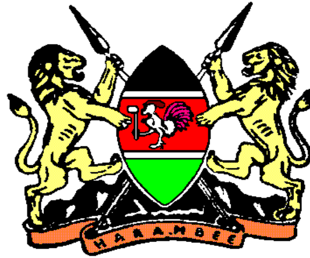

REPUBLIC OF KENYA

THE NATIONAL TREASURY AND PLANNING

2020 Medium Term Debt Management Strategy

February 2020

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February 2020

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FOREWORD

The Medium Term Debt Strategy (MTDS) is a policy document that guides government borrowing and public debt management in ensuring sustainability. It is published every year. The framework guides the government in pursuing the desired structure of the public debt portfolio which reflects its choice on cost and risk trade-offs.

The 2020 MTDS sets out the debt management strategy of the national government over the period 2020/21-2022/23 with respect to the current stock of debt (loans and guarantees) and in financing the fiscal deficits as outlined in the 2020 Budget Policy Statement. The BPS embeds reduction of the fiscal deficit reduction in the medium term that is aimed at curtailing the rate of debt accumulation to ensure that Kenya's debt remains sustainable in the long term.

The strategy highlights the total stock of debt as at the end of December 2019; the structure of the debt and guarantees issued; the sources of the debt as well as the major risks associated with the borrowing and guarantees. It also outlines the assumptions underlying the debt management strategy; an analysis of the sustainability of the existing and projected debt arising from funding of fiscal deficits as outlined in the BPS.

The 2020 MTDS has been prepared by evaluating the costs and risks of several alternative financing options to determine the financing option that is feasible under the prevailing and projected local and international financial market developments to inform sources of funds; their risks and costs to guarantee the government's financial capability to meet its debt obligations. Fundamental to these considerations was the need to keep debt within sustainable levels and to minimize refinancing risks and costs.

Continued publication of the MTDS on a regular basis is a demonstration of the commitment to transparency in public borrowing and public debt management.

As part of the ultimate debt management strategy objective of ensuring debt remains sustainable and that it does not distort budget implementation. The National Treasury is committed to enhancing the capacity of the local debt

market and improving operational efficiency at both issuance and secondary trading. In particular the government is committed to deepening automation in these two areas. By closely working with other players, it is expected that Over-the-Counter Trading (OTC) will be implemented during the FY2020/21. This is a long outstanding reform that is expected to enhance transparency in trading, price discovery and attract more capital flows and promote competition for debt instruments eventually leading to lowering of the cost of credit in the economy.

To achieve this objective, the key regulators in the financial sector must support and cooperate in ensuring that the requisite complimenting information technology infrastructure and accompanying regulations are in place without unnecessary delays. These are key ingredients of prudent sovereign debt management strategy that seeks to ensure that budget financing is increasingly sourced from the local currency debt market to cushion the economy and its debt stock from erratic external vulnerabilities.

HON. (AMB). UKUR K. YATANI, EGH
CABINET SECRETARY/ THE NATIONAL TREASURY&PLANNING

ACKNOWLEDGEMENT

The 2020 MTDS has been prepared in compliance with the requirements of PFM Act, 2012 to inform borrowing sources over the period 2020/21-2022/23. The strategy presents the projected optimal combination of costs and risks of refinancing debt maturities and financing the fiscal deficits outlined in the 2020 Budget Policy Statement (BPS). Considering the current and projected local and international financial market developments, the ultimate goal of the strategy is to ensure that Kenya's public debt is sustainable and at least cost and risks.

The MTDS is approved by Cabinet and the National Assembly and articulates the strategy to be implemented in accordance with the Public Finance Management (PFM) Act, 2012. It will guide debt management operations and financing fiscal deficits for the FY 2020/21 to 2022/23. Its implementation will be supported by the issuance calendar to be prepared in consultations with market participants. Finalization of the 2020 MTDS benefitted from inputs of the Central Bank of Kenya. I thank the team from various departments within the National Treasury and the Central Bank who participated in the preparation of the draft 2020 MTDS.

It is notable that the quality of Kenya's MTDS has improved over the years due to continuing capacity building collaboration with the IMF, World Bank and the Macro-Economic and Financial Management Institute (MEFMI). I therefore thank these multilateral institutions for their invaluable support in capacity building in the area of MTDS preparation.

As is the case with previous versions of the Medium Term Debt Management Strategies. The 2020 MTDS will be available in the National Treasury Website www.treasury.go.ke

JULIUS MUIA, PhD, CBS
PRINCIPAL SECRETARY, NATIONAL TREASURY

Publication of the Debt Management Strategy

Section 33 of the Public Finance Management Act, 2012 provides:

1) On or before 15th February in each year, the Cabinet Secretary shall submit to Parliament a statement setting out the debt management strategy of the national government over the medium term with respect to its actual liability in respect of loans and guarantees and its plans for dealing with those liabilities.

2) The Cabinet Secretary shall ensure that the medium term debt management strategy is aligned to the broad strategic priorities and policy goals set out in the Budget Policy Statement.

3) The Cabinet Secretary shall include in the statement the following information:-

    a) The total stock of debt as at the date of the statement;

    b) The sources of loans made to the national government and the nature of guarantees given by the national government;

    c) The principal risks associated with those loans and guarantees;

    d) The assumptions underlying the debt management strategy; and

    e) An analysis of the sustainability of the amount of debt, both actual and potential.

4) Within fourteen days after the debt strategy paper is submitted to Parliament under this section, the Cabinet Secretary shall submit the statement to the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council, publish, and publicize the statement.

ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
ADF	African Development Fund
ATM	Average Time to Maturity
ATR	Average Time to Re-fixing
BPS	Budget Policy Statement
CBK	Central Bank of Kenya
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ECA	Export Credit Agencies
FX	Foreign currency denominated debt
FY	Financial Year
FCCL	Fiscal commitment and Contingent Liabilities
GDP	Gross Domestic Product
GoK	Government of Kenya
IDA	International Development Association
IMF	International Monetary Fund
ISB	International Sovereign Bond
Ksh	Kenya Shilling
KenGen	Kenya Electricity Generating Company
LMIC	Lower Middle Income Countries
MTDS	Medium Term Debt Strategy
MTDS AT	MTDS Analytical Tool
NPV	Net Present Value
PFM	Public Finance Management
PPP	Public Private Partnerships
PPG	Public &Public Guaranteed Debt
PV	Present Value
USD	United States Dollar
QEBR	Quarterly Economic and Budget Review

EXECUTIVE SUMMARY

The 2020 MTDS provides guidance on how to refinance maturing public debt and funding of the annual fiscal deficits during the period 2020/21-2022/23 while at the same time minimizing costs and risks of overall public debt. The strategy is underpinned by the 2020 Budget Policy Statement (BPS) macroeconomic assumptions, taking into account the need to minimize the costs and risks of public debt. The existing stock of debt, called-up publicly guaranteed debt stock and the fiscal deficits spelled in the 2020 BPS have been taken into account in the 2020 MTDS.

In 2019, major credit rating agencies, Standard and Poor's and Fitch Ratings placed Kenya at B+ with a stable outlook. There is potential for higher rating given Kenya's strong and diversified economy. However, persistent high fiscal deficits and rising stock of public debt remains a threat to fiscal sustainability and better sovereign credit rating. The rising stock of the public debt calls for an innovative approach to financing the fiscal deficits going forward. Kenya's international investment position is supported by strong macroeconomic stability, narrowing of the current account deficit and strong growth in diaspora remittances.

As at end December 2019 public and publicly guaranteed debt in nominal terms was Ksh 6,010 billion (US$59.31 billion), equivalent to 58 percent of GDP. Debt Sustainability Analysis (DSA) indicates that public debt remains sustainable over the medium term. The World Bank Country Policy and Institutional Assessment (CPIA) classifies Kenya as a strong performer. The applicable debt sustainability threshold in this category is 70 percent Present Value of Debt to GDP. As at end December 2019 Kenya's PV of Debt to GDP ratio was 51.1 percent.

The 2020 MTDS is anchored on the medium-term macroeconomic framework as articulated in the 2020 Budget Policy Statement (BPS). The BPS outlines key priority areas under the "The Big Four" Plan as prioritized in the Third Medium Term Plan of the Vision 2030.

In the context of the current expenditure pressures, high fiscal deficits and the level of the current debt stock, the MTDS Analytical Tool (MTDS AT) ranks the resultant costs and risks characteristics of debt in the medium term under different financing alternatives.

The results of the foregoing structure of the gross borrowing to finance fiscal deficits is 40 percent net domestic borrowing and 60 percent net external borrowing over the same period. The MTDS AT suggests that minimization of costs and risks of public debt will be achieved through 72 percent gross borrowing from of domestic debt market and 28 per cent from external sources over the medium term. Gross borrowing refers to all borrowing including borrowing to refinance maturing debt and raising new debt to fund fiscal deficits during the period 2020/21-2022/23.

The focus of the 2020 debt management strategy is to fund the fiscal deficits while at the same time reducing refinancing risk by lengthening the maturity of existing securities and shifting more of the financing needs to the external sector. In particular, it is aimed at accessing more concessional funding to minimize the carrying cost of debt, as well as local currency international bond issuance over the medium term. Gross external borrowing on concessional and semi-concessional terms is projected at 15 percent and 13 per cent respectively. The strategy envisions that part of external borrowing will be in local currency to minimize foreign exchange risk exposure.

As part of debt management strategy, fiscal deficits must be kept below the rate of economic growth so as to reduce the overall cost of debt on the economy and safeguard debt sustainability. It will be imperative that the Government continues to pursue fiscal consolidation and maintain macroeconomic stability. Any adverse shock on the macroeconomic variables, such as exchange rate or interest rates, will directly translate to deterioration of the debt position and debt service burden and hence fiscal instability.

Over the recent years, increasing proportion of commercial banks deposits have been held in government securities, beside cash reserve requirement stock and

repo stock. This implies that the capacity of commercial banks to further fund domestic debt at reasonable costs is limited. Accordingly, in addition to reducing fiscal deficits, the actual financing of the fiscal deficits must gradually be biased away from domestic sources and towards external sources and to ease crowding out of the private sector in the domestic credit debt market. The Government will endeavor to explore nontraditional sources of financing budget deficits to safeguard stability of domestic debt market.

