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2021Medium Term Debt Management Strategy

February 2021

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SECRET

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TABLE OF CONTENTS

SECRET

LIST OF FIGURES

LIST OF TABLES

SECRET

FOREWORD

The preparation of the Medium-Term Debt Strategy (MTDS) marks an important step in the budget making cycle. The strategy framework outlines the government intentions to achieve the optimal debt portfolio which reflects choice ranking of cost and risk trade-offs. The 2021 MTDS has been prepared on a background of global Covid-19 health pandemic which has put more strain on the country's resources.

The 2021 MTDS has been prepared in line with the Debt and Borrowing Policy which was approved by the Cabinet in March 2020 and outlines the government intentions over the Medium Term. The strategy articulates borrowing and refinancing measures necessary to reduce the costs and risks of borrowing as articulated in the Public Finance Management Act 2012. The strategy is anchored on the Budget Policy Statement as provided for in the Public Finance Management Act and market assumptions. The strategy considers the existing stock of public debt and potential financing alternatives for the stated fiscal deficits as contained in the 2021 Budget Policy Statement.

In preparing the 2021 MTDS, financing options were evaluated based on costs and risks of alternative strategies. The most optimal cost-risk trade-off is determined by considering a range of financing alternatives. Key consideration included potential sourcing from local and international financial markets with the objective of minimizing risks and costs.

The practice of reviewing MTDS on a regular basis demonstrates Government commitment to promoting transparency and accountability in public debt management. Regular review provides input into the MTDS by ensuring that the implementation considers new debt policy direction and emerging economic environment with a view to ensuring that debt is set on a sustainable path over the medium to long term.
The domestic debt market has grown over the years in depth and efficiency improving significantly. In particular, the government has initiated automation in the domestic market at both the primary and secondary segments. The Government is also riding on public debt instruments to promote financial

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inclusion and domestic debt market development through exploring issuance of new and innovative debt instruments such as M-Akiba bond.

Domestic debt market development objective is undertaken through collaboration with other stakeholders such as the Central Bank of Kenya, Capital Markets Authority and market players through consultative forums. This reform agenda is aimed at enhancing information exchange, policy consistency and market flexibility to enhance transparency in trading, price determination and increase capital investment flows ultimately lowering the overall cost of credit in the economy.

Going forward reducing fiscal deficit remains key to stemming debt accumulation and maintaining debt at sustainable levels. The objective is to reduce the fiscal deficits and public debt vulnerabilities and lower Kenya's risk of debt distress from high to moderate in the medium term. To achieve this, the government will reduce the fiscal deficit to levels consistent with the GDP growth rate. In the Medium Term, MDAs will be expected to use low-cost innovative service delivery strategies to reduce expenditure.

In December 2020, Kenya signed the Memorandum of Understanding with the Paris Club group of lenders under the framework of the G20 Debt Service Suspension Initiative (DSSI). Kenya is also engaging with non-Paris Club lenders with a view to reaching a similar arrangement as a measure to free fiscal space necessary to fund Covid-19 related mitigation expenditures in the remaining second half of 2020/21 financial year.

HON. (AMB). UKUR K. YATANI, E.G.H.
Cabinet Secretary/ The National Treasury &Planning

ACKNOWLEDGEMENT

Preparation of the 2021 MTDS is an annual review exercise which seeks to comply with Section 33(2) of the Public Finance Management Act, 2012 and which informs borrowing operations and liability management over the Medium Term.

The 2021 Medium Term Debt Management Strategy is aligned to broad strategic priorities as set out in the 2021 Budget Policy Statement. The optimal debt management strategy outlines debt management measures that seek to minimize the costs and risks of financing the fiscal deficits without disrupting macroeconomic stability.

The preparation of the 2021 MTDS was a collaborative effort involving various departments within the National Treasury and the Central Bank of Kenya. I recognize the tireless effort of the Public Debt Management Office (PDMO) for spearheading the process. Likewise, I acknowledge the effort of the representatives from Macro and Fiscal Affairs Department in the National Treasury and the Financial Markets Department of the Central Bank of Kenya.

Prudent implementation of the strategy will help in reverting Kenya's public debt trajectory to a sustainable path over the medium to long term.

The 2021 MTDS and previous years' versions of the MTDS are available for reference in the National Treasury website: www.treasury.go.ke.

JULIUS MUIA, PhD, CBS
Principal Secretary, National Treasury.

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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
DSSI	Debt Service Suspension Initiatives
ECA	Export Credit Agencies
ECF	Extended Credit Facility
EFF	Extended Fund Facility
FX	Foreign currency denominated debt
FY	Financial Year
FCCL	Fiscal commitment and Contingent Liabilities
G20	Group of 20 Developed Countries
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
MDAs	Ministries, Departments and Agencies
MTDS	Medium Term Debt Strategy
MTDS AT	Medium Term Debt Strategy 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

1. The strategy covers the period FY2021/22- FY2023/24 over which the optimal debt portfolio is to be achieved. The 2021 Medium Term Debt Strategy (MTDS) has been prepared against the backdrop of the unfolding global health crisis which has led to a slowdown in economic activity resulting in low domestic revenue mobilization. Consequently, the government instituted measures to contain the spread of the pandemic. The strategy is underpinned by the 2021 Budget Policy Statement (BPS) consistent with the government objective of minimizing the costs and risks of public debt. The scope of coverage of this strategy is the existing debt stock, non-performing guarantees, and the stated fiscal deficits in the 2021 BPS.

2. The 2020 credit rating by major sovereign rating agencies Standard and Poors and Fitch Ratings placed Kenya at B+ with a negative outlook signifying the effects of the Covid-19 pandemic on the economy and depressed internal revenue. The mitigating measures to the rising debt levels lies in active debt management and fiscal consolidation programme supported by a sound macroeconomic environment.

3. The nominal stock of public debt was Kshs 7,281.6 billion or US$ 65.6 billion as at end December 2020 equivalent to 65.6 percent of GDP. The World Bank and International Monetary Fund composite indicator (CI) for economic and institutional performance classifies Kenya as a strong performer with sustainable debt but with rising risks. The public debt accumulation has been on elevated mode due high fiscal deficits. The government commitment to achieving reduced fiscal deficits over the medium term remains key to Kenya's debt sustainability.

4. The government plan over the medium term is to focus on the "Big Four" that will ensure increased investments in key strategic areas such as: Food security and nutrition, manufacturing, Universal Health Coverage, Affordable Housing and mitigation against Covid-19 pandemic. The 2021 MTDS also anchors its objectives on the Medium-Term Plan III which supports these strategic initiatives aimed at creating the right business environment, jobs and ultimately promote broad based inclusive growth.

5. The optimal strategy that minimizes costs and risks of public debt suggests borrowing in the ratio of 57:43 in net external and net domestic borrowing.

This strategy is underpinned by the need to move away from high interest cost of domestic debt. In terms of gross borrowing, external and domestic financing accounts for 27 percent and 73 percent respectively. However, the 2021 BPS proposes a borrowing in the ratio of 21:79 for FY2021/22 net external and domestic borrowing; and an average ratio of 30:70 for the medium term. The financing strategy under the fiscal framework is informed by external Debt Limit Policy applicable to countries under the IMF program.

6. The optimal strategy for 2021 for financing the fiscal deficit seeks to achieve gradual repayment of Treasury bills and part of commercial debt in the external portfolio through liability management operations. It considers the cost and risk trade-offs, the net borrowing and the need to diversify the funding sources. The strategy also reflects the need to maintain issuance of Treasury bills as cash management tool and gradually reduce its stock over the medium term. The strategy further underpins the need to issue medium to long term bonds to lengthen the maturity structure thus reducing refinancing risk of borrowing as well as supporting domestic debt market development through benchmark bond program. The strategy has modest exposure levels to foreign exchange rate risk which is consistent with the plan to raise the larger amount of resources from external sources. The envisaged borrowing will continue to maximize concessional and semi-concessional debt from the external sources. The Strategy also envisages tapping into the international capital market.

7. While the domestic debt market has been the major source of funding of the fiscal deficits providing about a half of the financing needs, the market remains shallow and is mainly dominated by commercial banks. The reforms to deepen the domestic debt market include: the enhancement of market infrastructure through automation of processes at both the primary and secondary market, restructuring of interbank repo and setting up of Over-the-Counter (OTC) trading platform to complement the Nairobi Securities Exchange. Significant progress has been made with new and innovative debt instruments making a debut in the domestic market. Going forward, commitment to these reforms will expand the capacity of the domestic debt market to take up higher share of the public debt.

8. In selecting the optimal strategy, the associated indicators considered include: *Treasury bills as a percentage of total debt, Average time to re-fixing, Debt*

as a percentage of GDP, Average time to maturity for domestic debt portfolio and Average time maturity of total portfolio. The key differentiating factor was interest rate and refinancing risks. The *optimal strategy presented* is "S4" which considers the cost and risk trade-offs, the net borrowing, and the need to diversify the funding sources. The strategy also reflects the need to reduce Treasury bills as a source of funding the budget.

9. Although strategy 4 was chosen as the optimal plan, current uncertainties related to Covid-19 pandemic, global economic and market conditions, geopolitics, may necessitate deviation from this strategy path to align to policy actions at the time.

10. The success of this strategy depends on prudent implementation and government commitment to fiscal consolidation program supported by a sound macroeconomic environment and how the Covid-19 pandemic unfolds. Further, the implementation of the strategy will require close monitoring and evaluation of the proposed work plan.

I. INTRODUCTION

1. Section 33(2) of the Public Finance Management Act (PFM) 2012 provides guidance on the preparation of the 2021 Medium Term Debt Management Strategy (MTDS).

2. The public debt management objectives as outlined in Section 62(3) of the PFM Act, 2012 consist of: (a) minimizing the cost of public debt management and borrowing over the long-term taking risks into account; (b) promoting the development of the market institutions for Government debt securities; and (c) ensuring the sharing of the benefits and costs of public debt between the current and future generations.

3. The scope of the 2021 MTDS comprises national government external and domestic debt and non-performing[1] guarantees. The MTDS covers the Medium-Term Expenditure Framework (MTEF) period of FY2021/22-2023/24, consistent with the 2021 Budget Policy Statement (BPS). The analysis begins with outstanding debt as at 31st December 2020 and projected borrowings.

4. The MTDS is anchored on macroeconomic assumptions outlined in the 2021 BPS for the period FY2021/22-2023/24, and projected deficits in addition to the cost and risk characteristics of existing public debt stock.

Background to the Medium-Term Debt Strategy

5. Kenya's economy was adversely affected by the outbreak of Covid-19 Pandemic and the containment measures which not only disrupted livelihoods, but also economic activities. As a result, the economy is expected to slow down to around 0.6 percent in 2020 from 5.4 percent in 2019. The economy is projected to recover and grow by about 7.0 percent in 2021 and above 6.0percent over the medium term.

