Kenya at the Economic Frontier: Challenges and Opportunities

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Introduction

Ladies and gentlemen,

Good afternoon— *Jambo* (*hello…*). It is a great privilege to be here today, addressing the Private Sector Alliance Forum.

I am particularly pleased to be meeting so many members of Kenya's business community. It is you and your colleagues who have spearheaded this country's extraordinary growth performance. You have achieved this with a vibrant service sector with access to high-end technology, by consolidating Kenya's position as a regional hub, and through impressive progress in financial inclusion.

The late Kenyan Nobel-laureate Wangari Maathai used to say: "*There are great opportunities even in the most difficult of moments*". I believe this conviction underlies the resilience of Kenya's private sector.

Indeed, Kenya's economic gains over the past few years have been nothing short of remarkable. Coming on the heels of a delicate political transition, growth remains robust—at more than 5 percent in 2013. And a set of bold economic reforms have laid the foundations to lift the economy to middle-income status within the next decade—if Kenya maintains the reform momentum.

It is also very important to me to be here today to underline the commitment of the IMF to Kenya. We have been by Kenya's side through the many challenges you have faced. We were here during the 2009 global downturn, during the 2011 drought, and we stood with you during the Westgate attack.

We have provided financial support through our Extended Credit Facility to deal with adverse shocks—and I am very happy that our Executive Board gave its seal of approval for the successful completion of the program just a few weeks ago. We have also worked with the Kenyan government as it designed and implemented reforms, and we supported that agenda with financing, advice, and stepped-up technical assistance.

What I am saying is that the IMF has been Kenya's partner—through thick and thin.

But let me be clear on this point: Kenya's achievements are Kenya's. Your country has had full ownership of the reform agenda. You have implemented it. You have garnered domestic support for it. And that is why it was a success.

Now is a good time to commend Kenya on its performance. But this is not the time for complacency. Yes, Kenya's future holds great promise. Looking ahead, achievements need to be deepened and broadened, so the economy can be made even more resilient, and the benefits of growth can be even more widely shared among all the Kenyan people.

In this context, I would like to focus my remarks today on three broad themes: the immediate outlook for the global economy; the outlook for Sub-Saharan Africa; and, finally, the key priorities that will enable Kenya to achieve its quest of reaching emerging market status.

1. The Global Economic Environment

First, the global economic environment. The IMF will be coming out with revised forecasts for the global outlook in a few weeks, so I will not be discussing numbers, but only trends.

The world economy is certainly in a better place now than it was five years ago—at the height of the financial crisis. But we are not out of the woods yet. The global recovery that is underway remains uneven and subdued, and its underlying dynamics are shifting.

Recent indicators suggest that activity in advanced economies is gaining momentum. This is particularly the case in the United States, where private demand has been robust, prompting the Fed to signal an eventual normalization in financial conditions. In Japan, the government has taken important steps to stimulate growth. And while Europe is slowly emerging from a deep recession, a host of challenges remains to be addressed.

At the same time, emerging market economies are slowing, following several years in which they were the main engine of global growth—and a particularly important engine for Kenya and Africa. In fact, the momentum in emerging market economies was a key factor in softening the impact of the global financial crisis on Sub-Saharan Africa. So any change in emerging market economies' prospects is bound to be a matter of concern.

As financial conditions in advanced economies normalize, the risk of heightened volatility in financial markets may create new challenges in emerging market economies. There is also the risk of potential spillovers from emerging market economies to countries in Sub-Saharan Africa, particularly those that are more financially integrated with the global economy— such as Kenya.

2. The Outlook for Sub-Saharan Africa

Which brings me to my second point: the outlook for Sub-Saharan Africa. Here the news is encouraging.

In fact, Sub-Saharan Africa remains the second-fastest-growing region in the world—5.6 percent on average over the past decade. Africa is now beginning to take its rightful place at the table of global prosperity. Countries in Eastern Africa, in particular, have experienced strong growth for the last decade.

In many countries, this growth has contributed to higher living standards and poverty reduction. Low inflation, reduced levels of public debt, and adequate reserve levels – have helped to shield much of the region from the crisis.

Overall, we expect Sub-Saharan Africa to enjoy continued robust growth—which our projections in October place at 5 percent in 2013 and close to 6 percent in 2014. But this outlook is not without risks. Policymakers must remain vigilant to threats from slower demand in emerging market economies, unfavorable changes in commodity prices, or higher financing costs.

Looking forward, I would like to reiterate the same message for Sub-Saharan Africa that I just gave to Kenya: there can be no complacency. Immense challenges remain. Africa can—and must—grow faster to address pressing social problems, and provide jobs for its young and growing population. Poverty remains unacceptably high, and progress toward the Millennium Development Goals remains too slow.

Indeed, "Africa Rising" will be the subject of a major conference the IMF is organizing, in partnership with the government of Mozambique, to which all Sub-Saharan Africa countries have been invited—including your Finance Minister and Central Bank Governor. Following the successful conference entitled "Kenya: Ready for Take Off" that Kenya and the IMF organized in Nairobi last September, the conference in Mozambique will take stock of Africa's economic successes, as well as the challenges ahead.

