



BACKGROUND TO THE MPC DECISIONS ON 8TH JULY, 2014

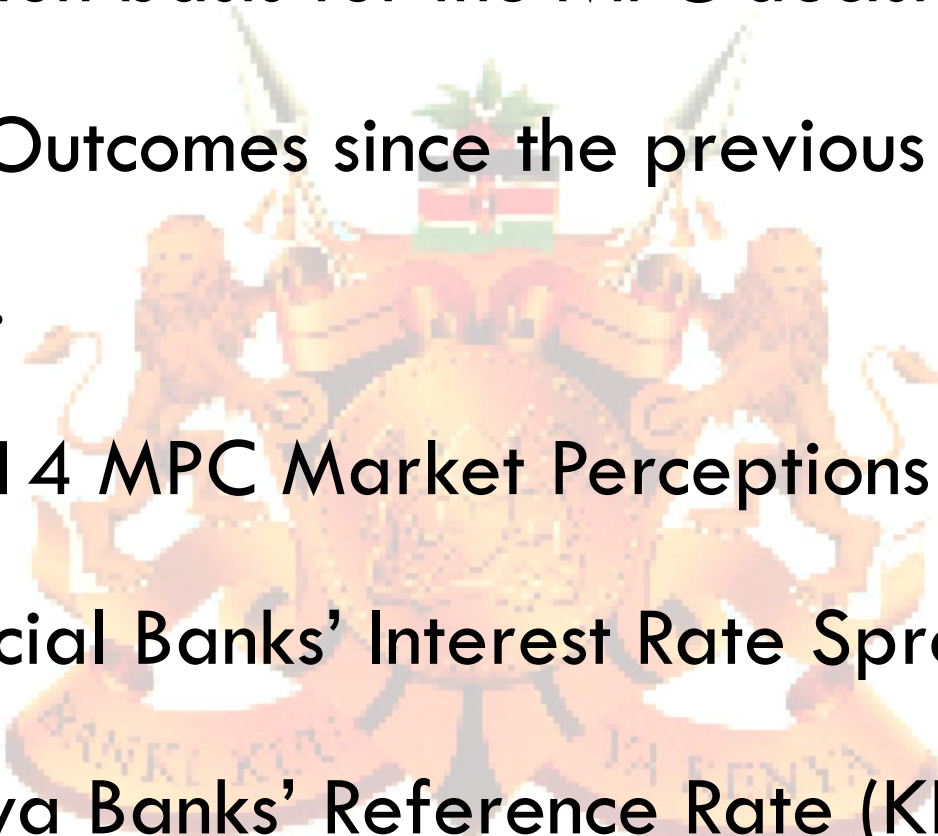
**Presentation to Chief Executive Officers of Commercial
Banks**

**Prof. Njuguna Ndung'u, CBS
Governor, Central Bank of Kenya**

July 10, 2014



Outline

- 
1. Information basis for the MPC decision
 2. Market Outcomes since the previous MPC Meeting.
 3. June 2014 MPC Market Perceptions Survey.
 4. Commercial Banks' Interest Rate Spreads
 5. The Kenya Banks' Reference Rate (KBRR)



1. Information basis for the MPC Decision

The MPC retained the CBR at 8.50 percent at its Meeting on 8th July 2014 percent to continue anchoring inflationary expectations and maintain price stability. The CBK has computed and set the Kenya Banks' Reference Rate (KBRR) at 9.13 percent:

- The overall month-on-month inflation increased marginally from 7.30 percent in May 2014 to 7.39 percent in June 2014 driven largely by the base effect – but remained within the prescribed target range.
- Month-on-month non-food-non-fuel inflation which measures the impact of monetary policy increased slightly from 4.35 percent to 4.47 percent.
- The exchange rate remained generally stable supported by resilient Diaspora remittances, increased foreign investor participation in the NSE , and enhanced confidence following the issuance of the Sovereign Bond.
- The CBK level of usable foreign exchange reserves increased from USD 6,308.23 million (4.28 months of import cover) at the end of April 2014 to USD6,501.37 million (4.34 months of import cover) as at 7th July, 2014 – this build-up will continue as the Government utilizes the proceeds of the Sovereign Bond.
- The fiscal measures spelt out in the Government Budget for the Fiscal Year 2014/15 are consistent with the monetary policy objective – the Sovereign Bond issuance is expected to dampen pressure on Government domestic borrowing and interest rates.
- Stress tests and data show that the banking sector remains solvent and resilient – private sector credit growth has been towards the productive sectors of the economy while credit risk declined in May 2014.
- Introduction of the KBRR as the base rate for all lending by banks (including microfinance banks) will enhance the transmission of monetary policy signals through commercial banks' lending rates – the CBR is one of the components of the KBRR.