[1] Materialized guarantees

6. The overall inflation was 5.6 percent in December 2020 down from 5.8 percent in 2019. Inflation is expected to remain within the target range of 5 ± 2.5 percent. The foreign exchange market remained largely stable compared to regional and global currencies but was partly affected by a significant strengthening of the US Dollar in the global markets and uncertainty with regard to the Covid-19 pandemic. Domestic interest rates remained fairly low and stable.

7. Kenya`s Sovereign credit rating by both Fitch Ratings and Standard & Poor was B+ with a negative outlook in June /July 2020 due to the adverse effects of Covid-19 pandemic on the economy and low internally generated revenues. The rating agencies noted that Kenya's rising government debt is mitigated by a diversified economy, favourable debt composition and manageable debt maturity profile. Kenya's international investment position continues to be supported by macroeconomic stability, narrowing of the current account deficit and strong growth in diaspora remittances.

8. National Government debt in nominal terms as at end December 2020 was Kshs. 7,281.6 billion, equivalent to 65.6 percent of Gross Domestic Product (GDP). Total external debt was Kshs. 3,792.8 billion (34.2 per cent of GDP) while total domestic debt was Kshs. 3,488.8 billion (31.4 per cent of GDP). The Public Finance Management Act, 2012 sets the the statutory debt ceiling at Kshs 9.0 trillion. To accommodate the fiscal deficits in FY2021/22 and into the medium term, the statutory debt limit has to be expanded.

9. Under the World Bank (WB) and International Monetary Fund (IMF) Composite Indicator (CI) for economic and institutional performance, Kenya is a strong performer. Debt Sustainability Analysis (DSA) for Kenya indicates that Kenya's public debt remain sustainable but risks to sustainability have increased. Debt indicators are expected to improve as fiscal consolidation progresses and the global economy recovers from the Covid-19 shocks over the medium term.

10. Due to Covid-19 pandemic environment the government participated in the Debt Service Suspension Initiative (DSSI) under the G20 framework to free up resources for Covid-19 related expenditures.

II. REVIEW OF ACTUAL COSTS AND RISK CHARACTERISTICS AGAINST 2019 AND 2020 DEBT MANAGEMENT STRATEGIES

i. Review of the implementation of the 2019 and 2020 MTDS.

11. The gross external and domestic financing target for the 2019 MTDS was 38 and 62 percent respectively. The strategy envisaged external concessional borrowing and semi-concessional at 34 percent and commercial at 4 percent **(Table 1)**. Domestic financing was envisaged to be met mainly through issuance of medium to long term benchmark bonds with the objective of lengthening the domestic debt maturity profile.

12. The actual gross domestic financing in 2019/20 was 78.6 percent of the total borrowing compared to 62.0 per cent envisaged in the strategy while the gross external borrowing was 21.4 percent compared to 38.0 percent. Gross external borrowing comprised of concessional and semi concessional at 21.1 percent compared to 34.0 percent. On the other hand, commercial borrowing stood at 0.3 percent compared to 6.0 percent as envisaged in the strategy.

13. In the financial year 2019/20, the net borrowing was Ksh. 790.8 billion to fund the fiscal deficit. The net foreign financing was Ksh 340.4 billion against a target of Ksh 324.0 billion, while net domestic financing was Ksh 450.4 billion raised in the domestic debt market against a target of Ksh 593.9 billion. The actual borrowing from Treasury bills and bonds was Ksh 410.5 billion.

Table 1: Gross Financing for FY2019/20

	MTDS 2019 targets (%)	2019-2020 actuals (%)	2019-2020 (Kshs millions)
Gross domestic borrowing	62.0	78.6	1,622,506
Gross external borrowing	38.0	21.4	442,031
O/w Concessional and semi concessional	34.0	21.1	436,161
Commercial borrowing	4.0	0.3	5,870

Source: The National Treasury

14. Table 2 compares the performance of debt risk indicators between the 2019 and 2020 MTDS. The Table shows a decrease in portfolio of government debt maturing in one year from 17.1 percent in 2019 to 15.5 percent in 2020, reflecting a reduction in the overall refinancing risk. Both interest rate and foreign exchange risk indicators remained relatively stable.

Table 2: Review of Cost and Risk Indicators

Risk Indicators						
		Baseline Dec 2018	2019 MTDS Targets	Actual End Dec 2020	Deviation (4-3)	Remark on deviation
1		2	3	4	5	6
Nominal debt as % of GDP		50.3	55.7	63.3	7.6	Increased public debt accumulation
Present value debt as % of GDP			51.1	56.8	5.7	
Interest payment as % of GDP		3.9	4.4	4.4	0.0	Low fiscal risk
Refinancing risk	Debt maturing in 1yr (% of total debt)	27.4	17.1	15.5	-1.6	Reduced refinancing risk
	Debt maturing in 1yr (% of GDP)	13.8	11.1	11.0	-0.1	
	ATM External Portfolio (years)	10.1	11.0	11.2	0.1	

Risk Indicators						
		Baseline Dec 2018	**2019 MTDS Targets**	**Actual End Dec 2020**	**Deviation (4-3)**	**Remark on deviation**
	ATM Domestic Portfolio (years)	4.7	5.7	6.3	0.6	
	ATM Total Portfolio (years)	7.4	8.7	9.1	0.4	
Interest rate risk	ATR (years)	7.3	8.0	8.4	0.4	Stable interest rate risk indicators
	Debt refixing in 1yr (% of total)	32.4	31.0	27.1	-3.9	
	Fixed rate debt (% of total)	91.9	85.9	86.9	1	
Foreign exchange (FX) risk	FX debt as % of total debt	50.9	50.1	51.2	1.1	Marginal rise in foreign exchange risk

Source: The National Treasury

15. The Average Time to Maturity (ATM) for both domestic and external debt improved from 5.7 years and 11.0 years in 2019, to 6.3 years and 11.2 years in 2020 respectively, implying lower refinancing risk (**Table 2**).

16. Interest payment as a share of GDP remained unchanged at 4 percent implying lower fiscal risk. Lower interest cost is key in ensuring debt sustainability in the medium term and lowering cost of public debt (**Table 2**).

17. The newly contracted external debts in the year ending June 2020 had an average maturity and grace period of 26.1 years and 7.4 years compared to 15.3 years and 5.6 years in June 2019 respectively. The weighted average interest rate for new external debt declined from 3.9 percent in June 2019 to 0.5 percent in June 2020 (**Table 3**). The improved borrowing terms reflect government preference for concessional and semi-concessional external financing sources.

Table 3: Average Terms of New External Debt

Description	Jun-18	Jun-19	Jun-20
Average Maturity (years)	20.8	15.3	26.1
Grace Period (years)	10.3	5.6	7.4
Weighted Average Interest Rate (%)	3.9	3.9	0.5

Source: The National Treasury

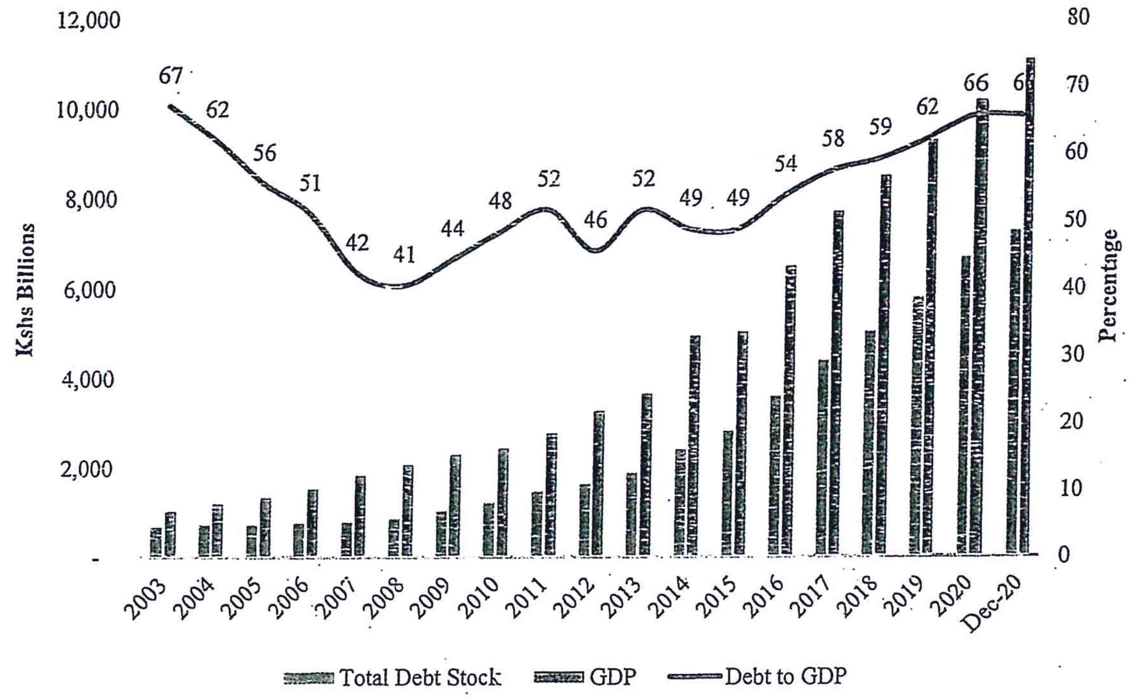
ii. Review of Actual Borrowing against 2020 MTDS Targets

18. The 2020 MTDS envisaged 72 percent of total gross domestic borrowing over the medium term to be raised from domestic financing and 28 percent from external borrowing. For external financing, concessional, semi-concessional and commercial borrowing accounts for 14 percent, 1 percent and 13 percent respectively, while domestic financing mainly comprised of the Treasury bonds.

III. NATIONAL GOVERNMENT PUBLIC AND PUBLICLY GUARANTEED DEBT

19. As at end December 2020, the national government's public and publicly guaranteed debt in nominal terms was Kshs 7,281.5 billion or US$66.7 billion (65.6 percent of GDP). Domestic debt was Kshs. 3,488.8 billion (31.4 percent of GDP) while external debt was Kshs. 3,792.82 billion (34.2 percent of GDP)

Figure 1: Nominal GDP, Gross Debt and Debt to GDP Ratio 2003-2020



Source: The National Treasury

20. As at end December 2020, the debt stock excluding guarantees, overdraft, bank advances and suppliers credit in the MTDS analysis was Kshs 7,041.2 billion or US$ 64.5 billion (63.4 percent of GDP) comprising external debt of Kshs 3,603.0 billion or US$ 33.0 billion (32.5 percent of GDP) and domestic debt of Kshs 3,438.2 billion or US$ 31.5 billion (31.0 percent of GDP).

