25.3	24.6	22.9	22.4		20.0	17.9	
Debt service-to-revenue ratio (in percent) 4/	28.3	27.7	28.3			26.2	24.3	26.6	25.9	24.1	23.2		20.5	18.0	
Primary deficit that stabilizes the debt-to-GDP ratio	4.0	-4.7	0.0			0.6	1.8	2.3	2.5	2.4	2.4		1.6	0.7	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.0	1.6	2.6	3.7	2.4	5.0	5.7	6.5	6.8	6.8	6.7	6.3	6.1	6.1	6.1
Average nominal interest rate on forex debt (in percent)	1.5	1.4	1.3	1.7	0.8	1.2	1.1	1.2	1.6	1.7	1.8	1.5	2.1	1.9	2.0
Average real interest rate on domestic debt (in percent)	7.3	1.1	4.0	7.4	5.6	3.8	2.5	2.5	4.1	4.2	3.7	3.4	5.1	3.9	4.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-11.7	13.3	-7.7	-4.5	8.0	0.2	…	…	…	…	…	…	…	…	…
Inflation rate (GDP deflator, in percent)	5.3	11.9	6.7	5.9	3.1	6.6	7.1	6.5	4.8	4.9	5.0	5.8	5.0	5.0	5.1
Growth of real primary spending (deflated by GDP deflator, in prevent)	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.0	0.1	0.1	0.0	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	…	…	…	…	…	31.4	35.1	16.9	25.2	21.1	23.3	25.5	27.2	23.4	…

Sources: Country Authorities and staff estimates and projections.
1/ Public debt refers to net debt of the central government and parastatals.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to availability

Appendix 8: Kenya Sensitivity analysis for Key Indicators of Public Debt 2010 – 2030

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
PV of Debt-to-GDP Ratio								
Baseline	42	43	43	42	41	40	32	26
A. Alternative scenarios								
A.1 Real GDP growth and primary balance are at historical averages	42	41	41	40	40	39	36	40
A.2 Primary balance is unchanged from 2010	42	44	46	47	48	50	54	65
A.3 Permanently lower GDP growth 1/	42	44	45	45	45	44	42	50
A.4 Alternative Scenario: Growth lower by one standard deviation 2011-2020	42	45	47	48	49	49	47	45
B. Bound tests								
B.1 Real GDP growth is at historical average minus one standard deviations in 2011-2012	42	46	51	53	54	55	54	58
B.2 Primary balance is at historical average minus one standard deviations in 2011-2012	42	42	42	41	41	40	34	30
B.3 Combination of B1-B2 using one half standard deviation shocks	42	42	43	44	46	46	46	49
B.4 One-time 30 percent real depreciation in 2011	42	50	50	48	47	46	37	32
B.5 10 percent of GDP increase in other debt-creating flows in 2011	42	52	52	51	50	49	40	33
PV of Debt-to-Revenue Ratio 2/								
Baseline	165	161	162	157	155	152	128	110
A. Alternative scenarios								
A.1 Real GDP growth and primary balance are at historical averages	165	154	153	149	147	148	141	163
A.2 Primary balance is unchanged from 2010	165	164	172	175	181	189	215	268
A.3 Permanently lower GDP growth 1/	165	164	168	166	167	168	166	207
A.4 Alternative Scenario: Growth lower by one standard deviation 2011-2020	166	169	177	179	183	187	185	188
B. Bound tests								
B.1 Real GDP growth is at historical average minus one standard deviations in 2011-2012	165	173	193	196	201	207	215	238
B.2 Primary balance is at historical average minus one standard deviations in 2011-2012	165	157	158	154	153	152	134	123
B.3 Combination of B1-B2 using one half standard deviation shocks	165	159	162	165	170	175	181	201
B.4 One-time 30percent real depreciation in 2011	165	188	188	180	177	174	149	133
B.5 10 percent of GDP increase in other debt-creating flows in 2011	165	196	197	190	187	185	157	135
Debt Service-to-Revenue Ratio 2/								
Baseline	25	23	25	25	23	22	20	18
A. Alternative scenarios								
A.1 Real GDP growth and primary balance are at historical averages	25	24	26	24	22	22	22	24

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
A.2 Primary balance is unchanged from 2010	25	23	25	25	24	25	28	33
A.3 Permanently lower GDP growth 1/	25	23	26	25	24	23	23	27
A.4 Alternative Scenario: Growth lower by one standard deviation 2011-2020	25	23	26	26	25	25	25	26
B. Bound tests								
B.1 Real GDP growth is at historical average minus one standard deviations in 2011-2012	25	24	28	28	27	28	29	31
B.2 Primary balance is at historical average minus one standard deviations in 2011-2012	25	23	25	24	22	21	20	18
B.3 Combination of B1-B2 using one half standard deviation shocks	25	24	26	25	23	23	25	26
B.4 One-time 30percent real depreciation in 2010	25	24	27	27	25	25	23	21
B.5 10 percent of GDP increase in other debt-creating flows in 2010	25	23	28	29	27	26	22	19

Sources: Country Authorities and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.