While Kenya's debt stock is sustainable, reforms to deepen the domestic debt markets to increasingly take up a higher share of the public debt will be implemented. A deep, diversified and efficient domestic debt market is an important factor in underpinning debt sustainability. A domestic debt market that supports bigger proportion of public debt provides a cushion against foreign exchange risk exposure. Deliberate interventions will be put in place to deepen the domestic debt market. The strategic domestic debt market reforms to be implemented include: separation of institutional investors and retail investors in the primary issuance to facilitate full automation of securities auction and shortening of primary auction settlement cycle to T+0; regular publication of issuance calendar; regular market engagement; restructuring of the horizontal repo master agreement to ensure transfer of title/ownership in horizontal repo transactions; establishment of Over-The-Counter (OTC) trading platform aimed at fostering transparency and efficiency in secondary securities trading and settlement in order that attract and promote market competition and price discovery eventually leading to reduced yields and costs of public debt. These reforms will be complemented by issuance of fewer but large size benchmark bonds to enhance market liquidity and attract capital inflows.

The prospective benefits of the 2020 MTDS include:

i. Lower the potential of crowding out the private sector by reducing Government- Private sector competition in the domestic credit market;
ii. Decrease interest burden as a percent of GDP;
iii. Lower refinancing and rollover risk by reducing the stock of Treasury bills;

iv. Reduced frequency of issuance of Treasury Bills to create fiscal flexibility;
v. Lengthening of the maturity profile of debt;

The National Treasury will execute the MTDS through an issuance calendar and continuous monitoring and evaluation of the implementation of the strategy.

I. INTRODUCTION

1. The 2020 MTDS has been prepared pursuant to Section 33 (2) of the Public Finance Management Act (PFM) 2012.

2. Section 62(3) of the PFM Act provides the debt management objectives as to (a) minimize the cost of public debt management and borrowing over the long-term taking risks into account; (b) promote the development of the market institutions for Government debt securities; and (c) ensure the sharing of the benefits and costs of public debt between the current and future generations as provided for under the Constitution.

3. The MTDS covers both national government external, domestic and called-up guaranteed debt. It excludes government guaranteed debt portfolio amounting to US$1.56 billion that is performing. The MTDS covers FY2020/21-2022/23, consistent with the Government's 2020 BPS. The start point for the analysis is 31st December 2019 outstanding National Government public debt and called-up publicly guaranteed debt coupled with borrowing projections.

4. The MTDS is informed by macroeconomic assumptions as articulated in BPS 2020 including the fiscal deficit period FY2020/21-FY2022/23; and analysis of costs and risks of existing debt stock and the projected gross borrowing; projected domestic and external market conditions.

Background to Medium Term Debt Strategy

5. Kenya's economy remains robust and grew by 5.7 percent, 5.6 percent and 5.1 percent, in the first, second and third quarters of 2019. Key macroeconomic indicators were relatively stable in the year 2019. The overall inflation stood at 5.8 in December 2019 up from 5.7 percent in 2018. Inflation is expected to remain within the target of 5 ± 2.5 percent.

6. In 2019 the sovereign rating for Kenya by both Standard and Poor's and Fitch Ratings was B+ with a stable outlook. However, sustained high fiscal deficits and rising stock of sovereign debt remains a threat to fiscal sustainability.. Kenya's international investment position continues to be supported by macroeconomic stability, narrowing of the current account deficit and strong growth in diaspora remittances.

7. Public and publicly guaranteed debt, in nominal terms as at end-December 2019 amounted to Kshs. 6,010.0 billion, equivalent to 58.0 percent of GDP. Total external debt amounted to Ksh. 3,066.9 billion (29.6 per cent of GDP) while total domestic debt amounted to Ksh. 2,943.1 billion (28.4 per cent of GDP).

8. Kenya's public debt sustainability threshold as a strong performer under the World Bank's Country Policy and Institutional Assessment (CPIA) and a low middle-income country is 70 percent Present Value of Debt to GDP. Debt Sustainability Analysis (DSA) for Kenya indicates that Kenya's public debt remain sustainable over the medium term.

II. REVIEW OF ACTUAL COSTS AND RISK CHARACTERISTICS AGAINST 2018 AND 2019 DEBT MANAGEMENT STRATEGIES

9. This section reviews implementation of the 2018 and 2019 MTDS.

10. The 2018 MTDS provided that 57 percent of total gross borrowing over the medium term be raised from external financing and the balance (43 percent) from domestic sources. External borrowing was to be comprised of 35 percent concessional and semi-concessional while commercial sources were to account for 22 percent of total borrowing. Domestic borrowing was to be through issuance of Treasury bills and Treasury bonds with a bias on benchmark bonds at the ration of 30:70.

11. During the financial year 2018/19 (ended June 2019), a total of Ksh. 721.1 billion net new borrowing was raised to fund the fiscal deficit Of this amount Ksh 414.5 billion was raised through external borrowing against a target of Ksh 321.5 billion, while Ksh 303.7 billion was raised in the domestic debt market against a target of Ksh 310.1 billion in addition to Ksh. 2.9 billion raised as other domestic financing against a target of Ksh. 3.9 billion. Net external borrowing target for 2018/19 was overshot by Ksh 93 billion while net domestic borrowing target was under achieved by Ksh 3.5 billion.

12. In the domestic borrowing, the actual proportion for Treasury bills and bonds stood at 35 per cent and 65 per cent, respectively. Thus the desired target of 30:70 in terms Treasury Bills and Treasury bonds mix was not met in 2018/19. This is because domestic debt borrowing took in more Treasury bills than the set targets.

13. As at end June, 2019, gross domestic financing was 70.3 percent. Gross external borrowing comprised of concessional and semi concessional at 13.4 percent and commercial at 16.3 percent.

14. The intentions of the 2018 MTDS strategy over the period were to lengthen the maturity structure of debt, lower interest rate costs and minimize

refinancing risk in deed the maturity of domestic debt was lengthened as reflected by improved refinancing risk indicators on account of increased issuance of long term Treasury Bonds. Average Time to Maturity (ATM) on Government domestic debt securities increased to 5.7 years by end December 2019 against the 2018 MTDS target of 4.1 years. The ATM for Treasury bonds was 8.0 years by end December 2019 compared to 6.9 years by end December 2018 (15.9 percent growth) **(Table 1).**

Table 1: Monitoring and Evaluation of Cost and Risk Indicators Under Alternative Strategies

Risk Indicators						
		Baseline Dec 2017	2018 MTDS **Targets**	Actual End Dec 2019	Deviation (4-3)	Remark on deviation
1		2	3	4	5	6
Nominal debt as % of GDP		50.3	48.7	55.7	7.0	Increased public debt accumulation
Present value debt as % of GDP		46.4	40.6	51.1	10.5	
Interest payment as % of GDP		3.9	2.9	4.3	1.4	Increased fiscal risk
Implied interest rate (%)		7.7	6.5	7.6	1.1	
Refinancing risk	Debt maturing in 1yr (% of total)	27.4	19.2	17.8	-1.4	Reduced refinancing risk
	Debt maturing in 1yr (% of GDP)	13.8	9.3	11.1	1.8	
	ATM External Portfolio (years)	10.1	12.2	11.1	-1.1	
	ATM Domestic Portfolio (years)	4.7	4.1	5.7	1.6	
	ATM Total Portfolio (years)	7.4	9.4	8.7	-0.7	
Interest rate risk	ATR (years)	7.3	9.1	8	-1.1	Marginal rise in interest rate risk
	Debt refixing in 1yr (% of total)	32.4	25.0	31.2	6.2	
	Fixed rate debt (% of total)	91.9	93.2	85.3	-7.9	
Foreign exchange (FX) risk	FX debt as % of total	50.9	62.2	50.1	-12.1	Improved foreign exchange risk

Source: The National Treasury

15. The Average Time to Maturity for new external loans contracted was lower at 15.3 years as at end June, 2019 compared with 20.8 years as at end June 2018. The Grace Period declined to 5.6 years from 10.3 years over the

same period. The decline in Average Time to Maturity and grace period is due to the rise in commercial borrowing on account of reallocation of borrowing supported by conducive international debt markets and drying up of concessional sources of financing. The weighted average interest remained unchanged at 3.9 per cent during the year **(Table 2).**

Table 2: Average Terms of New Loan Commitments

Description	**Jun-17**	**Jun-18**	**Jun-19**
Average Maturity (years)	17.6	20.8	15.3
Grace Period (years)	4.5	10.3	5.6
Weighted Average Interest Rate (%)	2.6	3.9	3.9

Source: The National Treasury

16. Interest payment as a share of GDP is rising on account of accumulation of debt. Fiscal consolidation is critical to the realization of the objective of lowering cost of public debt. Interest rate risk rose marginally on account of rise in debt re-fixing within one year. Gradual reduction of treasury bills stock and variable interest rate external debt is important to lower interest rate risk.

(ii) Review of Actual Borrowing against 2019 MTDS Targets

17. The 2019 MTDS provided that 62 percent of total gross borrowing over the medium term be raised from domestic financing and the balance (38 percent) from external sources. External borrowing was to be comprised of 34 percent concessional and semi-concessional while commercial sources were to account for 4 percent of total borrowing. Domestic borrowing was to be through issuance of Treasury bills and Treasury bonds with a bias on benchmark bonds at the ration of 30:70.

18. The review of the 2019 MTDS targets against the actual outturn will be provided in the 2021 MTDS.

III. NATIONAL GOVERNMENT`S PUBLIC AND PUBLICLY GUARANTEED DEBT

19. The National Government public and publicly guaranteed debt was Ksh 6,010 billion (US$59.31 billion) equivalent to 58 per cent of GDP in nominal terms as at end-December 2019. Total external debt amounted to Ksh. 3,066.9 billion (29.6 per cent of GDP) while total domestic debt amounted to Ksh. 2,943.1 billion (28.4 per cent of GDP).

20. The scope of 2020 MTDS covers existing public debt totaling Ksh 5,768.2 billion which comprises external debt component equivalent to 27.9 percent of GDP (US$28.54 billion) and domestic debt equivalent to 27.8 percent of GDP (US$ 28.38 billion) and called up publicly guaranteed debt totaling Ksh 305 million as of end December, 2019. The MTDS analysis excludes Ksh 241.8 billion being guaranteed but performing debt totaling Ksh 157.8 billion, overdraft of Ksh 63.7 billion, Suppliers credit Ksh 16.8 billion and Bank advances of Ksh 3.6 billion.

21. External public debt stock comprises principally loans from multilateral, bilateral and commercial creditors. Multilateral debt accounted for 9.65 percent of GDP, out of which, IDA remains the largest multilateral creditor accounting for 6.86 percent of GDP. Outstanding external commercial debt and International Sovereign Bond are equivalent to 3.60 and 5.97 per cent of GDP respectively, and debt from bilateral creditors is 8.71 percent of GDP **(Table 3).**

22. Domestic debt mainly comprises Treasury bills and bonds. Treasury Bills stock (91, 182, and 364 days) was Ksh 878.9 billion (8.49 percent of GDP) while Treasury bonds stock was to Ksh 1,974.7 billion (19.07 percent of GDP). The Pre-1997 government debt was Ksh. 22.2 billion (0.21 per cent of GDP).