21. The 2021 MTDS excludes Kshs. 240.4 billion comprising of guaranteed debts of State owned Enterprises servicing their own debts amounting to Kshs

171.7 billion, overdraft of Kshs 47.6 billion, Suppliers credit of Kshs 18.1 billion and Bank advances of Kshs 3.0 billion.

22. The main sources of external public debt are multilateral, bilateral and commercial creditors. As a proportion of GDP, multilateral, bilateral and commercial debt (including international sovereign bond) accounted for 13.5 percent (IDA was the largest share at 8.8 percent), 9.7 percent and 9.3 percent (6.0 per cent international sovereign bond) respectively **(Table 4).**

23. As at end December 2020, domestic debt comprised mainly of Treasury bills in tenors of 91, 182, and 364 days as well as Treasury bonds, accounting for Kshs 855.7 billion (7.7 percent of GDP) and Kshs 2,561.3 billion (23.1 percent of GDP) respectively. The remaining 0.2 per cent of GDP is Pre-1997 government debt of Kshs. 21.1 billion.

Table 4: Public and Publicly Guaranteed Debt in the MTDS, End-December 2020

	Kshs. (millions)	USD (millions)	% of GDP
I. Domestic Debt (included in MTDS)			
Treasury Bills	855,714.7	7,838.2	7.7
Treasury Bonds	2,561,331.2	23,461.5	23.1
Pre-1997 Government Debt	21,118.8	193.4	0.2
Sub Total	**3,438,164.7**	**31,493.2**	31.0
II. External debt (included in MTDS)			
IDA	980,317.6	8,979.6	8.8
ADF	317,347.2	2,906.9	2.9
Bilateral	1,072,273.0	9,821.9	9.7
Multilateral	195,998.0	1,795.3	1.8
Commercial Banks	371,146.3	3,399.7	3.3
International Sovereign Bond	665,948.0	6,100.0	6.0
Sub Total	**3,603,030.03**	**33,003.3**	32.5
III. Excluded from MTDS			
Suppliers Credit	18,069.48	165.51	0.2
CBK Overdraft	47,597.7	436.0	0.4
Performing Guarantees	171,725.61	1,572.99	1.5
Bank advances	2,964.60	27.16	0.0

	Kshs. (millions)	USD (millions)	% of GDP
Sub Total	**240,357.4**	**2,201.6**	**2.2**
TOTAL DEBT Included in MTDS (I+II)	**7,041,194.7**	**64,496.5**	**63.4**
TOTAL DEBT (I+II+III)	**7,281,552.1**	**66,698.1**	**65.6**

Source: The National Treasury and Central Bank of Kenya.

24. The Strategy excludes performing guarantees debt of Kenya Airways (KQ), Kenya Ports Authority(KPA), Kenya Power (KPLC) and Kenya Electricity Generation Company (KenGen) amounting to Kshs 171.7 billion or US$1.6 billion (**Table 5**).

Table 5: Outstanding Government Guaranteed Debt (End-December 2020)

Beneficiary Entity	**KSH (millions)**	**USD (Millions)**
Kenya Power Company	12,794.2	117.2
Kenya Electricity Generating Company	29,853.9	273.5
Kenya Ports Authority	41,624.5	381.3
Kenya Airways	82,540.1	756.1
Kenya Railways (IDA Concessionaire)	4,912.7	45.0
Sub-Total Un-Called Guarantees	**171,725.6**	**1,579.9**

Source: The National Treasury.

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

25. This section analyses the cost and risks of existing National Government debt as at end December 2020. The analysis also informs the 2021 MTDS in terms of cost and risk minimization.

26. The total outstanding debt included in the 2021 MTDS analysis was Kshs 7,041.2 billion equivalent to 63. 5 percent of GDP. Domestic debt comprises of Kshs 3,438.2 billion (30.9 percent of GDP) while external debt accounts for Kshs 3,603.0 billion (32.4 percent of GDP) The external debt portfolio is dominated by concessional debt at 38.8 percent while semi concessional and commercial debt accounts for 30.4 percent and 30.7 per cent respectively. Domestic debt portfolio comprises of Treasury bills, bonds, and Pre-1997 debt at 24.9 per cent, 74.5 per cent and 0.6 per cent respectively. The cost and risk characteristics of the debt portfolio are presented in **Table 7.**

27. As at end-December 2020, total National Government public debt interest payments as a share of GDP was 4.4 per cent, domestic debt interest payments was 3.4 percent of GDP while external interest payments as a share of GDP was 1.0 per cent. Interest rates remained fairly stable in line with the central bank's monetary policy stance.

28. The maturity structure of domestic debt improved significantly during the year 2020. The proportion of instruments with remaining maturities longer than 11 years in December 2020 rose to 44.7 per cent from 19.8 percent in December 2019. Conversely, the proportion of instruments with 2 - 3 years declined to 0.9 per cent in December 2020 from 12.4 per cent in December 2019 **(Table 6)**. This outcome was attributed to the government`s deliberate strategy of implementing the benchmark bond programme aimed at lengthening the debt maturity profile.

Table 6: Domestic Debt by Maturity

Remaining Maturity in Years	End Dec 2019 In million US$	In Percent of Total	End Dec 2020 In million US$	In Percent of Total
Less than one year	9,909.22	34.9	7,838.24	25.04
2 to 3 years	3,528.58	12.4	285.06	0.91
4 to 5 years	3,317.56	11.7	3,078.33	9.84
6 to 10 years	6,029.96	21.2	6,123.54	19.56
Above 11 years	5,593.97	19.8	13,974.54	44.65
Total	**28,379.29**	**100**	**31,299.71**	**100**

Source: The National Treasury

29. The key indicators for measuring refinancing risk are; debt maturing in one year as a percent of total debt, Average Time to Maturity (ATM) and debt maturing in one year as a percent of GDP. Overall, the refinancing risk reduced significantly during the year. ATM of total debt portfolio was 9.1 years as at end December 2020. Debt maturing in 1 year as a percentage of total debt was 15.5 per cent in December (Table 7). This is attributed to the successful implementation of the benchmark bond programme and gradual reduction of Treasury bills stock in the domestic debt market, improving the ATM for Treasury bonds to 8.3 years in December 2020.

Table 7: Cost and Risk Indicators for Existing Debt, December 2020

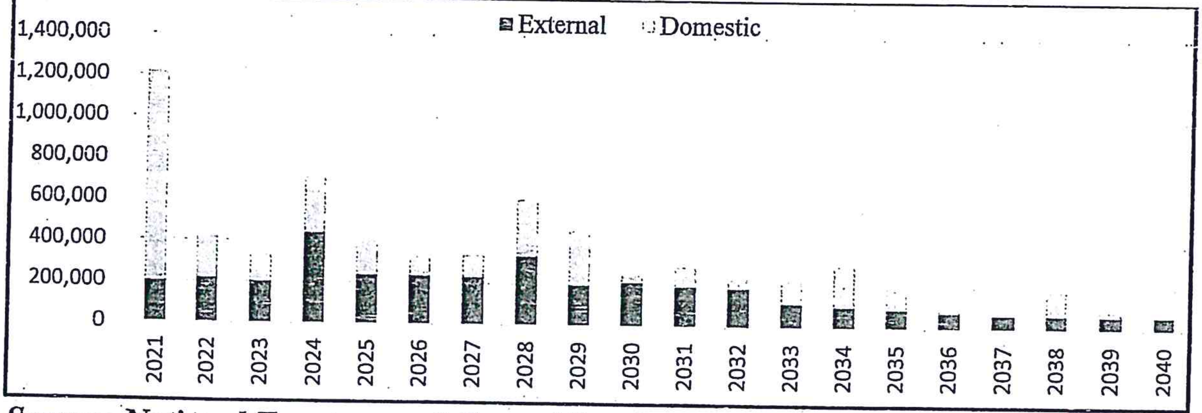
Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of KSH)		3,603,030.0	3,438,164.7	7,041,194.7
Amount (in millions of USD)		33,003.3	31,493.2	64,496.5
Nominal debt as percent of GDP		32.4	30.9	63.3
PV as percent of GDP		25.9	30.9	56.8
Cost of debt	Interest payment as percent of GDP	1.0	3.4	4.4
	Weighted Av. IR (percent)	3.1	10.9	6.9
Refinancing risk	ATM (years)	11.2	6.3	9.1
	Debt maturing in 1yr (percent of total)	4.6	29.7	15.5
	Debt maturing in 1yr (percent of GDP)	1.8	9.2	11.0
Interest rate risk	ATR (years)	10.0	6.3	8.4
	Debt refixing in 1yr (percent of total)	25.1	29.7	27.1
	Fixed rate debt incl T-bills (percent of total)	76.7	100.0	86.9
	T-bills (percent of total)	0.0	24.9	10.8
FX risk	FX debt (percent of total debt)			51.2
	ST FX debt (percent of reserves)			23.0

Source: The National Treasury

30. Overall, interest rate risk reduced during the period. For the total public debt portfolio, Average Time to Refixing (ATR) improved to 8.4 years in December 2020 while debt refixing in 1 year and fixed rate debt was 27.1 per cent and 86.9percent in December 2020 respectively (**Table 7**).

31. Figure 2 shows the redemption profile of total debt as at end of December 2020. Domestic debt accounts for Kshs 1,019.4 billion or 83.9 per cent of the total amortization in 2021 mainly Treasury bills, while external debt accounts for Kshs 194.7 billion or 16.1 per cent of the total amortization in 2021. The profile shows a relatively smooth repayment structure, with maturities spread out in future years except for speaks in 2024 and 2028 relating to international sovereign bonds.