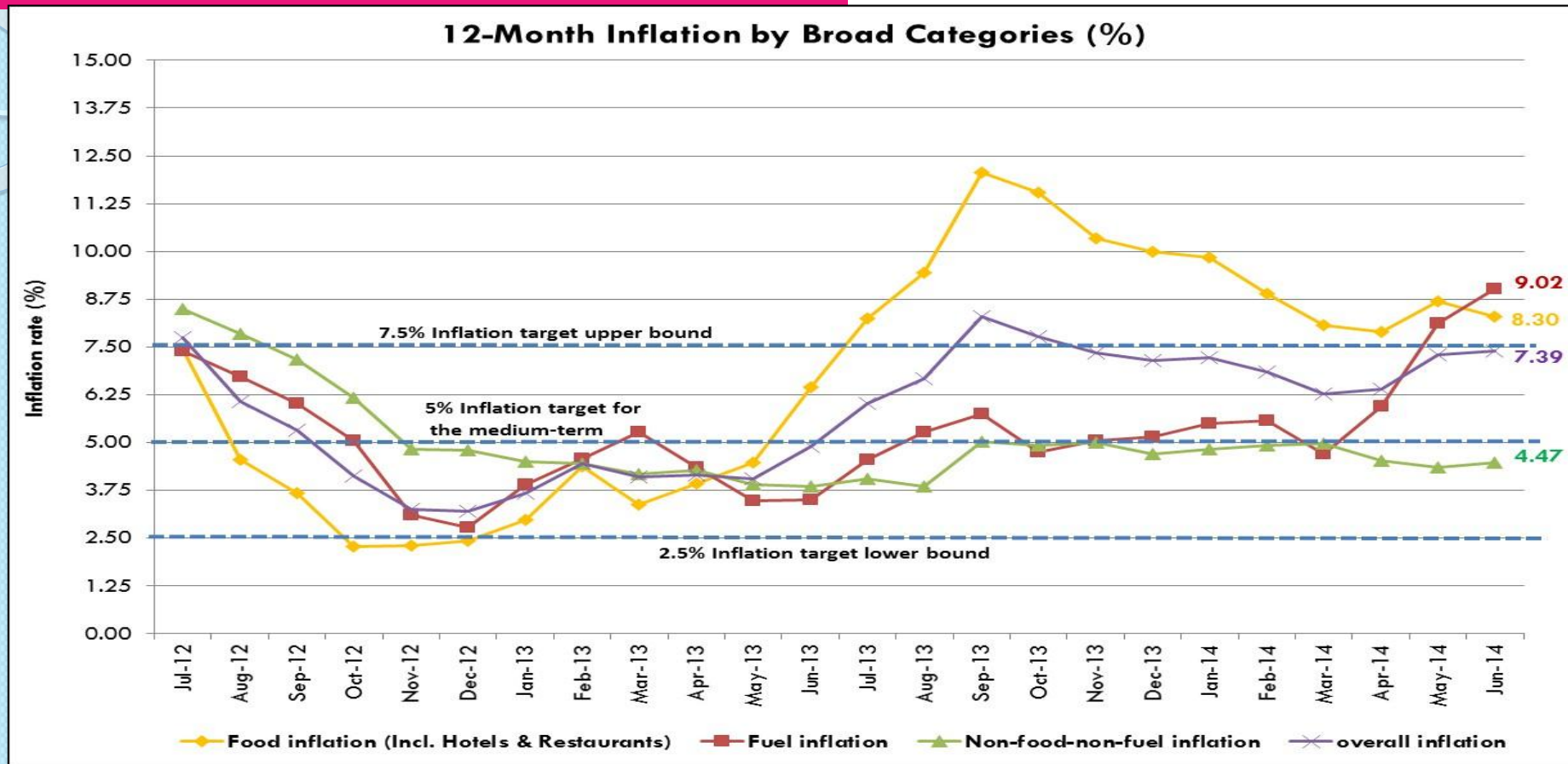


1. Information basis for the MPC Decision...

- **Confidence in the economy remains strong:**
 - The latest sovereign rating by Moody's places Kenya at "B1 with stable outlook"
 - The debut Sovereign Bond was massively oversubscribed – entry into the international capital markets has boosted Kenya's rating and enhanced the capacity for a faster rollout of public investments; it will also help to benchmark the country's credit and facilitate access to international capital markets by corporate entities.
 - Purchases of equity at the NSE by foreign investors remain high.
 - Diaspora remittances have remained resilient – they rose from USD113.41 million in April 2014 to USD119.66 million in May 2014.
 - The MPC Market Perception Survey conducted in June 2014 showed that the private sector expects a strong growth in 2014 with inflation and the exchange rate remaining stable for the remainder of 2014.
- **The growth outlook for the global economy and that of Kenya's main trading partners is improving –** this will boost exports and support exchange rate stability.
- Global long-term interest rates have been declining suggesting that interest rates may remain low over the long-term – this is expected to dampen the threat of excessive volatility in the global currency and financial markets.
- **But there are risks to the macroeconomic outlook –** the instability in the Middle East and North African region remains a threat to the stability of international oil prices and the overall price stability objective.
- **The CBK is monitoring the key macroeconomic aggregates and any emergent risks from the external and domestic economies that may impact on price stability.**

2a. Market outcomes since the previous MPC Meeting:

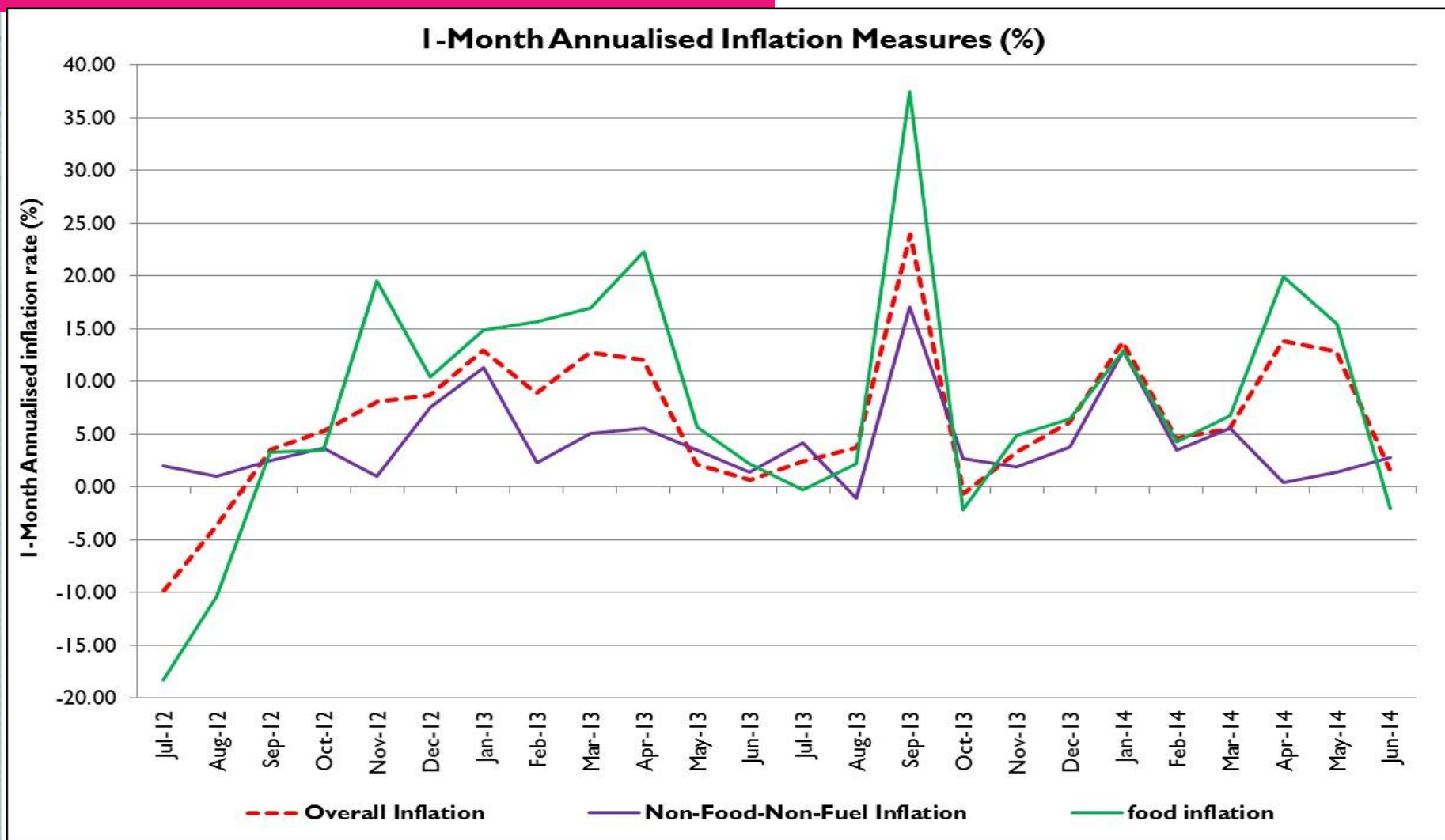
Overall inflation has remained within the prescribed target range



- The overall month-on-month inflation increased marginally from 7.30 percent in May 2014 to 7.39 percent in June 2014 driven largely by the base effect but remained within the target range.
- But month-on-month NFNF has remained below 5 percent reflecting the success of monetary policy.

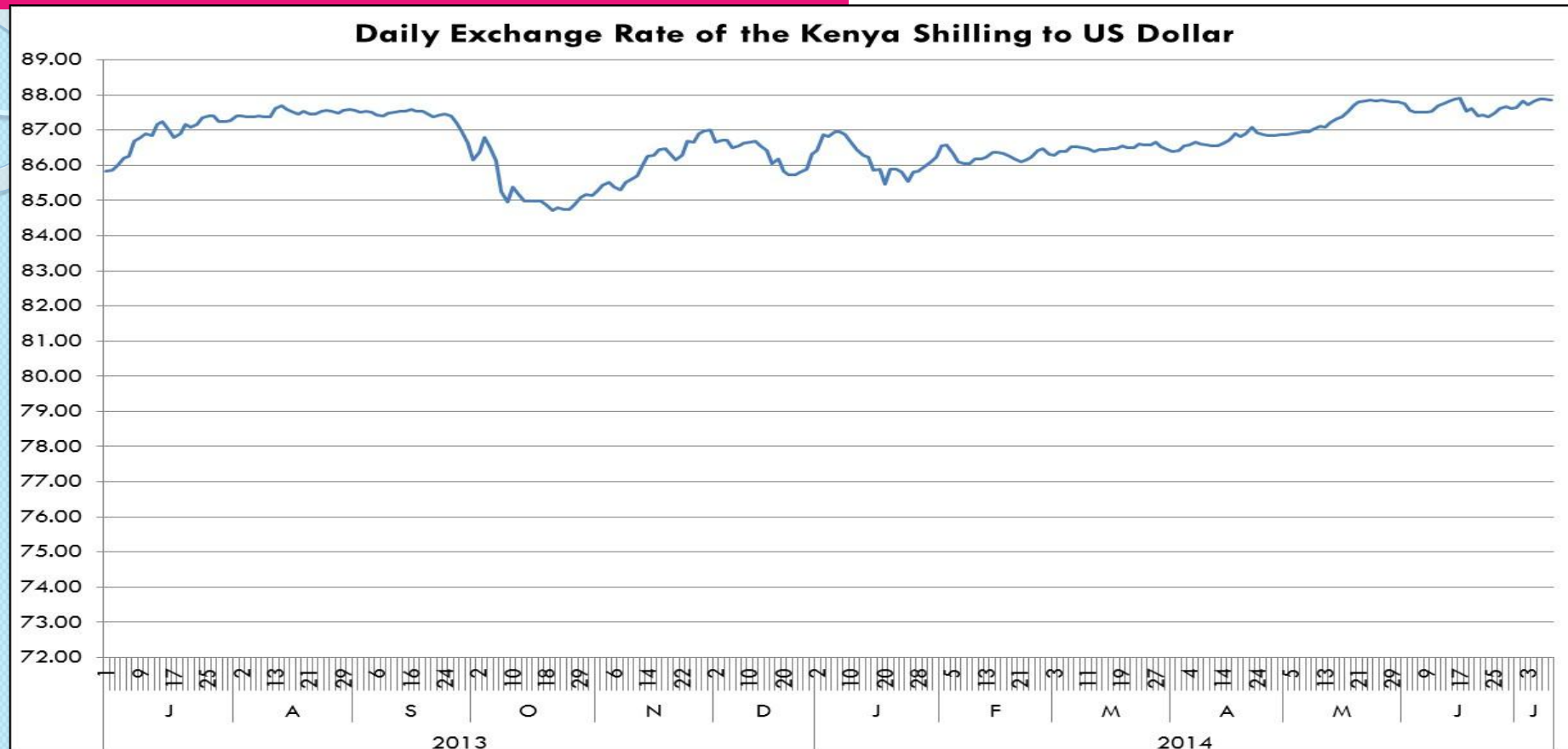
2a. Market outcomes since the previous MPC Meeting:

The 1-month annualised overall and food inflation measures declined in June 2014 indicating easing inflation pressure...