Table 3: Public and Publicly Guaranteed Debt in the MTDS, End-December 2019

	Ksh (millions)	USD (millions)	% of GDP
I. Domestic Debt (included in MTDS)			
Treasury Bills	878,935.60	8,673.44	8.49
Treasury Bonds	1,974,693.90	19,486.50	19.07
Pre-1997 Government Debt	22,228.76	219.36	0.21
Sub Total	**2,875,858.26**	**28,379.30**	**27.77**
II. External debt (included in MTDS)			
International Development Association	709,929	7,005.66	6.86
African Development Fund	233,859	2,307.74	2.26
Bilateral	902,413	8,905.11	8.71
Multilateral	54,925	542.01	0.53
Commercial Banks	372,784	3,678.7	3.60
International Sovereign Bond	618,153	6,100.0	5.97
Non Performing Guarantees	305.88	3.02	0.00
Sub Total	**2,892,367.88**	**28,542.21**	**27.93**
III. Excluded from MTDS			
Suppliers Credit	16,772.62	165.51	0.16
CBK Overdraft	63,724.46	628.84	0.62
Performing Guarantees	157,765.05	1,556.84	1.52
Bank advances	3,560.20	35.13	0.03
Sub Total	**241,822.33**	**2,386.32**	**2.34**
TOTAL DEBT Included in MTDS (I+II)	**5,768,226.14**	**56,921.51**	**55.70**
TOTAL DEBT (I+II+III)	**6,010,048.47**	**59,307.83**	**58.04**

Source: The National Treasury and Central Bank of Kenya.

23. The 2020 MTDS excludes all uncalled guarantees amounting to US$1.56 billion. The uncalled guarantees relate to loans contracted by Kenya power, Kenya Electricity Generation Company, Kenya Airways and Kenya Ports Authority while the called guarantees refer to loans to Tana and Athi River Development Authority and East Africa Portland Cement **(Table 4).**

Table 4: Outstanding Government Guaranteed Debt (End-December 2019) (In millions of Kenya Shillings and U.S. Dollars)

Beneficiary Entity	**Ksh**	**USD**
Kenya Power Company	12,549,335,918.02	123,838,260.82
Kenya Electricity Generating Company	27,808,475,106.38	274,417,165.64
Kenya Ports Authority	36,844,724,766.26	363,587,895.44
Kenya Airways	76,002,375,000.00	750,000,000.00
Kenya Railways (IDA Concessionaire)	4,560,142,500.00	45,000,000.00
Sub-Total Un-Called Guarantees	**157,765,053,290.66**	**1,556,843,321.91**
Guaranteed Debt included from the Analysis		
Tana & Athi Rivers Dev. Authority	136,365,022.08	1,345,665.40
East Africa Portland Cement	169,514,325.12	1,672,786.46
Sub-Total- Called Guarantees	**305,879,347.20**	**3,018,451.86**
Grand Total Guarantees	**158,070,932,637.86**	**1,559,861,773.77**

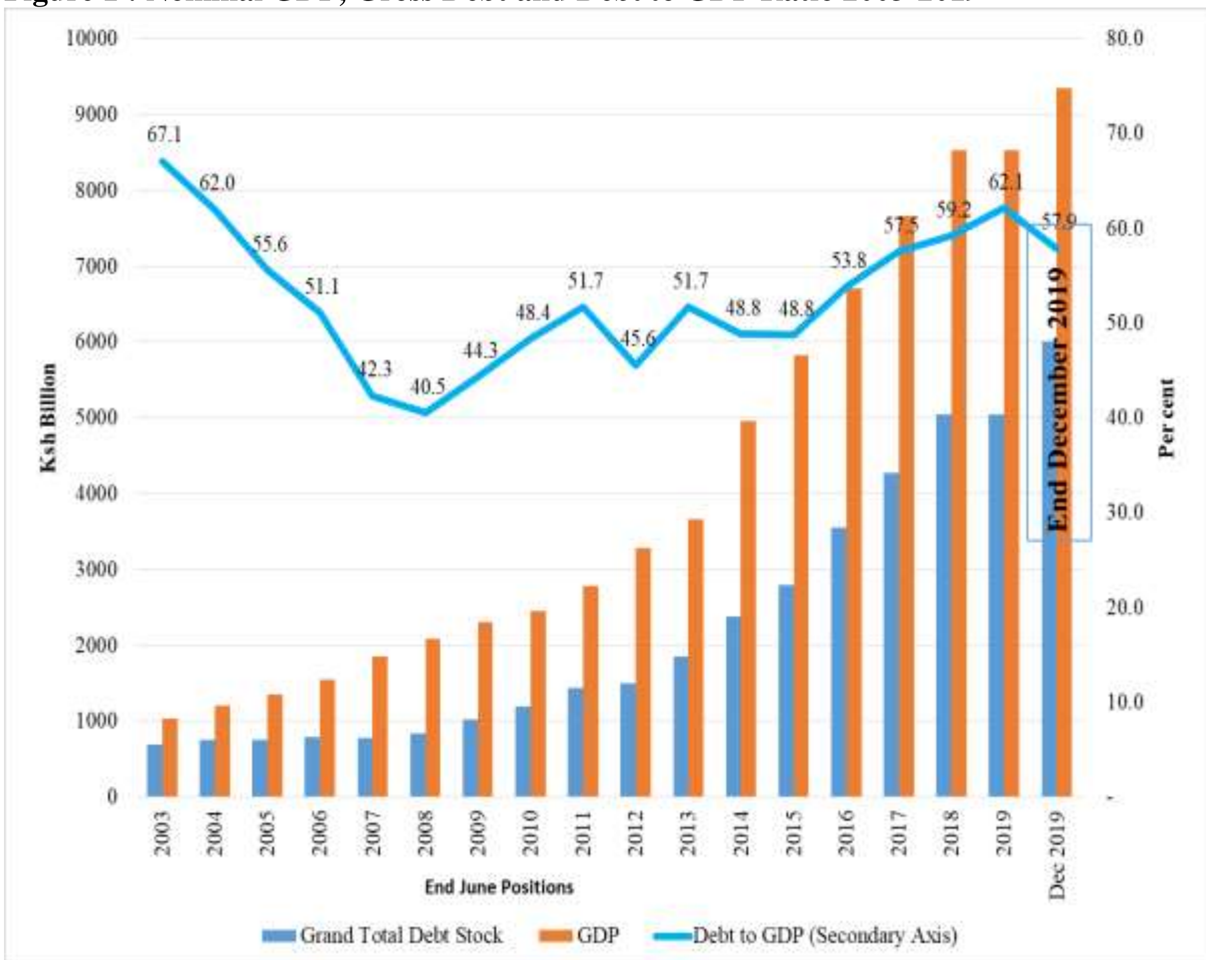
Source: The National Treasury.

IV. COST AND RISK ANALYSIS OF THE EXISTNG PUBLIC DEBT PORTFOLIO

24. This section diagnoses the cost and risk characteristics of existing stock of debt and to identifies the challenges that need to be addressed in the 2020 MTDS.

25. The overall outstanding debt as at end December 2019 was Ksh 6,010.0 billion (58.0 percent of GDP) comprising domestic debt of Ksh 2,943.1 billion (49 percent of total debt equivalent to 28.4 percent of GDP) and external debt Ksh 3,066.9 billion (51 percent of total debt equivalent to 29.6 percent of GDP).

Figure 1 : Nominal GDP, Gross Debt and Debt to GDP Ratio 2003-2019



Source: The National Treasury

26. Nominal GDP peaked at Ksh 9,348.3 billion in June 2019. Nominal GDP and public debt are projected to register a steady increase beyond 2020 with GDP expected to rise to Ksh. 16 trillion and debt is expected to reach Ksh 8.7 trillion or 52.8 per cent of GDP in 2024 **(Figure 1).**

27. The interest payment on debt during the FY 2019-20 is projected at Ksh 441.5 billion (4.3 percent of GDP) comprising Ksh 290.5 billion on domestic debt (66 percent of total interest payments equivalent to 2.8 percent of GDP) and Ksh 150.9 billion on external debt (34 percent of total interest payments equivalent to 1.5 percent of GDP). This higher interest cost of domestic debt vis a vis the cost of external debt must be interpreted with caution because whereas domestic debt is in local currency all other debt is in foreign currency with accompanying currency risk.

28. It is worth noting that although the proportion of domestic debt represents 51 percent of the total public debt, domestic interest payment is about twice that of external debt.

29. Maturity profile of the outstanding domestic debt is characterized by high refinancing risk with 34.9 percent of the debt maturing within 12 months **(Table 5).** This is as a result of continued uptake of Treasury bills.

Table 5: Domestic Debt by Maturity Comparatives

Remaining Maturity in Years	End Dec 2018 In million US$	In Percent of Total	End Dec 2019 In million US$	In Percent of Total
Less than one year	10,376	42.8	9,909.22	34.9
2 to 3 years	2,419	9.9	3,528.58	12.4
4 to 5 years	3,225	13.3	3,317.56	11.7
6 to 10 years	5,118	21.0	6,029.96	21.2
Above 11 years	3,168	13.0	5,593.97	19.8
Total	**24,306**	**100.00**	**28,379.29**	**100.00**

Source: The National Treasury

30. The average time to maturity (ATM) for domestic debt portfolio was 5.7 years by end December 2019 up from 4.5 years as at end December 2018 (26.7 percent growth). The ATM for T-bonds was 8.0 years as at end December 2019 compared to 6.9 years as at end December 2018 (15.9 percent

growth). The ATM for external debt portfolio was 11.0 years as at end December 2019 compared to 10.1 years as at end December 2018. The ATM for the total debt portfolio is 8.7 years as at end December 2019 compared to 7.4 years as at end December 2018 **(Table 5).**

31. Fixed interest rate debt accounts for 85.9 per cent of the overall debt portfolio, of which domestic debt component is 100 percent fixed rate. Out of the total debt, 31.0 per cent will re-fix in FY2020/21. The average time to re-fixing (ATR) for external and domestic debt portfolio is 9.7 years and 5.7 years respectively. It is worth noting that 71.8 percent of external debt is fixed. However, 28.2 per cent of external debt is floating rate debt (about Ksh 815.7 billion) and is exposed to fluctuations in international interest rates in the source markets **(Table 6).**