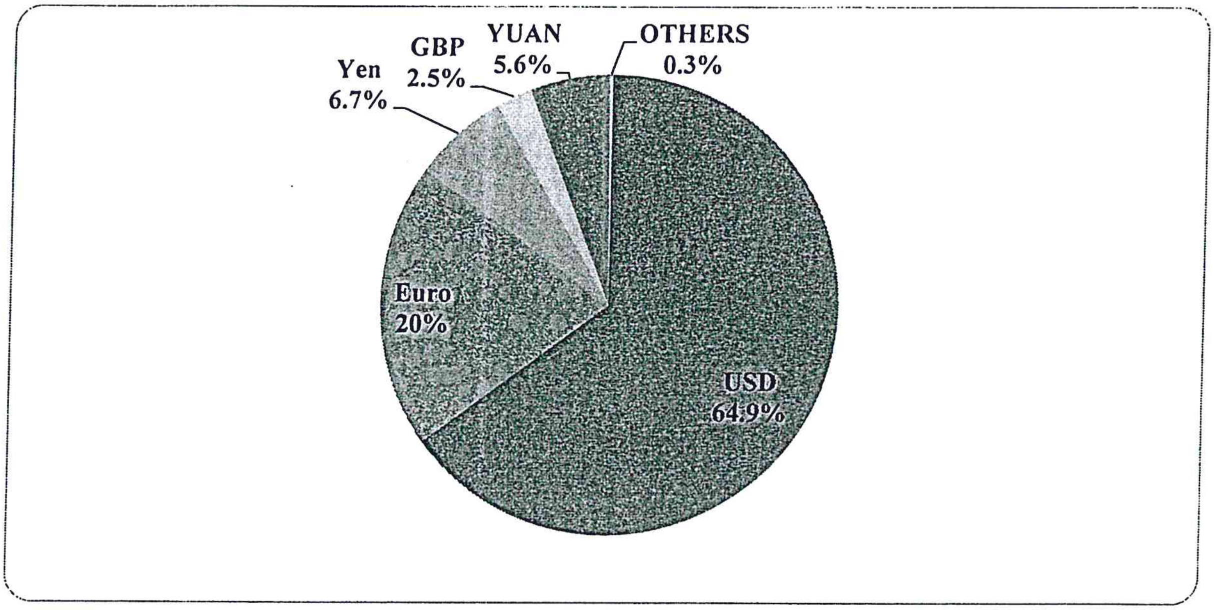
Figure 2:Redemption Profile (Ksh. millions) as at End December 2020



Source: National Treasury and Central Bank of Kenya

32. The exposure to foreign exchange rate risk is moderate with external debt accounting for 51.2 percent of the total public debt in 2020s. Currency composition of external debt comprise of 64.9 percent in U.S. dollar, 20.0 percent in Euro, 6.7 percent in Japanese Yen, 5.6 percent in Chinese Yuan, 2.5 percent in Great Britain Pound and other currencies accounting for 0.3 percent (**Figure 3**).

Figure 3: Currency Composition of External Debt, End-December, 2020.



Source: The National Treasury

33. From the foregoing analysis, the 2021 strategy seeks to achieve an optimal cost - risk trade-off in the debt portfolio.

V. BASELINE MACROECONOMIC ASSUMPTIONS AND KEY RISKS

a) Baseline Macroeconomic Assumptions

34. The 2021 MTDS is anchored on the macroeconomic assumptions outlined in the 2021 Budget Policy Statement (BPS) and are summarized in **Table 8.**

35. The economic growth is projected to improve slightly to 3.8 percent in FY2020/21 up from 3.0 percent in FY2019/20on account of recovery from the impact of Covid-19 pandemic and general improvement on economic activity and productivity (Table 8). Over the medium term, the growth in Real GDP is projected to improve to above 6.0 percent supported by stable macroeconomic environment, turnaround in trade as the economy recovers from the Covid-19 pandemic and expected favorable weather conditions to support agricultural output. To reinforce the growth outlook, the government will roll out the post-Covid-19 Economic Recovery Strategy (ERS).

Table 8: Baseline Macroeconomic Assumptions

	Unit	2018/19	2019/20	2020/21 (Proj.)	2021/22 (Proj.)	2022/23 (Proj.)	2023/24 (Proj.)	2024/25 (Proj.)
		Actual	Pre Act.		Projection			
Real GDP	Percent	5.9	3.0	3.8	6.3	5.7	6.0	6.1
GDP Deflator	Percent	3.2	5.6	6.4	5.2	5.0	5.4	5.3
Inflation	Percent	4.9	5.2	5.1	5.0	5.0	5.0	5.0
Revenue	Percent of GDP	18.2	17.1	16.6	16.4	17.3	18.2	18.1
Expenditure	Percent of GDP	26.0	25.2	25.6	24.3	23.3	22.7	22.0
Overall Fiscal Balance	Percent of GDP	-7.7	-7.8	-8.7	-7.5	-5.6	-4.2	-3.6
Primary Budget Balance	Percent of GDP	-3.6	-3.5	-4.6	-3.0	-1.0	0.3	0.6
Revenue	Kshs Billion	1,704.4	1,737.0	1,849.2	2,033.9	2,379.7	2,796.4	3,099.8
Expenditure	Kshs Billion	2,433.7	2,565.4	2,864.5	3,010.0	3,202.0	3,495.6	3,762.6
Overall Fiscal Balance	Kshs Billion	-721.1	-790.8	-966.6	-930.0	-775.3	-651.2	-613.5
Primary Budget Balance	Kshs Billion	-345.3	-353.6	-507.8	-369.4	-131.4	44.5	100.3
GDP (Current Prices)	Kshs Billion	9,367.3	10,175.2	11,168.5	12,393.1	13,759.9	15,373.1	17,128.4

Source: The National Treasury

36. Inflation rate is expected to remain within the government target range of 5 ± 2.5 percent. The economy is expected to remain competitive in the external market with the exchange rate against major currencies remaining stable to support exports while interest rates are expected to remain low and stable.

37. Supported by commitment to fiscal consolidation, the primary budget balance is projected to reach a surplus of 0.6 percent of GDP over the medium term from a deficit of 3.5 per cent in the FY 2019/20.

b) Risks to the Baseline Macroeconomic Assumptions

38. Global economic growth is expected to recover to 5.5 per cent in 2021 from a contraction in 2020 of 3.5 per cent due to the effects of Covid-19. The projected global economic growth in 2021 reflects optimism that the Covid -19 pandemic will stem the spread of the virus and support a steady strengthening in consumption and investment.

39. The favorable changes in the global macroeconomic conditions are expected to positively impact the domestic economy. The Kenyan economy is expected to rebound with the successful fight against the pandemic. However, significant changes in macro-economic variables such as inflation, exchange rates and interest rates may pose risks to both projected revenues and expenditures. Depreciation of the exchange rate may positively impact custom related revenues, may significantly raise debt service costs and pose fiscal risks since more than half of the total debt is held in foreign currencies. The government will continue to monitor macroeconomic risks and will take appropriate fiscal and monetary policy measures to preserve fiscal stability.

40. In addition, over the medium term, the government aims to raise main tax revenue by 2.6 per cent of GDP from 12.9 per cent in FY2020/21 to 15.5 per cent in FY 2024/25. The Government through KRA will implement administrative policy measures that leverage on ICT and innovations to seal revenue leakages, improve compliances and revenue collections. These efforts and targeted expenditure prioritization and rationalization will support fiscal

consolidation over the medium-term and help reduce debt liabilities and ensure overall debt sustainability.

41. The government through active monitoring and evaluation will seek to implement fiscal measures aimed at reducing potential risks arising from Fiscal Commitments and Contingent Liabilities (FCCL).

VI. POTENTIAL SOURCES OF FINANCING

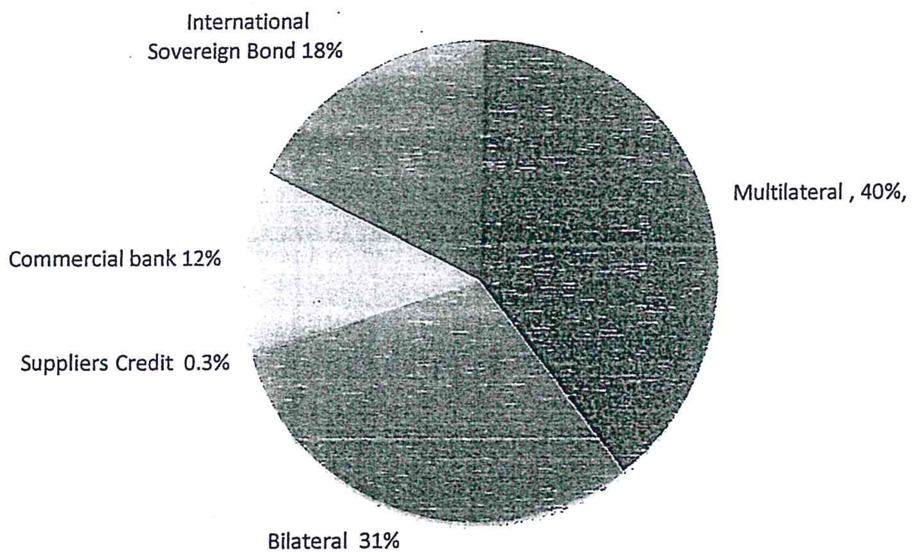
A. Sources of Financing for the Existing Debt

42. Government's borrowing needs have been met from both domestic and external sources. The main domestic sources have been Treasury bills and bonds while external sources include various multilateral, bilateral and commercial lenders.

43. The largest segment of the domestic debt market is commercial banks at 54 percent, while pension funds, insurance firms and retail sectors account for 31.7 percent and 4 percent respectively.

44. The largest external financing was from concessional and semi-concessional sources. The stock of bilateral debt was 34.6 percent of total external debt while multilateral lenders, international sovereign debt and commercial debt (syndicated loans) accounted for 33.3 per cent, 19.7 per cent and 11.9 percent respectively (**Figure 4**).

Figure 4: Existing Sources of External Financing



Source: The National Treasury

B. Potential sources to finance the medium-term budget

i. Domestic Sources

45. The domestic debt market has been an important financing source, contributing substantially to the total funding needs. Over the years, the government has successfully met its financing targets from the domestic market at stable costs.

46. It is important to consider measures to promote the growth of the non-bank institutional sectors such as pension, insurance and mutual funds, to increase the capacity of the domestic market. The growth of new financial products such as post retirement and contributory pension schemes and asset classes like the Real Estate Investment Trusts (REITs), private equity and venture capital is expected to enhance the expansion of the pension industry. Further, to safeguard the stability of the domestic debt market, the government will continue to explore non-traditional financing sources.

47. The government is committed to continue issuing retail securities through the M-Akiba platform targeting the retail investors to promote a savings culture, support financial inclusion and access to government securities. The M-Akiba platform will be revamped and linked to the micro pension scheme to provide alternative investment opportunities for the informal sector savings.

ii. External Sources

48. The net external financing contributed 43 percent of the government's financing needs in the FY 2019/2020.The ggovernment will continue to explore innovative external financing mechanisms to reduce currency risk and expand the borrowing capacity at reasonable cost.

49. In terms of instrument diversification, the government plans to explore various alternative financing options such as private placement, diaspora bonds,

Islamic bonds (Sukuk) and issuance of sovereign green bonds over the medium term to finance climate friendly public projects.