2b. Market outcomes since the previous MPC Meeting:

The exchange rate has remained generally stable despite the recent short-term seasonal pressures

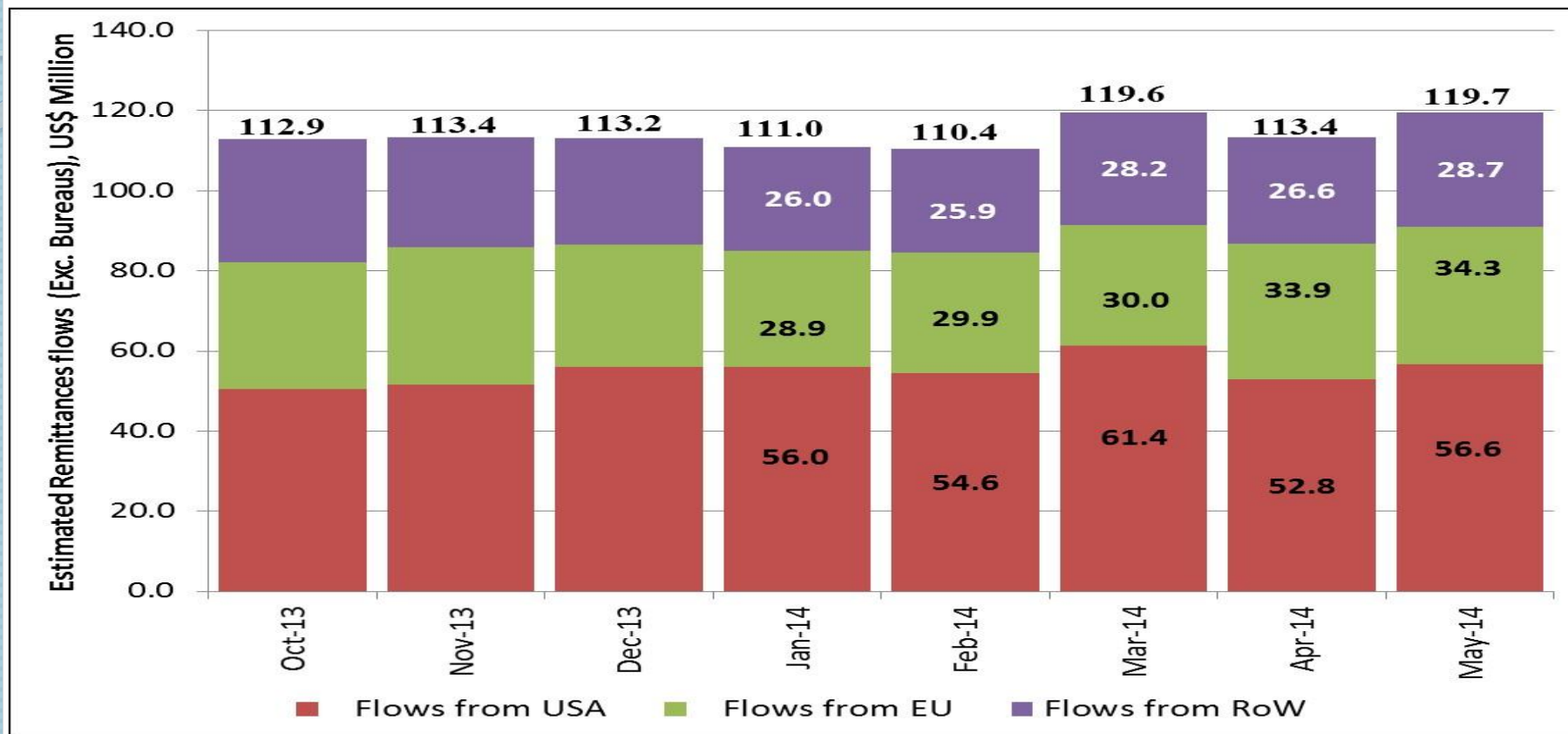


- The Kenya shilling exchange rate stability continues to dampen the threat of imported inflation – the stability is supported by resilient Diaspora remittances, increased foreign investor participation in the NSE, and enhanced confidence following issuance of the Sovereign Bond.

2b. Market outcomes since the previous MPC Meeting:

Exchange rate stability supported by resilient Diaspora remittances...