3. Kenya—The Quest for Middle-Income Status

Let me now turn to my third topic and the main theme of today's meeting—Kenya's quest to become a middle-income economy.

Kenya today is already a "*frontier*" economy. The impressive turnaround in its performance is the outcome of important changes in the economic, political, and social landscape over the past few years.

At the *economic* level, prudent policies have helped anchor the conditions for strong and stable growth. Fiscal discipline has improved both the external and domestic debt positions. A more modern framework for monetary policy has helped keep inflation expectations in check, despite adverse shocks. And stronger supervisory powers have maintained financial stability, even as the financial system is expanding rapidly and capital markets opening up.

The result? Kenya has built a strong external position and is now in a favorable condition to tap international financial markets with the planned Eurobond issue.

Going forward, as Kenya becomes more integrated in the global economy, it is bound to be exposed to external shocks—through spillovers from trading partners' economies or volatility in international financial markets. Further bolstering its foreign reserve position and lowering its debt burden will ensure that the country is resilient to these shocks.

At the *political* level, Kenya has not only overhauled its form of government by implementing the 2010 Constitution, but also gone through a delicate political transition—a transition that culminated with the March 2013 peaceful elections. Kenya's new system of checks and balances means that management of public resources is now more transparent and subject to more accountability. These changes should support overall economic stability.

In addition, Kenya has fully embraced the opportunities afforded by technology in enhancing *financial inclusion*. This country now boasts the highest share of population with access to financial services in Sub-Saharan Africa (more than 70 percent).

What does this mean practically speaking? It means that millions of Kenyans who were previously outside the financial system now have a stake in the economy. The younger generation, in particular, has been increasingly empowered to take advantage of new opportunities.

Kenya has indeed come a long way over the past few years. The key is now to build on this momentum, with emphasis in the following areas. We might call them the "Three C's": *completing*fiscal devolution; *closing* infrastructure gaps; and *continuing*regional integration.

The first "C": Completing fiscal devolution

We can all agree that devolution and fiscal decentralization are important steps. And yes; the process will be complex and the risks are significant. But I recognize that expectations are high. It is crucial that devolution is implemented successfully: crucial to secure access to resources to all parts of the country; and crucial to ensure that every region gets to benefit from improved economic conditions.

If done properly, this kind of devolution can bolster social cohesion, by increasing accountability in the management of public resources, and improving the quality of services delivery. It can also create new private sector opportunities in the new counties.

But coming back to the risks, it is imperative that devolution is done right. That means spending needs to remain within the available envelope of public resources—and be transparent. It also means avoiding duplication of functions between the central and local government.

The second "C": Closing infrastructure gaps

Kenya still has large infrastructure gaps that must be tackled, if growth is to be raised and jobs created. The country's newfound natural resource wealth is an opportunity to lift economic prospects, but these resources need to be exploited wisely and transparently.

Kenya is currently building a fiscal and regulatory regime to govern the use of revenues from natural resources development. This should provide a transparent framework for investors and a stable base for government revenue. Beyond that, the use of these fiscal resources should be carefully prioritized, and the quality of infrastructure projects closely scrutinized. The IMF stands ready to continue to provide extensive technical assistance on these issues.

Foreign investment should also be encouraged to help plug infrastructure needs. I understand that foreign investors are interested in financing major projects, such as the construction of a modern railway line from the coastal area of Kenya to neighboring countries, and the expansion of geothermal power generation. Again, these types of financing should be encouraged, provided that they remain consistent with a sustainable debt position.

My third "C": Continuing regional integration

In Sub-Saharan Africa, Kenya has led the way in the process of regional integration. It is now the second largest investor in the region, and is a strong advocate of regional economic integration in the context of the East African Community.

Regional integration has opened up new markets, supported the emergence of a middle class, and enabled domestic demand to become an engine of growth. The process must now be deepened. In that context, the heads of states of the East African Community recently agreed on a roadmap toward a monetary union. This is an opportunity but also a major challenge. It will be important to draw upon the experience and lessons learned from other regions, and to manage the process carefully. The IMF stands ready to provide technical assistance and advice, as needed.

Conclusion

Let me conclude: over the past several years, Kenya has embarked upon a successful journey that has transformed its economy. This has been achieved with the leadership and support from the public sector, but also largely through the efforts of a vibrant private sector. This partnership has increasingly helped to lift the Kenyan people out of poverty and generate job opportunities.

In this context, I would like to touch on a subject that is dear to me—education. Kenya's record in providing universal primary education is impressive, especially for girls. Going forward, it is crucial that girls have this access at the secondary and university levels.

So, Kenya's journey to middle-income status is not over. There is still a long way to travel, but I believe this country's high hopes are warranted. I have tried today to chart out how that path can be successfully navigated.

As the Kenyan wisdom goes: "Pamoja twasonga mbele"—"*Together we are moving forward*". As a nation you have made it this far and—together with the IMF—I am confident that Kenya will continue to move forward.
"*Asante sana*" – *Thank you very much*.