VII. COST-RISK ANALYSIS OF ALTERNATIVE DEBT MANAGEMENT STRATEGIES

A. Baseline-Pricing Assumptions and Description of Shock Scenarios

50. The pricing assumptions under the baseline scenario for interest rates and the exchange rates are as follows:

i. IDA/IFAD loans are priced at an average fixed rate of 0.75 percent, with a 50-year tenor and up-to 10-year grace period.
ii. Concessional external loans are priced at an average fixed rate of 0.8 percent, with a 40-year tenor and up-to 10-year grace period.
iii. Semi-concessional loans are assumed to be contracted at a fixed interest rate of approximately 2.0 percent and a maturity of 20 years including a grace period of up to 5 years.
iv. Commercial borrowings relate to the International syndicated loans and Export Credit Financing contracted at a reference rate plus a margin.
v. The pricing of Kenya's International Capital Market debt is based on the prevailing Sovereign Bond yield curve for December 2020.
vi. Pricing on the domestic debt instruments is based on the prevailing market yield curve as at December 2020.

51. The outlook on the baseline interest rates and exchange rates are based on the following status ;

i. 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 based on historical average over the medium term consistent with stable macroeconomic environment.
ii. The future interest rates of market-based fixed-rate debt instruments in both international and domestic markets are based on the prevailing interest rates and assumed to remain stable over the medium.

52. Three risk scenarios are evaluated as follows:

i. The risk scenario for interest rates assumes moderate interest rate shock of 2.5 percent over the baseline projections and a standalone extreme shock of 5 per cent which reverts to the original trend and remains constant thereafter.

ii. An exchange rate risk shock is applied by a moderate depreciation of the Kenya Shilling by additional 5 per cent and a stand-alone extreme shock of additional 12 per cent against the US$ in 2022 compared to the baseline exchange rate projections.

iii. The combined exchange-rate and interest-rate risk shock scenario assumes an increase in interest rate by a moderate shock of 2.5 percent in 2022 combined with a 5 percent exchange rate depreciation.

B. Description of Alternative Debt Management Strategies

53. Four financing strategies are considered in the 2021 MTDS. The strategies inform the financing of the fiscal deficit in the FY 2021-2022 and guide medium-term borrowing.

54. Each strategy considers a unique mix of borrowing instruments and seeks to provide financing from both external and domestic sources. The external financing constitutes concessional, semi-concessional and commercial sources while Treasury bills and bonds constitute domestic financing.

i. **Strategy 1 (S1-Baseline projection):** The strategy assumes 60 per cent external borrowing and 40 per cent domestic borrowing to finance the government budget in net terms, over the medium-term. On the external financing, concessional and semi-concessional is proposed at 15 per cent and commercial borrowing at 13 per cent. Treasury bonds is the the main source of net domestic financing while Treasury bills stock is projected to decrease.

ii. **Strategy 2 (S2):** The strategy assumes 71 percent net domestic and 29 percent net external borrowing over the medium term (in line with 2021 BPS financing assumptions). The composition of external financing consists of concessional, semi concessional and commercial at 7 percent, 15 per cent and 7 per cent respectively. This strategy focuses more on budget financing through external concessional borrowing. medium to long term instruments will be the main source of domestic financing.

iii. **Strategy 3 (S3):** The objective of this strategy is to reduce debt interest rate cost by maximizing external borrowing while maintaining the stock of Treasury bills unchanged and issuing medium-long term bonds in the domestic market over the medium term. In terms of net financing, the strategy assumes 38 percent domestic and 62 percent external financing. Domestic financing will be met largely through medium-long term Treasury bonds, with no new borrowing or repayment of existing Treasury bills during the year. External net financing will constitute 12 percent concessional, 22 percent semi-concessional and 28 percent commercial.

iv. **Strategy 4 (S4):** The strategy seeks to achieve gradual refinancing of Treasury bills and selected external debt by considering liability management operations. This strategy envisages to raise 43 percent and 57 percent of net financing from the domestic and external sources respectively. In terms of gross borrowing, external and domestic financing accounts for 27 percent and 73 percent respectively. Domestic financing is projected to be sourced mainly from medium to long term instruments, with net repayment of Treasury bills during the medium-term period. On the external financing, concessional, semi concessional and commercial will account for 21 percent, 26 percent and 10 percent respectively.

C. Cost-Risk Analysis of Alternative Debt Management Strategies

55. The resultant cost and risk indicators derived from the MTDS Analytical Tool helps to evaluate how the debt costs and risks evolve under each of the four alternative debt management strategies. Further, the analysis helps to assess the behaviour of debt portfolio under standard shock scenarios. The MTDS Tool generates characteristics of future debt profile in term of stock and cash flow ratios at the end of the medium-term period.

i. *Baseline Projection and Alternative Strategies*

56. Table **9 and 10** presents the average gross borrowing from alternative strategies, indicating the effect of the financing plan on the debt portfolio composition that the government intends to pursue during the period ending FY2021/22.

Table 9: Average New Debt by Instrument Under Alternative Strategies (in percent of gross borrowing by end of FY2024/25)

New debt in % of Total Gross Borrowing	S1	S2	S3	S4
IDA/IFAD	6	2	2	5
Concessional	5	4	2	7
Semi-Concessional	4	7	8	11
Commercial/International Sovereign Bond	14	3	10	4
Treasury bills	49	50	47	42
Treasury bonds 2-3 Years	1	3	2	2
Treasury bonds 4-7 Years	3	6	5	4
Treasury bonds 8-12 Years	5	8	7	5
Treasury bonds 13-17 Years	6	9	7	8
Treasury bonds 18-22 Years	5	5	6	8
Treasury bonds 23-30 Years	3	3	3	4
External	**28**	**16**	**22**	**27**
Domestic	**72**	**84**	**78**	**73**
Total	**100**	**100**	**100**	**100**

Source: The National Treasury

57. A combination of borrowing instruments results to different debt compositions at the end of the medium term **(Table 10)**.

Table 10: Composition of Debt Portfolio by Instrument under Alternative Strategies, (in Percent of Outstanding Portfolio as at end-FY2024/25)

In percent of Total	**FY2021**	**As at end FY2024/25**			
Outstanding by instrument	Current	S1	S2	S3	S4
IDA/IFAD	14	15	12	12	14
Concessional	6	9	8	6	10
Semi-Concessional	15	12	14	15	17
Commercial/International Sovereign Bond	15	18	9	15	10
Treasury bills	12	11	11	10	8
Treasury bonds 2-3 Years	0	1	2	1	1
Treasury bonds 4-7 Years	6	3	5	4	3
Treasury bonds 8-12 Years	12	10	13	12	10
Treasury bonds 13-17 Years	12	11	14	13	13
Treasury bonds 18-22 Years	4	7	7	8	9
Treasury bonds 23-30 Years	3	4	4	4	5
External	**51**	**53**	**43**	**48**	**51**
Domestic	**49**	**47**	**57**	**52**	**49**
Total	100	**100**	**100**	**100**	**100**

Source: The National Treasury

58. Table 11 shows the cost and risk characteristics of the debt portfolio under alternative strategies considering the underlying assumptions.

59. The outcomes of cost and risk trade-offs of the various alternative strategies reflect a balance between costs and risks and is used to inform the choice of the optimal strategy (**Table 11 and Figure 5**).

Table 11: 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		63.3	56.4	56.6	56.5	56.3
Present value debt as percent of GDP		56.8	49.7	51.0	51.3	49.1
Interest payment as percent of GDP		4.4	3.6	3.8	3.7	3.5
Implied interest rate (percent)		6.9	6.9	7.4	7.3	6.8
Refinancing risk	Debt maturing in 1yr (percent of total)	15.5	15.7	16.0	14.2	12.3
	Debt maturing in 1yr (% of GDP)	11.0	8.9	9.1	8.0	6.9
	ATM External Portfolio (years)	11.2	12.0	11.4	10.7	12.5
	ATM Domestic Portfolio (years)	6.3	7.6	7.7	8.3	8.8
	ATM Total Portfolio (years)	9.1	10.1	9.4	9.5	10.8
Interest rate risk	ATR (years)	8.4	9.8	8.9	8.9	10.2
	Debt refixing in 1yr (percent of total)	27.1	21.0	23.2	23.3	21.3
	Fixed rate debt incl T-bills (percent of total)	86.9	93.7	91.9	89.9	90.0
	T-bills (percent of total)	10.8	11.3	11.4	9.6	7.7
FX risk	FX debt as % of total	51.2	52.7	43.4	48.0	51.3
	ST FX debt as % of reserves	23.0	20.1	20.1	20.1	20.1

Source: The National Treasury

60. Both the nominal and Present Value (PV) of debt to GDP ratio across all the alternative strategies are lower than the levels in 2020, which indicates the Government's commitment to fiscal consolidation over the medium term.

61. As shown in table 11, Strategy 4 (S4) has greater benefits to debt management objectives than the other three strategies in terms of the following attributes;

i. Minimizes refinancing risk with the least ratios in terms of debt maturing in one year as a percent of total debt and as a percent of GDP.
ii. Has least PV of debt to GDP as a resulting outcome of the fiscal consolidation plan.
iii. Reduces refinancing risk by lengthening the ATM for both external and domestic debt.
iv. Least cost of debt in terms of interest payments as a percent of GDP and implied interest rate.

v. Minimizes interest rate risk in terms of the proportion of Treasury bills on total debt stock.

62. Strategy 1 is the status quo plan which minimizes interest rate risk by increasing the fixed rate debt as a percentage of total debt and reducing the proportion of debt re-fixing within 1 year.

63. Strategy 2 has the least ratio of FX debt to total debt and short-term FX debt to reserves, minimizing foreign exchange risk on the debt portfolio.

64. Strategy 1 and 4 performs better than other strategies in terms of interest rate risk and FX risk.

65. Strategy 4 is the optimal plan that results in satisfactory indicators given its desired net financing mix of 57 per cent from external sources and 43 per cent from domestic market. Further, the strategy seeks to achieve gradual repayment of Treasury bills and part of commercial debt in the external portfolio, through liability management operations including switches. Further, the strategy focuses on issuance of medium to long term bonds and support domestic debt market development through benchmark bond program.