Table 6: Cost and Risk Indicators of Existing Debt, as at December 2019

Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of Ksh)		2,892,412.3	2,875,858.3	5,768,270.6
Amount (in millions of USD)		28,542.7	28,379.3	56,921.9
Nominal debt as percent of GDP		27.9	27.8	55.7
PV as percent of GDP		23.3	27.8	51.1
Cost of debt	Interest payment as percent of GDP[3]	1.2	3.2	4.4
	Weighted Av. IR (percent)	4.2	11.4	7.8
Refinancing risk	ATM (years)	11.0	5.7	8.7
	Debt maturing in 1yr (percent of total)	3.9	34.9	17.1
	Debt maturing in 1yr (percent of GDP)	1.4	9.7	11.1
Interest rate risk	ATR (years)	9.7	5.7	8.0
	Debt re-fixing in 1yr (percent of total)	28.2	34.9	31.0
	Fixed rate debt (percent of total)	71.8	100.0	85.9
	T-bills (percent of total)	0.0	30.6	13.1
FX risk	FX debt (percent of total debt)			50.1

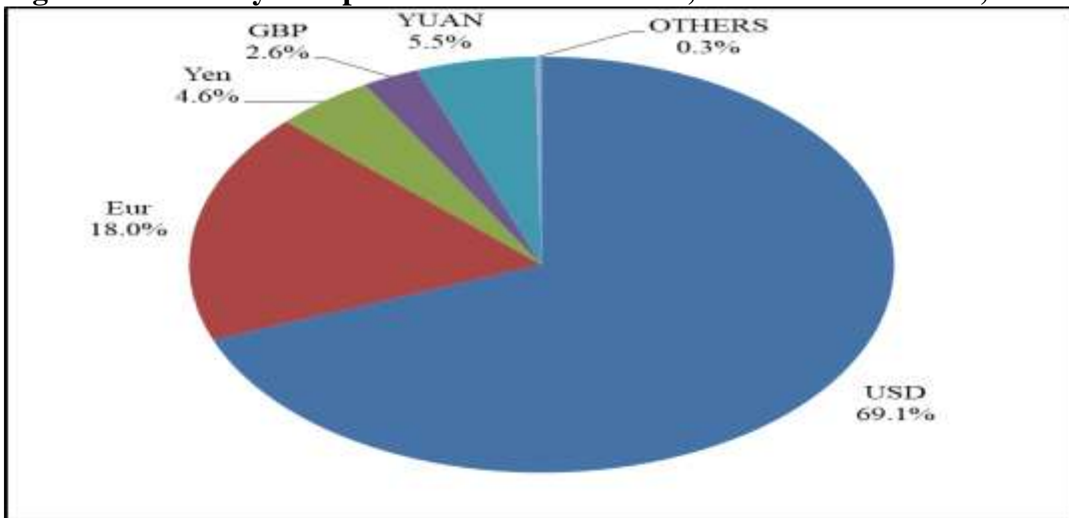
Source: The National Treasury

32. External debt forms 50.1 per cent of total debt and is exposed to exchange rate risk. Out of the total external debt, 69.0 per cent is U.S. dollar denominated, 18.1 percent in Euro, 5.5 percent in Chinese Yuan, 4.5 per cent in Japanese Yen, 2.6 per cent in Great Britain Pound and other currencies account for 0.3 percent **(Figure 2).**

33. Efforts will be made to contract debt in the major currencies that match the currencies of Kenya’s export proceeds. These achievements in lengthening

both external and domestic debt maturities are attributed to conscious implementation of transformative debt management strategies to date.

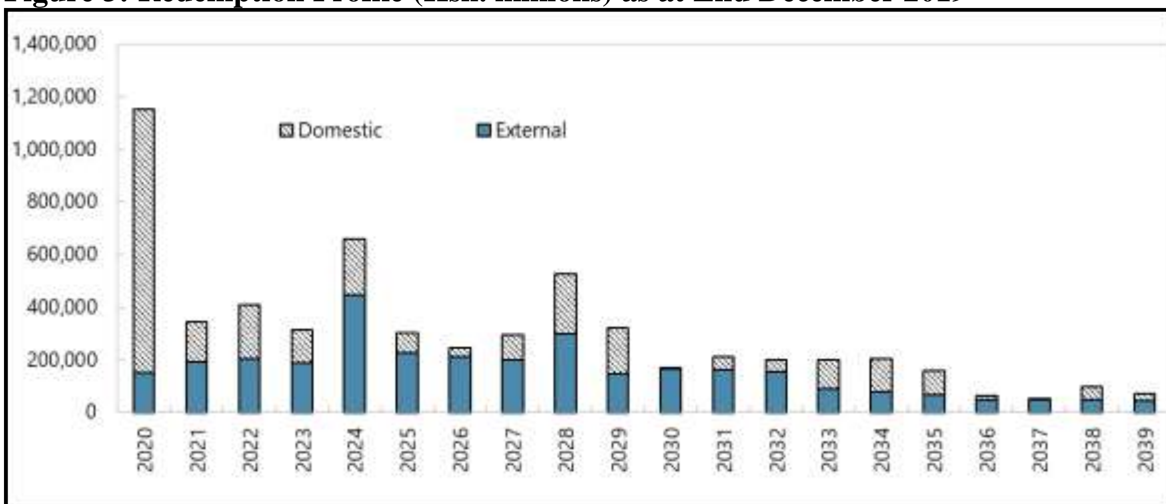
Figure 2: Currency Composition of External Debt, as at End-December, 2019.



Source: The National Treasury

34. Over the medium term maturities have been smoothened except for two maturity spikes in 2024 and 2028 related to international sovereign bonds **(Figure 3).**

Figure 3: Redemption Profile (Ksh. millions) as at End December 2019



Source: National Treasury and Central Bank of Kenya

35. The 2020 MTDS seeks to address the challenges identified in the foregoing analysis.

V. BASELINE MACROECONOMIC ASSUMPTIONS AND KEY RISKS

a) Baseline Macroeconomic assumptions

36. The 2020 Budget Policy Statement (FY 2020/21-2022/23) articulates macroeconomic assumptions summarized in **Table 7:**

Table 7: Kenya: Baseline Macroeconomic Assumptions

	Unit	2017/18	2018/19	2019/20*	2020/21**	2021/22**	2022/23**
		Actual	Pre Act.	Projection			
Real GDP	Percent	5.6	5.9	5.8	6.2	6.3	6.6
GDP Deflator	Percent	6.7	3.9	5.3	5.6	5.4	5.3
Inflation	Percent	5.2	4.9	5.1	5.0	5.0	5.0
Revenue	Percent of GDP	17.9	18.2	20.1	18.3	18.5	18.4
Expenditure	Percent of GDP	25.2	26.0	27.8	23.6	22.8	21.9
Overall Fiscal Balance	Percent of GDP	-7.4	-7.7	-6.3	-4.9	-3.9	-3.1
Primary Budget Balance	Percent of GDP	-3.6	-3.6	-2.1	-1.0	0.3	0.8
Revenue	Ksh Billion	1,522.5	1,698.8	2,084.2	2,134.1	2,417.1	2,706.6
Expenditure	Ksh Billion	2,146.7	2,433.7	2,874.2	2,748.2	2,968.2	3,214.1
Overall Fiscal Balance	Ksh Billion	-631.3	-721.1	-657.4	-571.2	-505.1	-460.6
Primary Budget Balance	Ksh Billion	-307.4	-339.4	-215.9	-115.2	36.2	116.4
GDP (Current Prices)	Ksh Billion	8,524.7	9,348.3	10,383.1	11,636.9	13,044.1	14,673.6

Source: The National Treasury

37. Real GDP growth is projected to increase from 5.9 per cent in FY 2018/19 to 6.6 percent over the medium supported by a stable macroeconomic environment, investments in the strategic areas under the “Big Four” Plan and their enablers, and existing business and consumer confidence in the economy.

38. The primary budget balance is projected to reach a surplus of 0.8 percent over the medium term from a deficit of 3.6 per cent in the FY 2018/19 provided the ongoing fiscal restraint is sustained.

b) Risks to the Baseline Macroeconomic Assumptions

39. The 2020 BPS highlights the following risks facing Kenya's macroeconomic outlook:

i. Risks from global economies relate to rising global oil prices due to tensions between the U.S.A and Iran, uncertainties of trade agreements between UK and European Union and low commodity prices. If geo-political tensions being experienced in different parts of the world are not subdued, they could negatively impact on Kenya's exports and exchange rate stability.

ii. Kenya faces a fiscal risk in the event of depreciation of the shilling due to the fact that 50.1 percent of debt is held in foreign currencies. Depreciation leads to an increase in debt service that may surpass the CFS budget allocation in local currency. Prudent macroeconomic management (including monetary policy and fiscal consolidation) is therefore necessary for debt sustainability.

iii. The Fiscal Commitments and Contingent Liabilities is a threat to fiscal stability. The government will adhere to the approved Government Support Measures policy in providing financial commitments to PPPs to minimize exposure to Fiscal Commitment and Contingent Liabilities (FCCL). This will be facilitated by way of monitoring and managing the existing FCCLs.

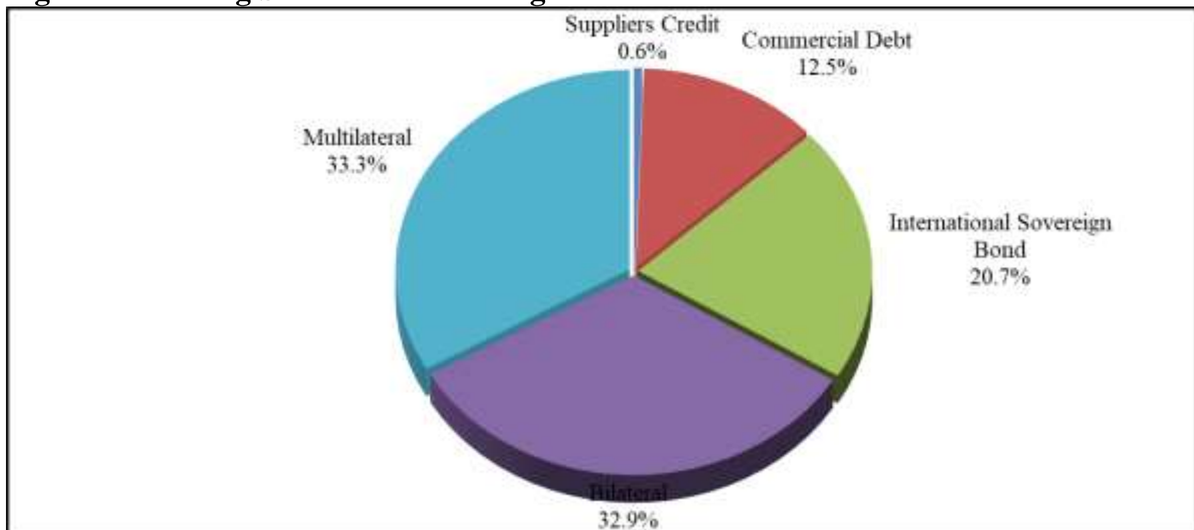
VI. POTENTIAL SOURCES OF FINANCING

A. Sources of Financing for the Existing Debt

40. The Government has in the past relied on Treasury bills and bonds for domestic borrowing and various multilateral, bilateral and commercial sources to meet its budget funding needs.