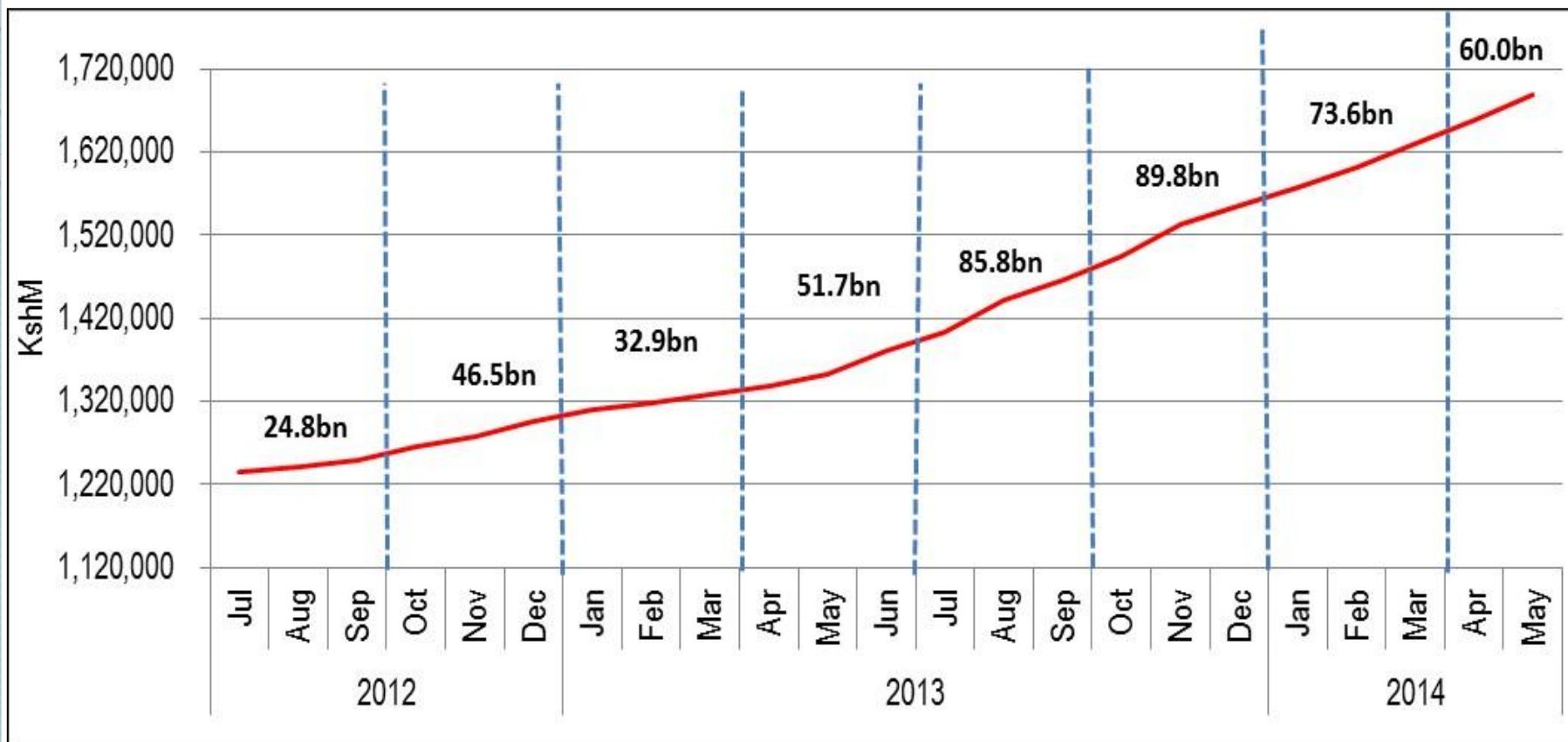
Monthly Diaspora Remittances by Source (USD Million)



- Diaspora remittances have remained resilient supported by the improving global economic activity – remittances from all sources increased in May 2014.

2c. Market outcomes since the previous MPC meeting:

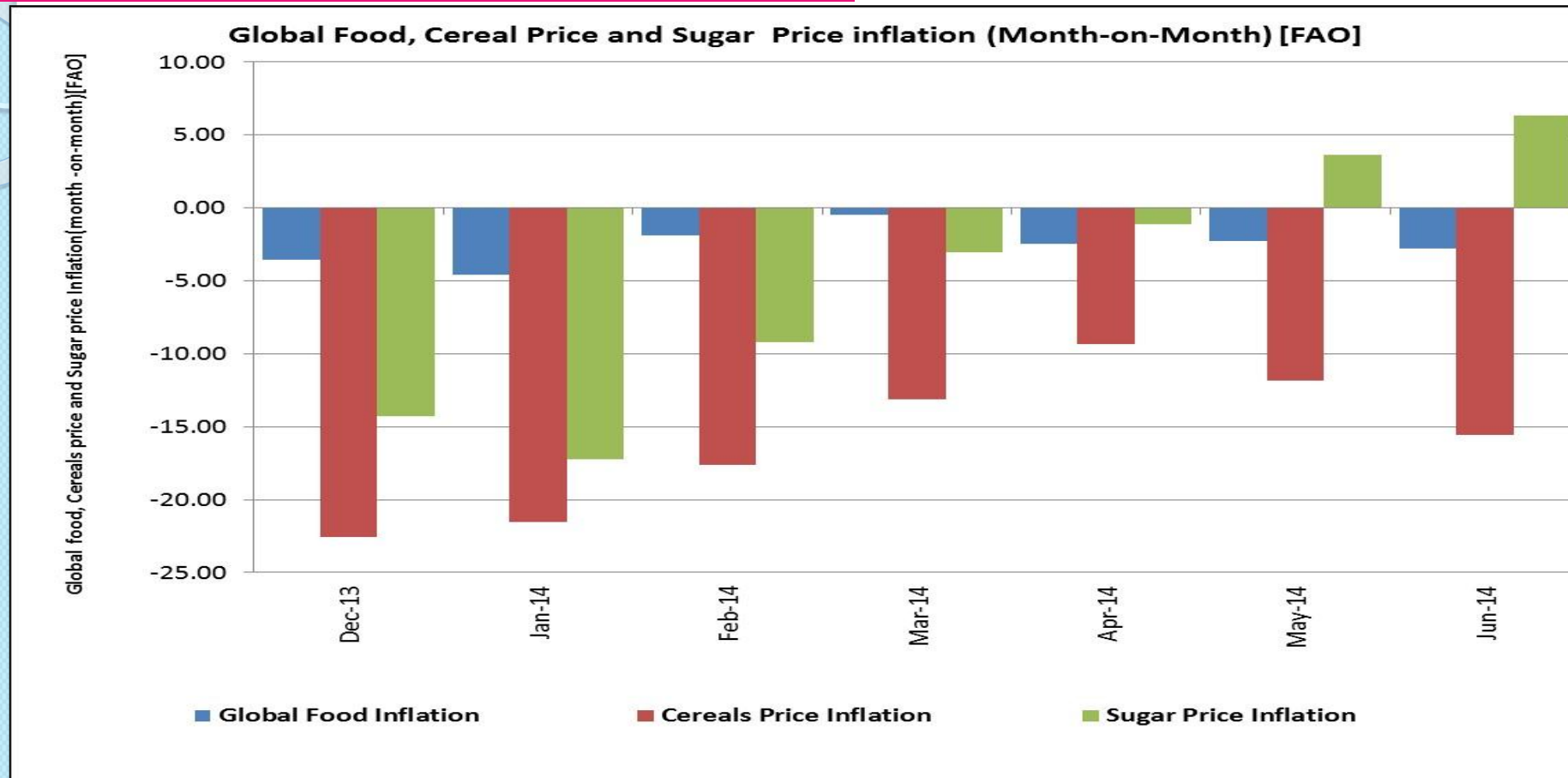
Private sector credit growth has been towards productive sectors of the economy