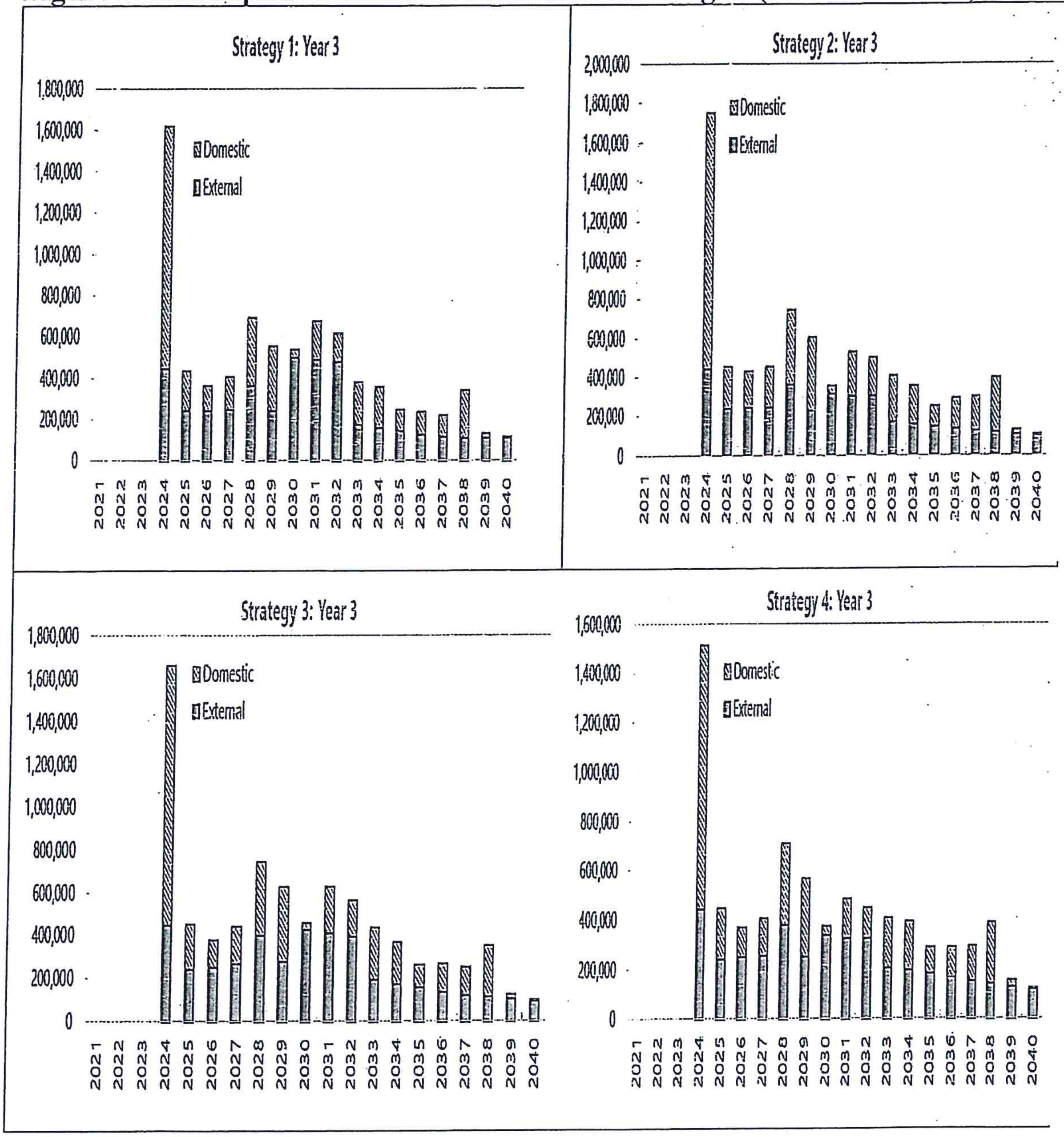
66. However, Strategy 4 has modest exposure to foreign exchange risk compared to the other strategies, which is consistent with the plan to raise the larger part of the borrowing from external sources considered during strategy formulation.

67. Although strategy 4 was chosen as the optimal plan, current uncertainties related to Covid-19 pandemic, global economic and market conditions, geopolitics, may necessitate deviation from this strategy path to align to policy actions at the time.

68. The redemption profiles for alternative strategies by end of 2024 are shown in Figure 5. High maturities of both domestic and external debt are observed in 2024 and 2028. These maturities are associated with the upcoming retirement

of International Sovereign bonds issued in 2014, 2018 and 2019, in addition to, Treasury bills and bonds due in the same period.

Figure 5: Redemption Profiles for Alternative Strategies (End-FY2024/25)



Source: The National Treasury

69. The 2021 optimal debt management strategy differs from the 2020 strategy in terms of the composition of net financing in external and domestic debt portfolios. Net external and domestic financing accounts for 57 percent to 43

percent in the 2021 strategy compared to 60 percent to 40 percent in the 2020 strategy.

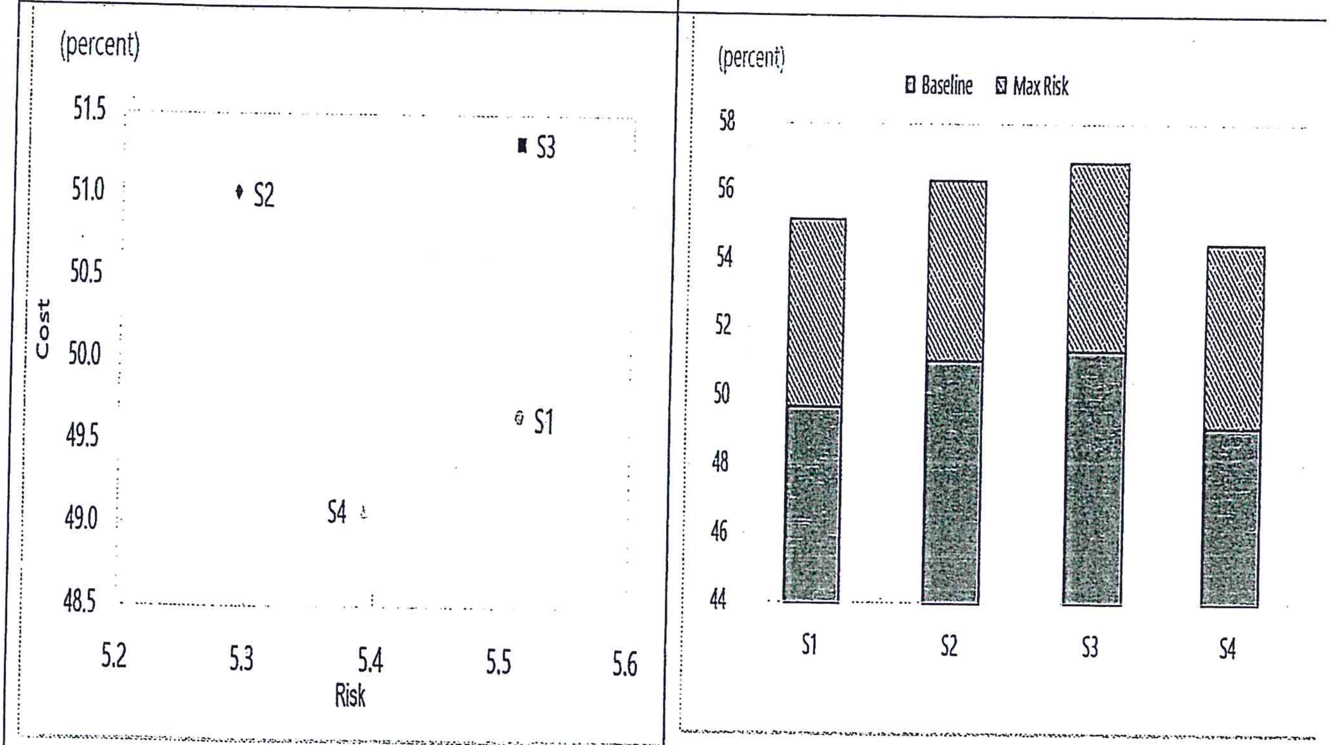
ii. *Effect of shocks on the costs and risks characteristics of debt*

70. Baseline pricing and shock scenarios analysis considered the following indicators: Present Value of Debt/GDP, interest payments/Revenues, interest payments/GDP and total debt service/GDP **(Figure 6).**

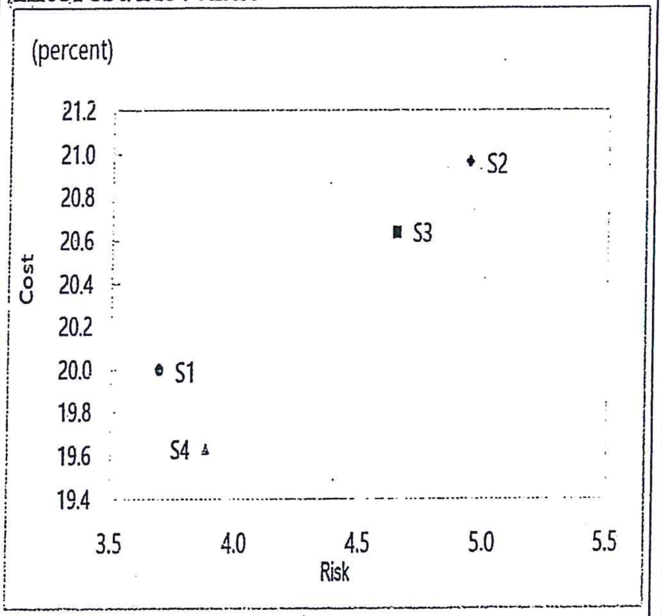
71. The outcome of the analysis indicates the extent of risk associated with each strategy under the baseline and shock scenarios. The optimal strategy has the lowest cost-risk combination.

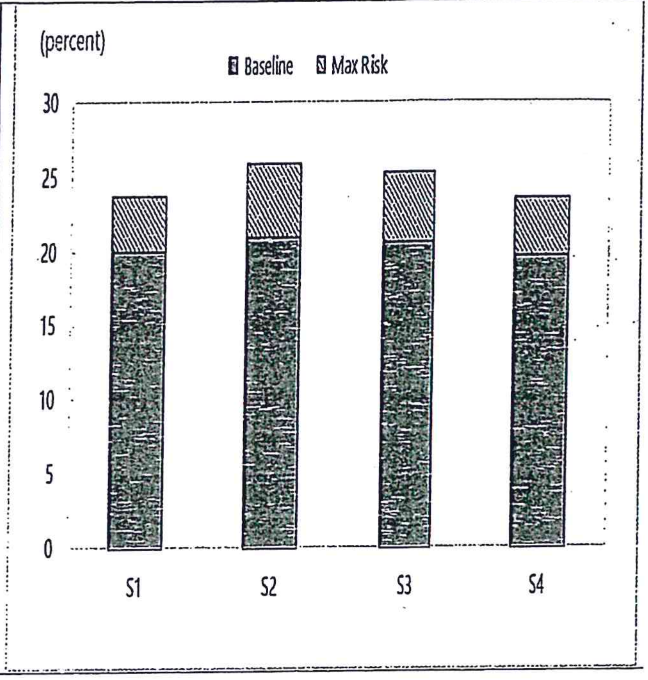
Figure 6: Cost-Risk Representation of Alternative Borrowing Strategies

