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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 3RD SEPTEMBER, 2013 MANAGING RISKS TO SUSTAIN PRICE STABILITY

The Monetary Policy Committee met on 3rd September, 2013 to review market developments and the outcomes of the monetary policy stance since its July 2013 meeting. The Committee noted that inflation had remained within the current allowable margin of 2.5 percent on either side of the Government's medium-term target of 5 percent while exchange rate stability was sustained. It noted the following positive outcomes in the market since its last meeting:

- Although overall month-on-month inflation rose from 6.02 percent in July 2013 to 6.67 percent in August 2013, it remained within the target band set by the Government. The increase in overall inflation was largely an outcome of a base effect following notable price declines in 2012, coupled with increases in fuel and some food prices. Nevertheless, non-food-non-fuel inflation, which measures the impact of monetary policy, declined from 4.04 percent to 3.86 percent during the period, reflecting reduced demand pressure in the economy. Similarly, the 3-month annualised overall and non-food-non-fuel inflation rates remained stable. These developments, coupled with non-inflationary private sector credit growth continued to support a stable short-term outlook for inflation.
- The exchange rate remained stable during the period, supported by effective liquidity management and resilient foreign exchange inflows from the Diaspora. The exchange rate fluctuated within a narrower range of Ksh.87.37 and Ksh.87.70 against the US Dollar in August 2013 compared to a range of Ksh.85.83 and Ksh.87.41 in July 2013. The CBK level of usable foreign exchange reserves stood at USD5,751.11 million (equivalent to 4.11 months of import cover) at the end of August 2013. The Committee noted that the ongoing initiatives by the Government to attract foreign investors and expand its trade markets would support exchange rate stability through increased foreign exchange earnings in the future.
- The Government domestic borrowing programme was within target and was therefore not driving or exerting pressure on interest rates.
- Movements in short-term interest rates were aligned to the Central Bank Rate (CBR) while sustained Open Market Operations continued to support the stability in the interbank market. Commercial banks' average lending interest rates declined between May and July 2013 to an average of 16.31% in line with the current monetary policy stance.

- The outcome of stress testing and other data on the banking sector showed that it remains solvent and resilient. The number of loan applications increased from 88,973 in May to 91,782 in June and further to 99,226 in July 2013. Consequently, private sector credit grew by 13.5 percent in July 2013 compared to 12.7 percent in June 2013, distributed across all key sectors of the economy.
- The Committee noted that confidence in the economy has been maintained. Activity at the Nairobi Securities Exchange (NSE) remains strong while foreign investor participation increased in August 2013. Specifically, the NSE-20 index rose from 4,598.16 in June 2013 to 4,697.75 in August 2013. Diaspora remittances increased from USD99.81 million to USD112.83 million between June and July 2013. In addition, the MPC Market Perceptions Survey conducted in August 2013 showed that the private sector expects inflation and the exchange rate to remain stable. The Survey also showed optimism for strong economic growth in 2013 largely on account of macroeconomic stability and expected inflows of foreign direct investments.

However, the Committee noted that there remain risks to the macroeconomic outlook emanating from the global economy. Economic activity in the Eurozone remains weak while the instability in the Middle East and North Africa (MENA) could escalate. Following the instability in the MENA region, international oil prices rose between June and August 2013 which contributed to the increase in domestic fuel prices. In addition, foreign exchange inflows from tea exports to the region, which account for about a third of Kenya's tea exports, could be affected. These developments coupled with the high current account deficit remain a threat to macroeconomic stability. Furthermore, implementation of the new VAT measures from this month will contribute to short-term increases in inflation, but the effects will be mild.

In view of these developments, the Committee concluded that there were no demand-driven inflationary pressures which would require a revision of its monetary policy stance. It therefore decided to retain the CBR at 8.50 percent. It will continue to monitor the key macroeconomic aggregates and any emergent risks that may impact on price stability.



PROF. NJUGUNA NDUNG'U, CBS
CHAIRMAN, MONETARY POLICY COMMITTEE

3rd September, 2013