- Bank credit to private sector has been increasing – the annual growth in private sector credit increased from 23.87 percent in April 2014 to 24.99 percent in May 2014.
- This has been non-inflationary as the NFNF inflation remained below 5 percent target.

2d. Market outcomes since the previous MPC meeting:

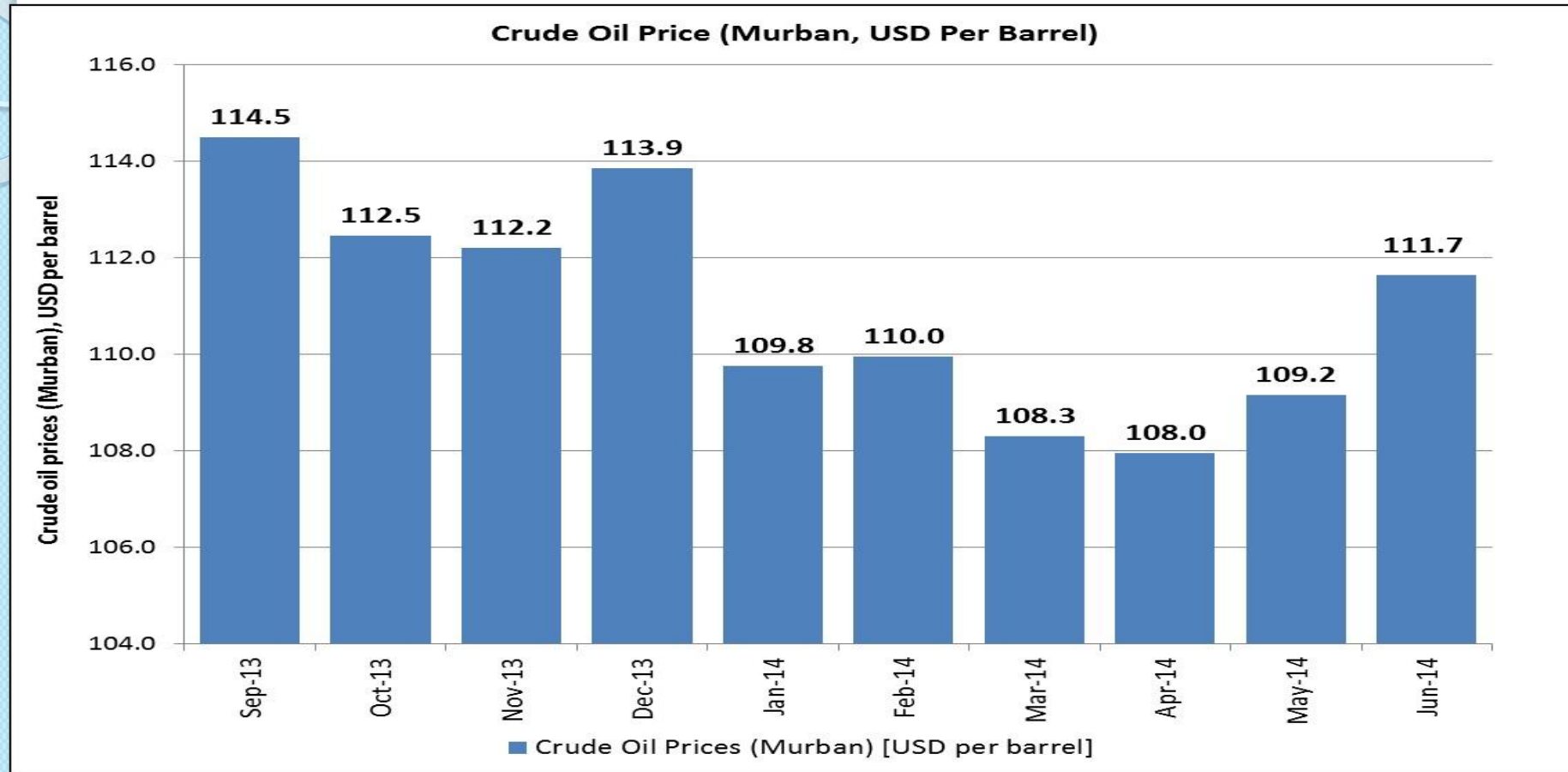
Global food inflation has continued to decline



- International prices of food and cereals have continued to decline, dampening the risks to domestic food prices in case of food imports.