41. Multilateral debt forms the largest single block source of financing at 33.3 percent, while bilateral debt is the second at 32.9 percent. The international sovereign debt and syndicated loans account for 20.7 percent and 12.5 percent respectively **(Figure 4).**

Figure 4: Existing Sources of Financing



Source: The National Treasury

B. Potential sources to finance the medium term budget

i. Domestic Sources

42. Although the domestic debt market has been providing more than 50 per cent of the total borrowing needs, the capacity of the domestic market to absorb more debt is limited. This is because, most of the recent increase in commercial banks deposits has gone to fund public sector debt (including purchase of government securities, and repo stock).

43. Over the recent years, increasing proportion of commercial banks deposits have been held in government securities, beside cash reserve requirement stock and repo stock. This implies that the capacity of commercial banks to further fund domestic debt at reasonable costs is limited. Accordingly, in addition to reducing fiscal deficits, the actual financing of the fiscal deficits must gradually be biased away from domestic sources and towards external sources and to ease crowding out of the private sector in the domestic credit debt market. The Government will endeavor to explore nontraditional sources of financing budget deficits to safeguard stability of domestic debt market.

i. External Sources

44. Kenya external debt currently stands at 51 per cent, wholly exposed to foreign exchange risk. To accommodate further borrowing to fund the fiscal deficits the National Treasury will explore innovative ways of financing fiscal deficit including international issuance of local currency debt.

45. In terms of instrument diversification the government plans to issue sovereign green bonds over the medium term to finance public projects that are climate friendly.

VII. COST-RISK ANALYSIS OF ALTERNATIVE DEBT MANAGEMENT STRATEGIES

A. Baseline-Pricing Assumptions and Description of Shock Scenarios

46. The pricing assumptions for interest rates and the exchange rate under the baseline pricing assumption are presented below:

    i. Concessional external loans are priced at a fixed rate of 1.75 percent, with a 25 year tenor and up-to 10-year grace period.
    ii. The terms of concessional borrowing from IDA/IBRD and ADB/ADF have hardened due to Kenya`s graduation from low income to lower middle income country.
    iii. Semi-concessional loans are assumed to be contracted at a fixed interest rate of approximately 2.0 percent, a maturity of 15 years including a grace period of up to 5 years.
    iv. Commercial borrowings refer to the international syndicated loans borrowing and the Export Credit Financing contracted at a reference rate plus a margin.
    v. Access to the international debt capital markets is based on the underlying forward US Treasury yield curves plus an assumed credit spread and inflation differentials.

47. Future baseline interest rates and exchange rates are projected based on the observed U.S. Treasury interest rates as at end December, 2019.

    i. The future interest rates of market-based fixed-rate debt instruments in the international capital markets are based on the currently prevailing interest rates.
    ii. Under the baseline scenario for the exchange rate assumptions, the Kenya shilling is assumed to depreciate annually at 3 percent against the U.S. dollar from 2020 and over the medium term; this is consistent with prudent macroeconomic management that will help keep the exchange rate stable.

48. Interest rates are expected to remain within the baseline projections and inflation is expected to remain within the target band.

49. Three risk scenarios are evaluated as follows:

i. The combined exchange-rate and interest-rate risk shock scenario assumes an increase in US Treasury rates by a moderate shock of 2.5 percent in the year 2020. The interest rate shock scenario is combined with the 3 percent exchange rate depreciation.

ii. The stand-alone risk scenario for interest rates assumes U.S. Treasury rates increase faster than expected in 2020 (an extreme shock of 5 percent) over the baseline projections and remains constant thereafter.

iii. A stand-alone exchange rate risk shock scenario is applied whereby the Kenya Shilling depreciates by 3 and 15 per cent against the US$ in 2020 compared to the baseline exchange rate projections.

B. Description of Alternative Debt Management Strategies

50. The 2020 MTDS considered four strategies. These strategies reflect alternative approaches to meet the borrowing requirement during FY2020/21-2022/23.

51. The strategies combine different mix of borrowing instruments that reflect the potential sources of financing outlined in Section VII. The strategies are first built on the split between gross external and domestic financing then on the share of Treasury bills and bonds used for net domestic financing.

i. **Strategy 1 (S1-Baseline projection):** The strategy assumes 28 per cent external borrowing and 72 per cent domestic borrowing to finance the government budget in gross terms over the medium-term. On the external debt, concessional is proposed at 13 per cent, semi-concessional 4 per cent and commercial 11 per cent while on the domestic side, it recommends issuance of medium term instruments (more borrowing through medium term and treasury bills to refinance treasury bills maturities).

ii. **Strategy 2 (S2):** The strategy assumes more concessional borrowing. External and domestic outstanding borrowing would amount to 20 per

cent and 80 percent respectively over the medium term. There is more concentration to finance the budget through external concessional borrowing.

iii. **Strategy 3 (S3):** This strategy maximizes domestic borrowing, assuming 78 per cent of gross financing needs are met through this source. The domestic gross financing is concentrated on medium to long-term debt securities. External gross financing would be 22 per cent of gross financing needs.

iv. **Strategy 4 (S4):** The proposed strategy envisages gross issuance of domestic debt (72 per cent) in the domestic debt market with external financing (28 per cent) over the medium term. On the external debt, concessional and semi-Concessional is proposed at 15 per cent and commercial 13 per cent. Although, strategy 4 is similar to strategy 1 in terms of composition of domestic and external borrowing, there are granular differences in the composition of debt **(Table 8).** For instance the proposed maturity of 8-12 year bonds in strategy 1 is 5% whereas strategy 4 is 8%.

C. Cost-Risk Analysis of Alternative Debt Management Strategies

52. The evaluation of how debt costs and risks evolves under each of the four alternative debt management strategies and behavior of debt under standard shock scenarios is analyzed through the resultant cost and risk indicators. This is done by running the MTDS Analytical Tool which analyses the results of alternative financing strategies to generate a projection of future debt characteristics in term stock and ratios cash flows ratios at the end of the medium term which in this analysis is FY2023/24.

i. Baseline Projection and Alternative Strategies

53. The effect of the financing policies to be pursued during FY2020/21 on the portfolio composition as at end FY2023/24 is presented in **Table 8 and 9**

which shows the average gross borrowing from the alternative strategies over the medium term.

Table 8: Average Percentage Gross Borrowing by Instrument Under Alternative Strategies Over the Medium Term (in percent of gross borrowing) -2022/23

New debt in % of Total Gross Borrowing	**S1**	**S2**	**S3**	**S4**
IDA/ADF Fixed	7	7	8	10
Concessional	6	3	3	4
Semi-Concessional	4	1	1	1
Commercial/International Sovereign Bond	11	9	10	13
Treasury bills	49	46	40	49
Treasury bonds 2-3 Years	4	5	4	4
Treasury bonds 4-7 Years	4	6	6	5
Treasury bonds 8-12 Years	5	14	14	8
Treasury bonds >13 Years	10	9	14	6
External	**28**	**20**	**22**	**28**
Domestic	**72**	**80**	**78**	**72**
Total	**100**	**100**	**100**	**100**

Source: The National Treasury

54. Each set of combination of borrowing instruments yields different debt compositions by instrument and source at end of the Medium term (Table 9).

Table 9: Composition of Debt by Instrument under Alternative Strategies, (in Percent of Outstanding Portfolio by 2023)

In percent of Total	**FY2020**	**As at end FY2022/23**			
Outstanding by instrument	Current	S1	S2	S3	S4
IDA/ADF Fixed	13	15	15	15	17
Concessional	12	13	10	10	11
Semi-Concessional	7	7	4	5	5
Commercial/International Sovereign Bond	20	19	18	18	22
Treasury bills	14	10	9	6	9
Treasury bonds 2-3 Years	1	3	3	3	3
Treasury bonds 4-7 Years	7	5	6	6	6
Treasury bonds 8-12 Years	11	10	17	16	12
Treasury bonds >13 Years	17	18	17	21	15
External	**51**	**54**	**47**	**48**	**55**
Domestic	**49**	**46**	**53**	**52**	**45**
Total	100	100	100	100	100

Source: The National Treasury

55. Alternative strategies yield different cost and risk indicators in accordance to underlying assumptions. The projects costs and risk characteristics of each alternative scenarios are as shown in **Table 10.**

56. The trade-offs between costs and risk outcomes means that a better result cannot be achieved in either cost or risk without losing on either. The results depicted in **Table 10 and Figure 6** were used to provide a quantitative and visual perspectives, respectively, of costs and risks trade-offs of various alternative strategies.

Table 10: Cost and Risk Indicators Under Alternative Strategies

Risk Indicators		**2020**	**As at end 2024**			
		Current	**S1**	**S2**	**S3**	**S4**
Nominal debt as percent of GDP		54.9	49.1	49.1	49.2	48.8
Present value debt as percent of GDP		50.3	43.6	44.4	44.4	43.1
Interest payment as percent of GDP		4.3	3.3	3.4	3.5	3.2
Implied interest rate (percent)		7.8	7.3	7.6	7.7	6.8
Refinancing risk	Debt maturing in 1yr (percent of total)	16.8	19.1	17.4	14.7	17.8
	Debt maturing in 1yr (% of GDP)	10.3	9.4	8.6	7.3	8.7
	ATM External Portfolio (years)	11.1	12.1	11.9	11.9	12.6
	ATM Domestic Portfolio (years)	5.8	5.7	6.0	6.7	5.5
	ATM Total Portfolio (years)	8.8	9.4	9.1	9.4	9.7
Interest rate risk	ATR (years)	8.1	8.7	8.8	9.1	9.4
	Debt re-fixing in 1yr (percent of total)	30.3	29.1	22.9	20.3	23.4
	Fixed rate debt including T-bills (percent of total)	85.1	88.1	93.4	93.2	93.1
	T-bills (percent of total)	12.5	9.9	8.9	6.3	9.2
FX risk	FX debt as % of total	50.8	54.2	48.4	48.5	55.3

Source: The National Treasury

57. Across all the alternative strategies, the nominal debt to GDP is lower than the current status; this is consistent with the projected government commitment to fiscal consolidation aimed at reducing debt to GDP levels over the medium term.