PV of Debt/GDP

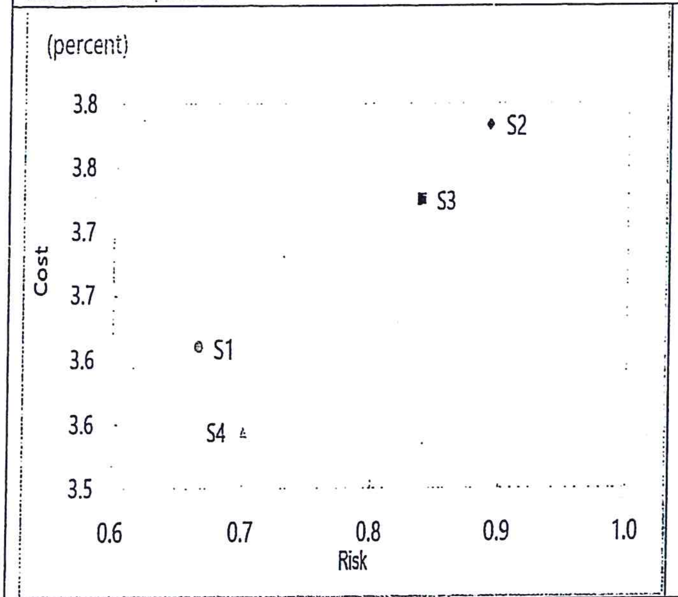


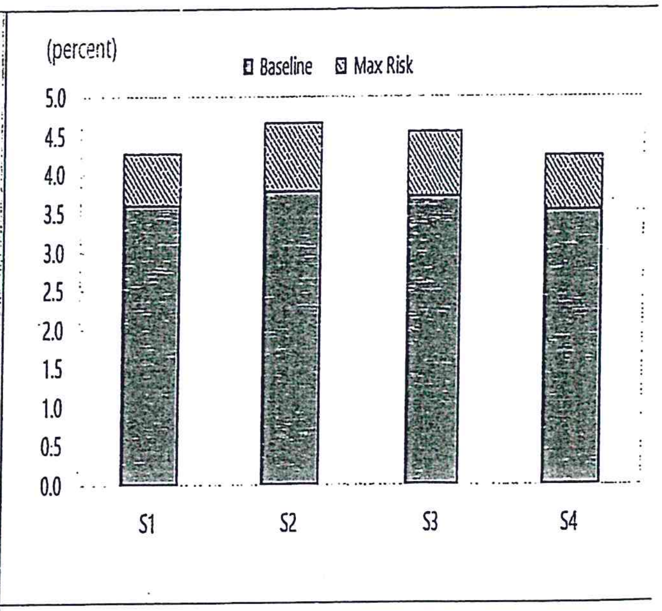
Interest/Revenue



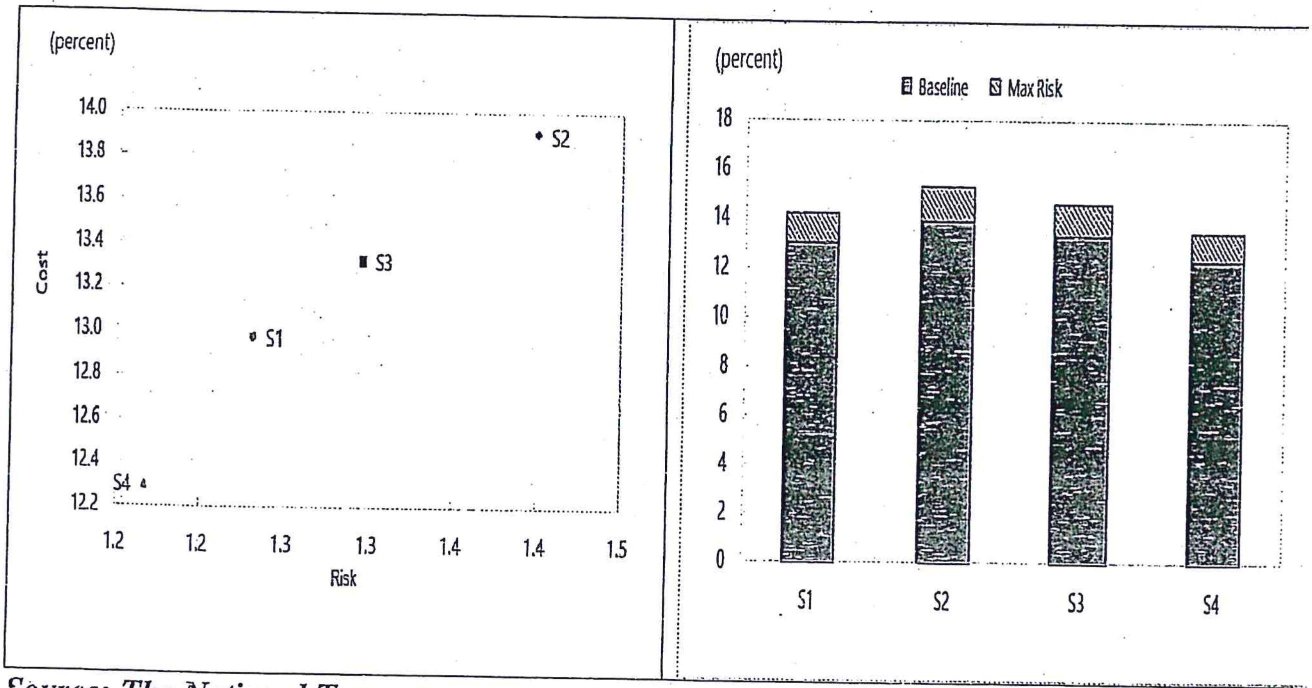


Interest/GDP





Total debt service/GDP



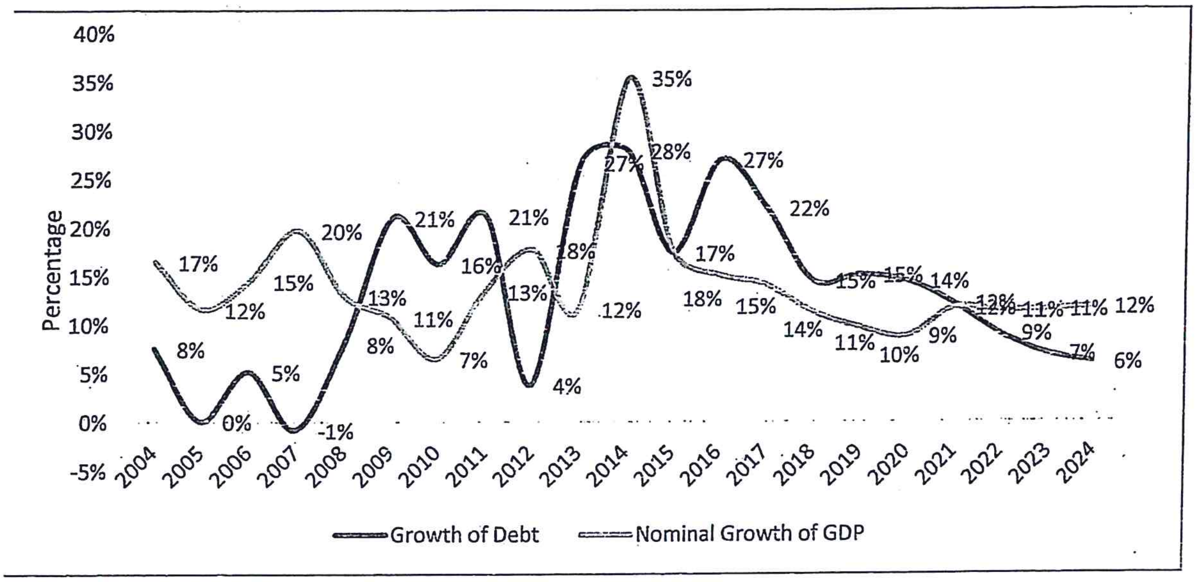
Source: The National Treasury

iii. *Optimal Debt Management Strategy: The Context*

72. Kenya's ambition to close infrastructure gap, opened up the economy, spur economic growth and development has borne significant dividends in the last two decades. The country has managed to expand its road and rail infrastructure and currently energy generation capacity has outstripped demand. These critical investments have led to faster accumulation of public debt at a time when domestic revenue mobilization measured as a share of GDP has been declining.

73. In order to improve debt sustainability indicators, the government will implement its fiscal consolidation plan aimed at reducing the fiscal deficit to about 3.5 per cent of GDP by FY 2024/2025. This will ensure the growth in debt remains below the growth of nominalGDP reversing the prevailing trend in recent years (**Figure 7**).

Figure 7: Growth of Debt and Nominal Growth of GDP, 2003 – 2024



Source: The National Treasury

In addition, the fiscal consolidation plan outlined in the 2021 BPS will not only reduce the high fiscal deficits but also help reduce the high debt service costs which will in turn release resources for priority programs. Debt service to revenue ratio is expected to rise from 16.7per cent in 2019 to 20.1 per cent in 2023 before declining to 19.0 percent in 2025. **(Table 12).**

Table 12: Public Debt Service, Revenue and Expenditure

	FY 2017/18	FY 2018/19	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24	FY 2024/25
PPG debt service to revenue (%)	17.6	19.8	16.7	16.0	18.6	20.1	19.9	19.0
Total Debt Service (Ksh. Billion)	377.9	481.6	428.0	458.2	560.6	643.9	695.6	713.8
Total Ordinary Revenue	1,365.1	1,499.8	1,573.4	1,594.0	1,775.6	2,141.6	2,516.3	2,807.4
Total Expenditure	2,146.8	2,433.7	2,565.4	2,864.5	3,010.0	3,202.0	3,495.6	3,762.6

Source: National Treasury

74. 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.

75. The 2021 MTDS is anchored on a rebounding economic growth supported by stable macroeconomic environment, favourable weather conditions for the agricultural sector, continuing investments in strategic priorities of the Government under the "Big Four" Agenda and the Post Covid-19 Economic Recovery Strategy to reverse the effects of Covid-19.

76. The debt strategy was formulated amid Covid-19 pandemic environment that affected economic growth and the country`s capacity to raise anticipated revenue leading to expenditure pressures. This adversely impacted the ability of the available resources to service the public debt and deliver on the Government priorities. Against this background, the Government participated in the Debt Service Suspension Initiative (DSSI) under the G20 framework to free up resources for Covid-19 related expenditures.

77. The formulation of this strategy has been on a background of public debt stock fast approaching the statutory ceiling of Kshs 9.0 trillion as set out in the Public Finance Management Act, 2012. As a result, the implementation of this strategy may require the revision of the debt ceiling through the amendment of the PFM Act based on future borrowing requirements.