2e. Market outcomes since the previous MPC meeting:

But international Murban crude oil prices have been volatile



- International crude oil prices have been volatile largely reflecting the instability in the Middle East and North Africa – this remains a threat to inflation

3a. April 2014 MPC Market Perceptions Survey:

Survey shows inflation is expected to increase slightly on average but remain within the Government target range

Survey Month	Large banks	Medium banks	Small banks	All banks	MFIs	Non-bank private firms
Aug-2013	7.60	6.88	6.91	7.03		6.73
Oct-2013	8.16	8.89	8.42	8.54		8.33
Dec-2013	7.14	7.50	7.25	7.32		7.10
Feb-2014	7.40	7.82	7.07	7.36		7.58
Apr-2014	6.68	6.63	6.32	6.49	6.33	6.15
Jun- 2014	7.06	7.37	7.50	7.40	7.20	7.15

- The June 2014 Survey shows a slight upward revision in inflationary expectations relative to the April 2014 Survey; but inflation expected to remain within the Government target band in the remainder of the year.
- But large banks, medium banks, MFIs and non-bank private firms expect a lower inflation on average in the rest of the year compared to what they indicated in February 2014.
- Inflationary expectations is attributed to expected increases in food and electricity prices due to inadequate rains as well as volatility in international oil prices due to the continued instability in the Middle East.
- However, a stable exchange rate and monetary policy measures in place expected to support a stable exchange rate.

3b. April 2014 MPC Market Perceptions Survey:

Survey shows exchange rate expected to remain stable

Survey month	Banks Ksh/USD Exchange rate			Non-Banks Ksh/USD Exchange rate		
	Strengthen	Remain the same	Weaken	Strengthen	Remain the same	Weaken
Feb-2013	34	25	41	21	29	46
Apr-2013	66	11	23	45	26	29
Jun-2013	33	20	47	17	42	31
Aug-2013	15	25	60	23	27	50
Oct-2013	47	32	21	33	37	30
Dec-2013	32	37	31	20	60	20
Feb-2014	27	40	33	14	47	39
Apr-2014	20	44	36	30	39	31
Jun-2014	47	17	36	33	37	30

- The June 2014 Survey shows banks and non-bank firms expect the exchange rate to either strengthen or remain stable in the remainder of 2014 on account of: receipt of proceeds of the Sovereign Bond which are expected to boost foreign exchange reserve; sustained confidence in the economy; expected increase in foreign exchange inflows from Diaspora remittances and exports with the recovery of the global economy; increased foreign direct investment in infrastructure and energy; and, the monetary policy measures in place.
- The main risks to the exchange rate were attributed insecurity which has affected tourism revenues, political noise, decline tea prices, and increase in import demand with pick-up in economic activity.

3c. April 2014 MPC Market Perceptions Survey:

Sustained expectations for a strong growth in 2014

Expected average economic growth in the year (%)

Survey Month	Large banks	Medium banks	Small banks	All banks	MFIs	Non-bank private firms
Aug-2013	5.60	5.63	5.73	5.67		5.63
Oct-2013	4.99	5.36	4.99	5.12		5.02
Dec-2013	5.71	5.70	5.76	5.73		6.20
Feb-2014	5.30	5.50	5.63	5.52		5.79
Apr-2014	5.36	5.31	5.68	5.49	6.07	5.38
Jun-2014	5.32	5.29	5.32	5.31	5.60	5.10

- The June 2014 Survey shows that banks, MFIs and non-bank private firms expect a strong growth performance in 2014.
- The expected strong growth performance in 2014 is attributed to: strengthening of the global economy which is expected to boost exports; the stable macroeconomic environment; increased FDI and GOK investment in infrastructure and energy segments of the economy; increase in private sector credit growth towards productive sectors in the economy; and, pick-up in the operations of the County governments which is expected to spur growth in the counties.
- But the impact of insecurity on tourism, decline in tea prices, and depressed rainfall which could affect agricultural production were cited as the main risks to the growth outlook.

4a. Commercial banks' interest rates:

Although ex ante average lending interest rates declined (on average) between 2013 and in the first five months of 2014, they have increased slightly between April and May 2014.

Average deposit rates have increased across all bank categories.

	Ex ante Average Lending rates (%)				Ex ante Average Deposit rates (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jan-13	18.23	17.04	15.66	17.43	7.91	7.21	3.50	7.04
Feb-13	17.58	16.14	15.61	16.77	7.39	6.91	3.18	6.62
Mar-13	17.17	16.09	15.31	16.51	7.16	6.87	3.29	6.51
Apr-13	16.93	16.33	15.81	16.55	7.48	7.01	3.22	6.71
May-13	16.91	16.38	15.97	16.58	7.48	7.00	3.67	6.77
Jun-13	17.10	16.13	14.87	16.43	7.35	6.80	3.03	6.54
Jul-13	17.11	16.01	14.82	16.38	7.17	6.42	2.91	6.30
Aug-13	17.08	15.71	14.65	16.23	7.30	6.41	2.95	6.36
Sep-13	16.79	15.80	14.50	16.10	7.29	6.35	2.94	6.33
Oct-13	16.90	15.76	14.45	16.13	7.56	6.33	2.90	6.45
Nov-13	16.62	15.35	14.15	15.81	7.31	6.53	3.06	6.43
Dec-13	16.37	15.53	14.23	15.76	7.86	6.66	3.84	6.86
Jan-14	16.46	15.24	14.15	15.69	7.78	6.85	3.48	6.83
Feb-14	16.31	15.00	14.19	15.53	7.78	7.03	3.48	6.90
Mar-14	16.02	15.12	14.19	15.43	7.62	6.88	3.27	6.74
Apr-14	15.94	15.14	14.18	15.40	7.38	6.75	3.33	6.58
May-14	16.10	15.40	14.35	15.60	7.53	6.91	3.35	6.72
Average 2013	17.07	16.02	15.00	16.39	7.44	6.71	3.21	6.58
Average 2014	16.17	15.18	14.21	15.53	7.62	6.88	3.38	6.75
Change 2013/14	-0.90	-0.84	-0.79	-0.86	0.18	0.18	0.18	0.18

4b. Commercial banks' interest rates:

Similarly, although ex post average lending interest rates have declined on average between 2013 and so far in 2014, they rose slightly in May 2014. Average deposit rates for small and medium banks rose slightly in May 2014.