58. On the refinancing risk, Strategy 3 outperforms other strategies under debt maturing in one year as a per cent of total debt and GDP.

59. Strategy 3 performs better in terms of interest rate risk minimization. Interest rate risk is reflected by proportion of debt re-fixed in one year, average time to re-fixing in years and the percentage of the overall debt with fixed interest rate.

60. Strategy 3 and 4 outperform the other strategies in terms of refinancing risk. Strategy 3 has the lowest debt maturing in one year and the longest ATM

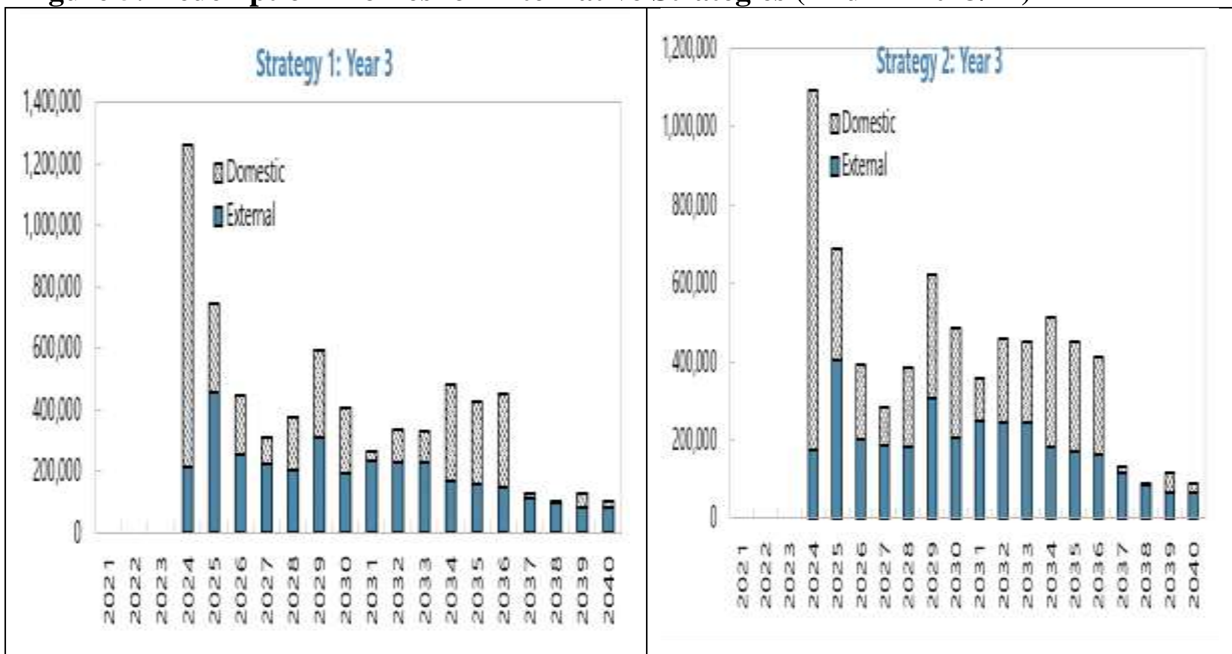
of domestic debt while strategy 4 has the longest ATM of external debt and total debt portfolio.

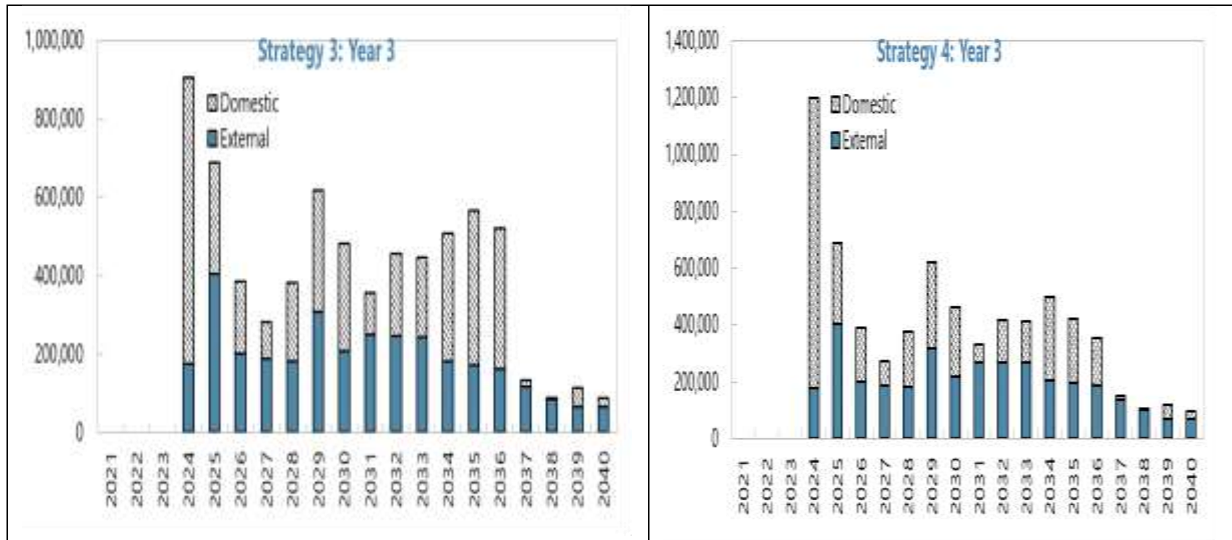
61. Strategy 4 outperforms other strategies by a number of favourable indicators but has slightly higher foreign exchange exposure of 55.3 percent. However, this exposure is consistent with the assumptions of more external financing.

62. **Figure 5**, which depicts the level of refinancing risk of the four alternative strategies. Sstrategies 3 and 4 demonstrate comparative advantage in terms of the redemption profiles.

63. Maturity spikes are noted in FY2023/24, and FY 2024/25 and FY2028/29 under all strategies relating to maturing Euro bonds issued in 2014, 2018 and 2019 in addition to high volume of Treasury Bills maturing in each year.

Figure 5: Redemption Profiles for Alternative Strategies (End-FY2023/24)





Source: The National Treasury

64. The optimal debt management strategy differs from the 2019 strategy in terms of composition of domestic and external borrowing, there are granular differences in the composition of debt. For instance, the proposed maturity of 8-12 year bonds in strategy 1 is 5 percent whereas in strategy 4, it is 8 percent.

ii. Effect of shocks on the costs and risks characteristics of debt under the Alternative Strategies

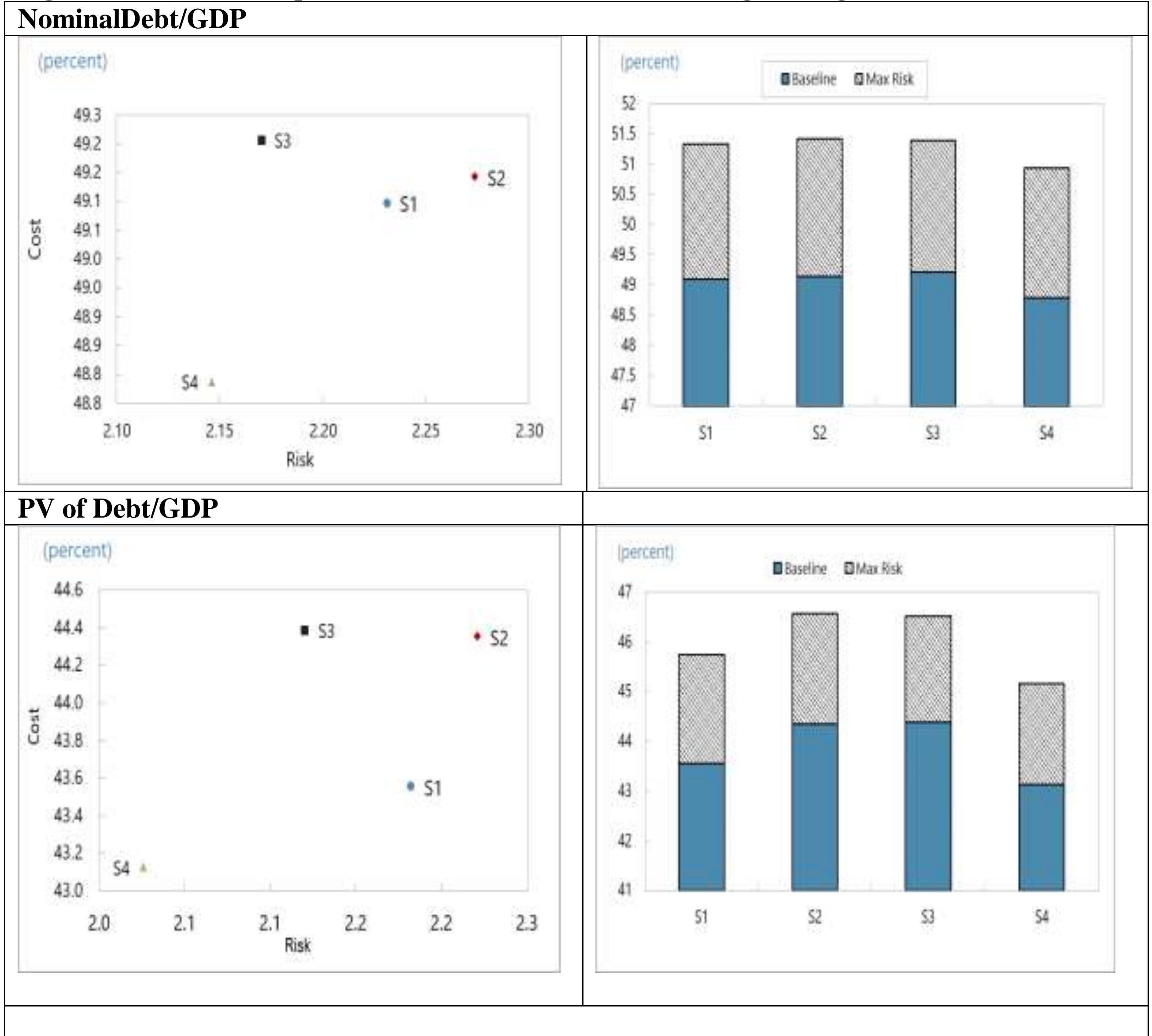
65. The analysis considered the following cost and risk indicators: Present Value of Debt/GDP, nominal debt/GDP, interest payments/Revenues and interest payments/GDP for both the baseline pricing scenario and shock scenarios **(Figure 6).**