78. Regulation 206(1) of the Public Finance Management Regulations, 2015, establishes the Government Sinking Fund to be used for redemption of loans and government securities. The National Treasury has developed draft guidelines for the operationalization of the Sinking Fund which will soon be published by the Cabinet Secretary of the National Treasury upon completion of the ongoing public review process.

79. As noted earlier, the optimal debt management strategy is Strategy 4 which assumes a declining fiscal deficit over the medium term in order to slowdown the accumulation of debt and maintain a sustainable path.

iv. *The Optimal Strategy*

80. The optimal strategy that minimizes costs and risks of public debt suggests borrowing in the ratio of 57:43 in net external and net domestic borrowing. In terms of gross borrowing, external and domestic financing accounts for 27 percent and 73 percent respectively. This strategy is underpinned by the need to move away from high interest cost of domestic debt.

81. The optimal strategy for 2021 for financing the fiscal deficit seeks to achieve gradual repayment of Treasury bills and part of commercial debt in the external portfolio through liability management operations. It considers the cost and risk trade-offs, the net borrowing and the need to diversify the funding sources. The strategy also reflects the need to maintain issuance of Treasury bills as cash management tool and gradually reduce its stock over the medium term. The strategy further underpins the need to issue medium to long term bonds to lengthen the maturity structure thus reducing refinancing risk of borrowing as well as supporting domestic debt market development through benchmark bond program. The strategy has modest exposure levels to foreign exchange rate risk which is consistent with the plan to raise the larger amount of resources from external sources. The envisaged borrowing will continue to maximize concessional and semi-concessional debt from the external sources. The Strategy also envisages tapping into the international capital market.

82. However, the 2021 BPS proposes a borrowing in the ratio of 21:79 for FY2021/22 net external and domestic borrowing; and an average ratio of 30:70 for the medium term. The financing strategy under the fiscal framework is informed by external Debt Limit Policy applicable to countries under the IMF program.

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

83. Development of the domestic debt market is a key precursor for accelerating attainment of affordable, long-term financing for both public and private sectors. Large proportion of domestic debt compared to external debt helps to mitigate against exposure to foreign exchange risk and cushion the country against the downside risks of the global market environment.

84. The National Treasury will continue to spearhead the implementation of reforms to develop the domestic debt market to promote the above objectives to position Kenya as the regional financial hub in Africa. Further, the Government will continue to promote collaborative partnerships among various stakeholders including regulators, investors and other market players to support faster market development.

85. A number of strategic reforms aimed at increasing market efficiency are under consideration and are at different stages of implementation. They include:

i. Enhancement of market infrastructure through automation of processes at both primary and secondary markets, including deployment of a new Central Securities Depository by the fiscal agent. This has been on course with an aim to achieve reduced time for primary market auction cycle, efficient payment and settlement process, greater and convenient access to government securities by both institutional and retail investors, among others.

ii. Product enhancement initiatives to increase liquidity including restructuring of the interbank repo to provide for transfer of ownership of securities provided as collateral. The issuance of fewer but large size benchmark bonds at the primary market will continue to foster market liquidity and the development of the benchmark yield curve.

iii. Enhancement of the market structure to increase liquidity, price discovery and transparency has been pursued through the ongoing initiative to establish the Over-The-Counter (OTC) trading to complement the exchange trading platform (Nairobi Securities Exchange).

iv. Other important initiatives such as sustained engagement forums between the National Treasury, market regulators, investors and market players have been instrumental to the growth of the domestic debt market.

86. The National Treasury will continue to explore diversification of government securities to include non-plain vanilla instruments as well as undertake liability management operations such as bond exchanges, as part of a market-based debt restructuring approach.

87. The optimal debt management strategy (S4) has the following underlying benefits to market development:

i. Higher financing from the domestic market will continue to help build bond market liquidity and a benchmark yield curve, and eventually lower the cost of debt
ii. Lowers the interest rate cost in the debt portfolio
iii. Lengthen the maturity profile of debt supports bond market development
iv. Gradual reduction of the Treasury bill stock and frequency of issuance helps to lower refinancing risk, create fiscal flexibility and promote bond market development as net financing from the domestic market is raised through Treasury bonds;

VIII. DEBT SUSTAINABILITY

88. Kenya has a strong debt carrying capacity as measured by the World Bank's Composite Indicator (CI). The CI captures the impact of various factors through a weighted average comprised of Country's Policy and Institutional Assessment (CPIA), real GDP growth, remittances, international reserves, and global growth.

89. Kenya's overall Debt Sustainability Analysis indicates that public debt remains sustainable. Due to the impact of the global COVID-19 crisis which exacerbated debt vulnerabilities the country's risk of debt distress has moved to high from moderate.

a) Kenya's External Debt

90. Kenya's debt remains sustainable with increased risk to sustainability in the context of the ongoing global COVID-19 shock (Table 13). The indicators are expected to improve as the Government implements fiscal consolidation measures and the global economy rebounds from the COVID-19 shock.

Table 13: Kenya's External Debt Sustainability

Indicators	Thresholds	2019	2020	2021	2022	2023
PV of debt–to-GDP ratio	**55**	27.6	26.8	27.9	27.8	27.6
PV of debt-to-exports ratio	**240**	225.2	288.1	260.6	258.5	255.2
PPG Debt service-to-exports ratio	**21**	31.4	27.5	25.9	25.5	24.4
PPG Debt service-to-revenue ratio	**23**	21.3	14.5	15.9	15.7	14.8

Source: IMF May 2020 DSA report

b) Total Public Debt

91. The public debt sustainability indicator is below the threshold of 70 percent as a proportion of GDP in PV terms (Table14). This indicates that public debt is sustainable but faces increased risk from the impact of COVID-19 pandemic.

Table 14: Kenya's Public Debt Sustainability

Indicators	Thresholds	2019	2020	2021	2022	2023
PV of debt–to-GDP ratio	70	57.6	61.3	63.4	63.9	63.6

Source: The National Treasury

92. The public debt sustainability outlook is expected to improve through implementation of the Post Covid-19 Economic Recovery Strategy (ERS) to reverse the impacts of the pandemic, commitment to fiscal consolidation and promote growth in exports.

93. To guide the design and structure of the reforms in debt management, there is need to monitor the debt management performance over time. To achieve this, the Debt Management Performance Assessment (DeMPA) tool becomes critical in comprehensively assessing debt management performance through a set of indicators. The indicators span five core areas of public debt management covering:

i. governance and strategy development
ii. coordination with macroeconomic policies
iii. borrowing and related financing activities
iv. cash flow forecasting and cash balance management
v. debt recording and operational risk management.

94. The indicators encompass a complete spectrum of government debt management operations including the overall environment within which these operations are to be carried out. While the DeMPA tool is not designed to specify reforms and institutional requirements, the performance indicators do however stipulate a minimum level that should be met under all conditions. Consequently, if the assessment shows that the minimum requirements are not met, this will clearly indicate an area requiring reform.

IX. MTDS IMPLEMENTATION, MONITORING AND EVALUATION

i. Implementation: Domestic and external borrowing Plan

95. The recommended strategy will be implemented through the annual borrowing plan that delivers the Government gross funding needs over the medium- term.

96. The mix of the borrowing instruments will be aligned to the 2021 MTDS objectives. Specifically, Treasury bonds of medium to long term tenor will be the major financing instruments for domestic market. The stock of Treasury bills will be gradually reduced to reduce refinancing risks and improve cash management.

97. Liability management operations will be part of the refinancing risk management strategy so as to achieve the desired debt portfolio structure.

98. The external borrowing plan outlines the expected disbursements per creditor within the financial year. The plan specifies the creditor, the purpose of financing, and the period and currency of disbursement.

ii. Implementation and Review

99. The issuance program will be reviewed on a quarterly basis based on the National Treasury's operational work plan and engagement with the market participants and other relevant stakeholders.

100. Review of the Strategy implementation will be through regular debt management reports.

iii. Monitoring and Review of Strategy: Cost and Risk Indicator Outturn

101. The outturn of the macroeconomic environment including fiscal deficits, general price levels (exchange rate, inflation and interest rates) will be assessed against the targets during strategy formulation.

102. The cost and risk indicators spelled out in the optimal plan will be evaluated against their respective outturns during strategy review. Deviations from targets verses the outturns will be used to inform strategy review in the next MTDS cycle.

103. The evolving public debt structure will inform the revision of the budget provision and management of costs and risks of public debt.

104. State corporation's debt and stock of PPPs fiscal commitments and contingent liabilities will be tracked and assessed against sustainability levels.

iv. Evaluation of MTDS Outcomes against Targets

105. Evaluation of the 2021 MTDS will be done semi-annually and annually against the costs and risks characteristics outlined in the MTDS to assess any deviations and suggest mitigation measures. **Table 15** outlines the costs and risks parameters to be evaluated.

v. Dissemination

106. To uphold debt transparency principles, and ensure compliance, the Cabinet Secretary for National Treasury will present to Parliament for approval and subsequently publish and post in the National Treasury's website the results of the evaluated MTDS.

107. The outcome of the implementation of the 2021 MTDS will inform the design of 2022 MTDS with a view of continuously improve on debt management and sustainability.

Table 15: Monitoring and Evaluation of Cost and Risk Indicators Under Alternative Strategies Template

Risk Indicators		Baseline Dec 2020	MTDS 2021 Targets	Actual Dec 2020	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

108. The outcome of the implementation of 2021 MTDS will inform the design of 2022 MTDS with a view to continuously improve on debt management and sustainability.

ANNEX I: MTDS IMPLEMENTATION WORK PLAN

NO.	OUTPUT	ACTIVITY	TIMEFRAME	ACTION BY	DATA/INFORMATION SOURCE
1.	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 2021, BROP 2020 CS DRMS CBK MTDS 2020
2.	Dissemination of the MTDS 2021 to the National Treasury Departments	Circulation of printed copies, clear dissemination of the information to implementing departments and training counties	March – April 2021	PDMO CBK	MTDS 2021
3.	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
4.	Monitoring reports and briefs	Access of domestic and external borrowing and repayment data-	Weekly	PDMO CBK	RMD CBK MFAD
5.	Monthly debt management reports	Access of domestic and external borrowing and repayment data-	Monthly	PDMO CBK	RMD CBK FMA/NT
6.	Report on cost and risk characteristics of debt	Technical Fora to review MTDS implementation,	Quarterly	PDMO MFAD CBK GIPE	CBK AGD
7.	MTDS 2021 half year performance review	Undertake half year review of performance of the 2021 MTDS	Every six months after effective date of the MTDS	PDMO CBK MFAD	RMD DRS CBK MFAD
8.	FCCL Report	Undertake analysis of FCCL and FCCL assessment	Annually	PDMO PPP Unit	Letters of support under PPPs
9.	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