	Ex post Average Lending rates (%)				Ex post Average Deposit rates (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jan-13	17.12	16.74	15.30	16.73	7.62	7.31	2.71	6.82
Feb-13	16.09	15.46	15.16	15.73	7.15	6.98	2.58	6.45
Mar-13	16.25	15.67	15.29	15.90	7.23	7.09	2.55	6.53
Apr-13	16.09	16.22	15.54	16.06	7.23	6.99	2.71	6.51
May-13	16.27	16.17	14.91	16.04	7.16	7.12	2.64	6.51
Jun-13	16.08	16.12	14.36	15.85	7.06	7.17	2.54	6.47
Jul-13	16.29	15.92	14.69	15.93	7.16	6.59	2.78	6.34
Aug-13	16.45	15.70	14.37	15.88	6.89	6.57	2.87	6.21
Sep-13	16.15	15.86	14.29	15.79	7.01	6.48	2.45	6.17
Oct-13	16.55	15.79	14.31	15.95	7.21	6.53	2.36	6.28
Nov-13	16.32	15.50	13.99	15.69	7.24	6.69	2.67	6.40
Dec-13	16.20	15.53	14.31	15.69	7.32	7.13	2.46	6.57
Jan-14	16.06	14.92	14.05	15.36	7.35	7.20	2.59	6.63
Feb-14	15.36	15.09	13.84	15.05	6.98	7.29	2.58	6.48
Mar-14	15.69	15.16	14.46	15.32	7.16	7.36	2.59	6.59
Apr-14	15.73	14.92	14.03	15.19	6.98	7.06	2.94	6.44
May-14	16.06	15.37	14.17	15.54	7.13	7.17	2.64	6.52
Average 2013	16.32	15.89	14.71	15.94	7.19	6.89	2.61	6.44
Average 2014	15.78	15.09	14.11	15.29	7.12	7.22	2.67	6.53
Change 2013/14	-0.54	-0.80	-0.60	-0.65	-0.07	0.33	0.06	0.09

4c. Commercial banks' interest rates:

Overall spreads declined on average between 2013 and so far in 2014, but spreads increased slightly between March and May 2014

	Ex ante Spread (%)				Ex post Spread (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jan-13	10.31	9.83	12.16	10.39	9.50	9.43	12.59	9.91
Feb-13	10.19	9.23	12.44	10.15	8.94	8.48	12.58	9.28
Mar-13	10.01	9.22	12.02	10.00	9.02	8.57	12.74	9.37
Apr-13	9.45	9.32	12.59	9.84	8.86	9.23	12.83	9.55
May-13	9.43	9.38	12.30	9.81	9.11	9.05	12.26	9.53
Jun-13	9.75	9.34	11.84	9.89	9.01	8.94	11.82	9.38
Jul-13	9.94	9.59	11.91	10.09	9.13	9.33	11.92	9.59
Aug-13	9.78	9.30	11.70	9.87	9.55	9.13	11.50	9.67
Sep-13	9.50	9.45	11.56	9.77	9.14	9.39	11.84	9.61
Oct-13	9.34	9.43	11.55	9.68	9.33	9.26	11.95	9.67
Nov-13	9.31	8.82	11.09	9.38	9.07	8.81	11.33	9.29
Dec-13	8.50	8.86	10.39	8.90	8.88	8.40	11.85	9.11
Jan-14	8.68	8.39	10.67	8.85	8.71	7.72	11.46	8.73
Feb-14	8.53	7.97	10.71	8.63	8.38	7.79	11.25	8.56
Mar-14	8.40	8.24	10.91	8.69	8.54	7.80	11.88	8.73
Apr-14	8.56	8.39	10.85	8.81	8.76	7.85	11.09	8.75
May-14	8.57	8.49	11.00	8.88	8.93	8.20	11.53	9.02
Average 2013	9.63	9.31	11.79	9.81	9.13	9.00	12.10	9.50
Average 2014	8.55	8.30	10.83	8.77	8.66	7.87	11.44	8.76
Change 2013/14	-1.08	-1.02	-0.97	-1.04	-0.47	-1.13	-0.66	-0.74



5. Operationalisation of the Kenya Banks' Reference Rate (KBRR)

1. The KBRR framework was developed and introduced following discussions between the stakeholders, CBK and led by The National Treasury.
2. KBRR is computed as an average of the CBR and the weighted 2-months moving average of the 91-day Treasury Bill rate – consultations with the KBA had preferred the 2-months moving average on the 91-day Treasury bill rate.
3. The **KBRR of 9.13** percent became effective from 8th July, 2014, and will remain at this level until its next review in January 2015 (if market conditions do not drastically change).
4. All banks (including microfinance banks) and mortgage finance companies will price their flexible rate loans using the **KBRR** as the base rate.
5. For individual banks, the interest rate they charge their customers will be **KBRR + K**. We expect banks and mortgage finance companies to vary their lending rates to be as close as possible to **KBRR**.
6. Banks and mortgage finance companies will disclose to their respective borrowers and the Central Bank the breakdown of any deviation, **K**, from the **KBRR**, thereby enhancing transparency in pricing of credit and mortgage.
7. All flexible/variable credit facilities applied for shall be priced using the new **KBRR** framework.
8. Existing flexible/variable credit facilities shall be transitioned to the new **KBRR** framework by 30th June 2015.
9. CBK will work closely with the institutions and stakeholders to facilitate a smooth and effective implementation of the framework as well as to facilitate a wide dissemination of the framework to the public.

5. Kenya Banks' Reference Rate (KBRR) is computed as an average of the CBR and the weighted 2-month moving average of the 91-day Treasury bill rates...