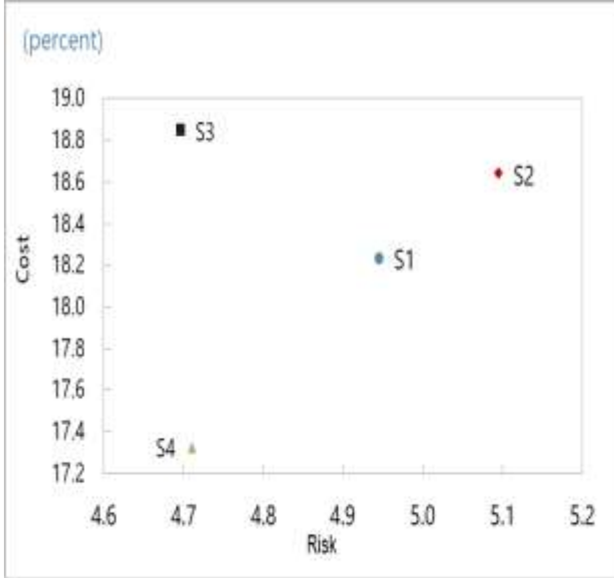
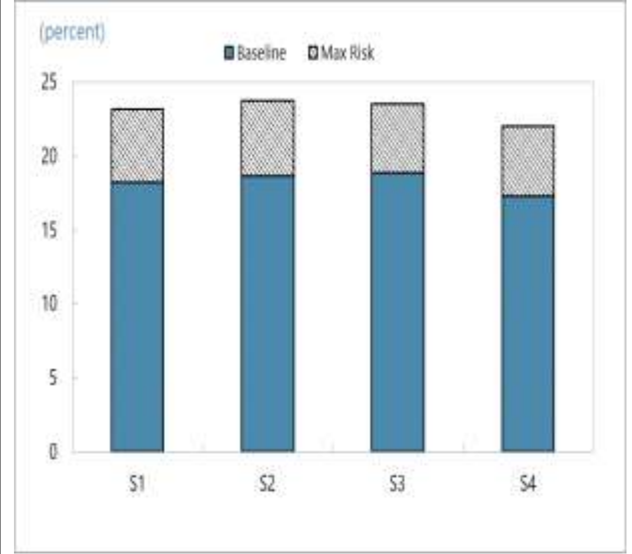
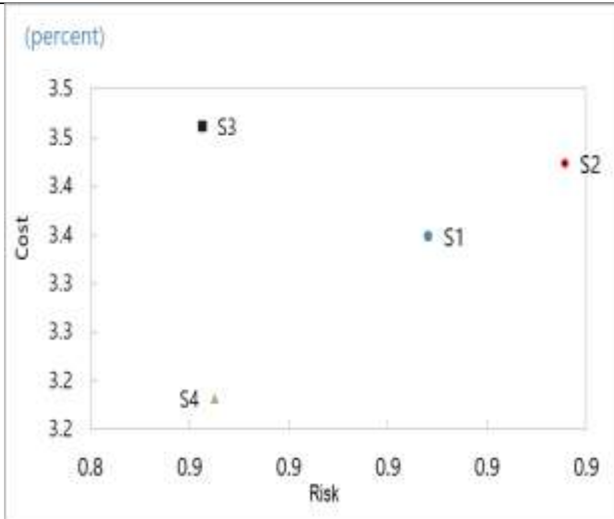
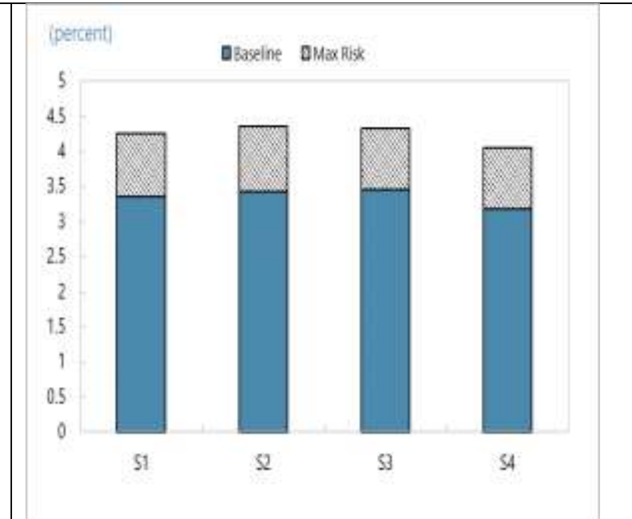
66. The variance between cost and risk outcome under the baseline and shock scenario indicate the extent of risk associated to each strategy. The worst-case outcome across the three stress scenarios described above is used to quantify the risk associated with each of the strategies.

Figure 6: Cost-Risk Representation of Alternative Borrowing Strategies

NominalDebt/GDP

PV of Debt/GDP



Interest/Revenue	
 	
Interest/GDP	
 	

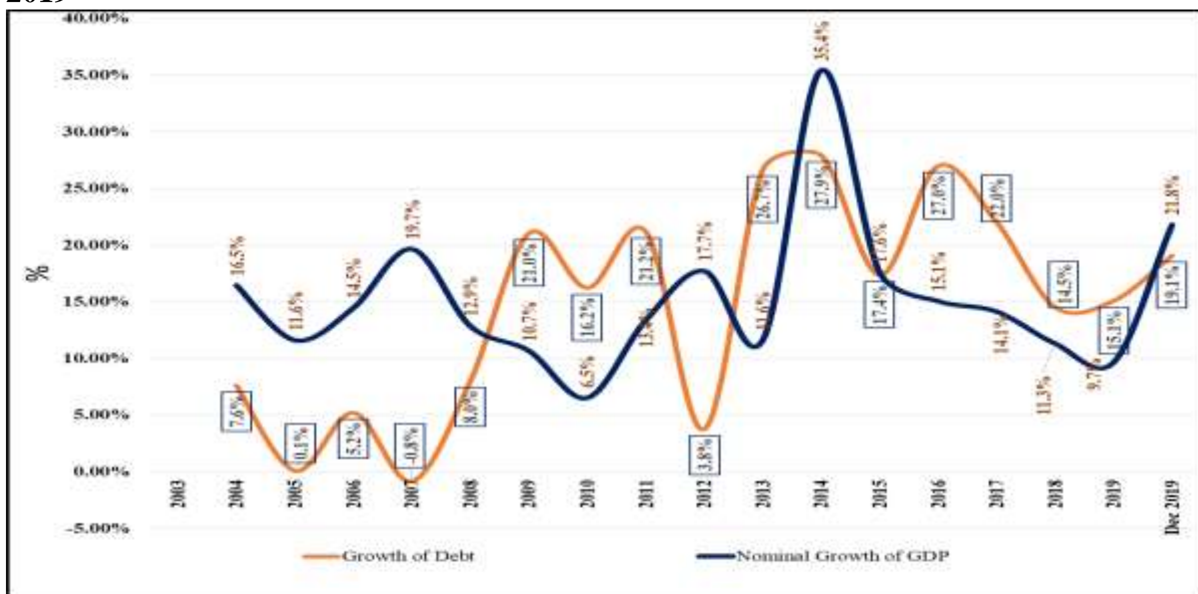
Source: The National Treasury

iii. Optimal Debt Management Strategy: The Context

67. Kenya's high public debt stock accumulation is the residual of operating fiscal deficits over the years. Sustained high domestic borrowing to fund the fiscal deficits has led high cost of domestic credit and crowding out of the private sector.

68. Growth of debt (fiscal deficits) has been above the growth of real GDP in recent years (**Figure 7**). It is therefore important that debt management strategy be accompanied by prudent fiscal policy, conscientious design of fiscal policy including keeping fiscal deficit below the rate of growth of the economy.

Figure 7: Comparison between Growth of Debt and Nominal Growth of GDP 2003 – 2019



Source: The National Treasury

69. As noted in the 2020 BPS high fiscal deficits have translated to into high debt service costs which in turn is emerging as a threat to fiscal sustainability. For instance in 2019 debt service to revenue ratio was 45.2 per cent and is projected to rise to 47.9 per cent in 2022 **(Table 11).** This is as a result of running high fiscal deficits leading to rapid debt accumulation.

Table 11: Public Debt Service to Revenue Projections

Indicators	Threshold	2017	2018	2019	2020	2021	2022	2023
PPG debt service to revenue	**30**	29.2	35.6	45.2	35.2	46.1	47.9	38.5

Source: The National Treasury

Kenya faces a fiscal risk in the event of depreciation of the Kenya Shilling due to the fact that 50 percent of the debt is held in external currencies. Any depreciation of the Kenya Shilling translates to a rise in public debt stock and an increase in debt service costs over and above the CFS budget in local currency.

iv. The 2020 MTDS

70. The optimal 2020 debt management strategy (2020 MTDS) is the one that performs better in terms of reducing the costs and risks characteristics of debt in the medium term.

71. Evaluation of the pertinent costs and risks of the foregoing alternative strategies indicate that Strategy 4, which involves keeping gross external financing at 28 per cent of total gross borrowing and gross domestic borrowing at 72 per cent is the optimal debt management. The strategy takes into account both risk and cost trade-offs, the projected quantity of gross borrowing, the need to sustain domestic debt market stability to avoid crowding out of the private sector.

72. From external sources, the 28 per cent gross external borrowing is distributed into concessional borrowing at 14 per cent; semi-concessional at 1 per cent; and commercial borrowing (programme loans) at 13 per cent. This structure is highly dictated by the heavy maturity of short term debts, mainly Treasury bills, which have to be refinanced each fiscal year. The strategy embeds both refinancing of existing debts as they fall due and net new borrowing to fund the fiscal deficits outlined in the 2020 BPS. Of the net new borrowing to finance projected deficits 60 per cent will come from external sources and 40 percent from domestic sources. This structure will not only minimize cost and risk of debt but also helps ease crowding out of private investors in domestic debt market. In this strategy, Treasury bonds will be the main source of net domestic financing, while Treasury bills will be used only for cash management purposes and not as a budget financing instrument. Both the quantity and proportion of Treasury Bills are projected to decrease.

73. As part of debt management strategy, fiscal deficits must be kept below the rate of economic growth so as to reduce the overall cost of debt on the economy and safeguard debt sustainability. Funding of the fiscal deficits should progressively shift away from domestic sources. Fiscal deficits must be kept under check even where Kenya shilling debt is issued international capital markets.

74. To mitigate the risks of funding fiscal deficits from external sources, it is recommended that Kenya shillings dominated debt be issued in international capital markets going forward to fund part of fiscal deficits. This will improve Kenya shillings liquidity and reduce yields on government debt and allow easing of credit costs for the rest of the economy.

75. In addition, the success of the medium term debt management strategy presumes that macroeconomic stability, including: exchange rate, inflation, interest rates and current account balance, will be preserved.

76. Careful implementation of the strategy accompanied by rapid reduction in fiscal deficits will allow Kenya to graduate to investment grade and attract cheaper credits from global markets.

v. Domestic Debt Market Development as Part of Debt Management Strategy

77. A deep, diversified and efficient domestic debt market is an important factor in underpinning debt sustainability. A domestic debt market that supports bigger proportion of public debt provides a cushion against foreign exchange risk exposure. To cushion the country against the downsides of the risks emanating from the global sphere, the National Treasury, in collaboration with the market participants and other regulators, will intensify implementation of reforms in the domestic debt market to ensure a deep, liquid and efficient debt market in Kenya capable of providing affordable, long-term financing for private sector and deficit financing.

78. The strategic domestic debt market reforms to be implemented include: separation of institutional investors and retail investors in the primary issuance to facilitate full automation of securities auction and shortening of primary auction settlement cycle to T+0; regular publication of issuance calendar; regular market engagement; restructuring of the horizontal repo master agreement to ensure transfer of title/ownership in horizontal repo transactions; establishment of Over-The-Counter (OTC) trading platform aimed at fostering transparency and efficiency in secondary securities trading and settlement in order that attract and promote market competition and price discovery eventually leading to reduced yields and costs of public debt. These reforms will be complemented by issuance of fewer but large size benchmark bonds to enhance market liquidity and attract capital inflows.

79. Additionally, the National Treasury will diversify funding instruments to include issuance of zero coupon bonds, indexed bonds and undertake periodic liability management operations including bond exchanges.

80. The National Treasury will develop guidelines for managing the Sinking Fund established under the PFM Act for purposes of managing debt settlement.

81. The underlying benefits of strategy 4 includes:

vi. Lower the potential of crowding out the private sector by reducing Government- Private sector competition in the domestic credit market;

vii. Decrease interest burden as a percent of GDP;

viii. Lower refinancing and rollover risk by reducing the stock of Treasury bills;

ix. Reduced frequency of issuance of Treasury Bills to create fiscal flexibility;

x. Lengthening of the maturity profile of debt;

VIII. DEBT SUSTAINABILITY

82. Public debt sustainability is the ability of a country to service its debt obligations as they fall due without disrupting budget implementation. Section 15 (2) (d) of the Public Finance Management (PFM) Act 2012 requires the Government through the National Treasury to maintain public debt and obligations at sustainable levels.

83. The 2020 Debt Sustainability Analysis (DSA) indicates that Kenya's public debt remains sustainable over the medium term.

84. Kenya is rated a strong policy performer in the Debt Sustainability Framework (DSF) that uses the World Bank's Country Policy and Institutional Assessment (CPIA) index. Based on the CPIA rating, Kenya's public debt sustainability threshold on PV of Debt/GDP as a strong performer and a low middle-income country is 70 percent.

a. Kenya's External Debt

85. Kenya's external debt sustainability is within sustainable levels as a strong performer. The debt sustainability indicators show that Kenya faces a moderate risk of external debt distress due to breach of one of the three external debt indicators **(Table 12).**

Table 12: Kenya's External debt sustainability

Indicators	Thresholds	2017	2018	2019	2020	2021	2022	2023
PV of debt–to-GDP ratio	**55**	25.9	31.4	27.2	27.4	26.5	25.3	24.0
PV of debt-to-exports ratio	**240**	165.4	191.1	224.8	234.9	229.6	222.3	197.5
PPG Debt service-to-exports ratio	**21**	16.5	19.9	29.3	20.7	24.0	23.2	19.1
PPG Debt service-to-revenue ratio	**23**	13.3	16.2	20.4	13.1	15.2	14.2	12.1

Source: The National Treasury

b. Total Public Debt

Total public debt as a proportion of GDP remains well below the public debt benchmark of 70 percent in PV terms.

86. Public debt sustainability analysis indicates that present value of public debt as a proportion of GDP was 55.4 per cent in 2019 and is projected to decline gradually over the medium term **(Table 13).**

Table 13: Kenya's Public Debt Sustainability

Indicators	Thresholds	2017	2018	2019	2020	2021	2022	2023
PV of debt–to-GDP ratio	**70**	55.4	60.6	55.4	55.7	54.0	48.5	42.2

Source: The National Treasury

87. In addition to reducing fiscal deficits, it is also important to promote Kenya's export competitiveness, facilitate increase in diaspora remittances and fast track domestic debt market development as key ingredients to public debt sustainability.

IX. MTDS IMPLEMENTATION, MONITORING AND EVALUATION

i. Implementation: Issuance Calendar

88. Implementations of the 2020 MTDS (Strategy 4) will be through the annual borrowing plans that take account of the Government gross funding needs for the period.

89. Borrowing and securities issuance composition will be structured to ensure that the desired objectives provided in the 2020 MTDS are achieved. Auction of Treasury bills will be scaled down as Treasury Bills are not a debt financing tool. PFM Act 2012 requires that Treasury Bills be used for temporary cash management and must be repaid within 12 months. This implies that the outstanding stock of Treasury Bills must be reduced gradually to conform to requirements of prudent debt management –reducing refinancing risk by using long tenor instruments to fund fiscal deficits. This will be achieved by way of reducing the volume and the frequency of issuance of Treasury Bills as a form of debt re-profiling.

90. As part of the refinancing risk management strategy, additional Treasury Bonds will be issued over and above deficit financing and bonds redemption requirements to cover Treasury Bills maturities so as to achieve the desired debt re-profiling.

91. External borrowing will be timed to coincide with scheduled maturities and Government cash requirements.

ii. Implementation and Review

92. The National Treasury will conduct quarterly review of the issuance program in line with its operational work plan and in consultation with the market participants.

93. Progress in implementation of the strategy will be disseminated in form of regular debt management reports.

iii. Monitoring and Review of Costs and Risks Characteristics of Debt Versus Strategy Targets

94. The MTDS is premised on underlying key macroeconomic assumptions highlighted in the 2020 MTDS and key risk parameters associated with them.

95. The sustainability of Kenya's public debt depends on macroeconomic performance, the design of the fiscal policy, particularly fiscal deficits, and stability in general prices levels (exchange rate, inflation and interest rates). The objective of measuring/assessing macroeconomic outturn as a debt management strategy is underpinned by the fact that instabilities in macro indicators (including interest rates, exchange rate, GDP growth rate, revenues, disbursements, etc) has effects on costs and risks of debt.

96. Macroeconomic instability affects fiscal stability and Government's ability to meet its debt services obligations as spelled in law and in the MTDS. The evolution of the cost and risk characteristics of public debt partly reflects the portfolio structure changes. Thus the evolving structure of public debt will be monitored to inform CFS budget provision and management of costs and risks of public debt.

97. The validity of the borrowing targets spelled out in the optimal strategy and the underlying assumptions will be evaluated against the outturn. Periodic review of the fiscal outturn will be undertaken regularly and any deviations from the underlying assumptions assumed in the MTDS analysis will prompt revision of the strategy. State corporations debt and stock of PPPs fiscal commitments and contingent liabilities will be tracked and assessed against sustainability thresholds/levels.

iv. Evaluation of MTDS Outcomes Against Targets

98. The actual costs and risks characteristics (including the redemption profile) of the public debt will be evaluated annually against the previously projected profile to assess progress in improving the costs and risk exposure.

99. The costs and risks parameters to be evaluated are listed in **Table 14** below.

v. Dissemination

100. The results of the evaluation will be published in subsequent MTDS editions and adverse deviations from targets or baseline positions will be brought to the attention of the Cabinet Secretary, the Cabinet and Parliament as part of the compliance to enhance debt transparency principles.

Table 14: Monitoring and Evaluation of Cost and Risk Indicators Under Alternative Strategies Template

Risk Indicators		**2019**				
		Baseline Dec 2019	MTDS 2020 **Targets**	Actual Dec 202…	Deviation	Remarks
Nominal debt as % of GDP						
Present value debt as % of GDP						
Interest payment as % of GDP						
Implied interest rate (%)						
Refinancing risk	Debt maturing in 1yr (% of total)					
	Debt maturing in 1yr (% of GDP)					
	ATM External Portfolio (years)					
	ATM Domestic Portfolio (years)					
	ATM Total Portfolio (years)					
Interest rate risk	ATR (years)					
	Debt refixing in 1yr (% of total)					
	Fixed rate debt (% of total)					
FX risk	FX debt as % of total					

Source: The National Treasury

101. The outcome of the implementation of 2020 MTDS will inform the design of 2021 MTDS with a view to continuously improving debt management and debt sustainability.

ANNEX I: MTDS IMPLEMENTATION WORK PLAN

NO.	OUTPUT	ACTIVITY	TIMEFRAME	ACTION BY	DATA SOURCE
1)	MTDS 2020	Preparation and approval of MTDS 2020	January –June 2020	PDMO PS/NT CS/NT&P Cabinet Parliament	BPS II 2020, BROP 2019 CS DRMS CBK MTDS 2019
2)	CFS (Debt) Budget estimates	Prepare the debt service projections and CFS budget estimates	Annually as per Budget Calendar and during revisions	PDMO BD MFAD CBK PS/NT CS/NT&P Cabinet Parliament	PDMO
3)	Monitoring reports and briefs	Access of domestic and external borrowing and repayment data-	Weekly	PDMO CBK	RMD CBK MFAD
4)	Monthly debt management reports	Access of domestic and external borrowing and repayment data-	Monthly	PDMO CBK	RMD CBK FMA/NT
5)	Report on cost and risk characteristics of debt	Technical Fora to review MTDS implementation,	Quarterly	PDMO MFAD CBK GIPE	CBK AGD
6)	MTDS 2020 performance review	Undertake review of performance of the MTDS	Every six months	PDMO CBK MFAD	RMD CBK MFAD
7)	FCCL Report	Undertake analysis of FCCL and FCCL assessment	Annually	PDMO PPP Unit	Letters of support under PPPs
8)	Review of issuance calendar	Stakeholders Forums to review issuance calendar	Quarterly	PDMO AGD CBK MFAD Market Participants PS/NT CS/NT&P	PDMO CBK AGD Market Participants
9)	2021 MTDS	Review of 2020 MTDS, preparation and approval of 2021 MTDS	December 2020 January 2021	PDMO PS/NT CS/NT&P Cabinet Parliament	BPS II 2021, BROP 2020 CS DRMS CBK MTDS 2020