



BACKGROUND TO THE MPC DECISIONS ON 3RD SEPTEMBER, 2014

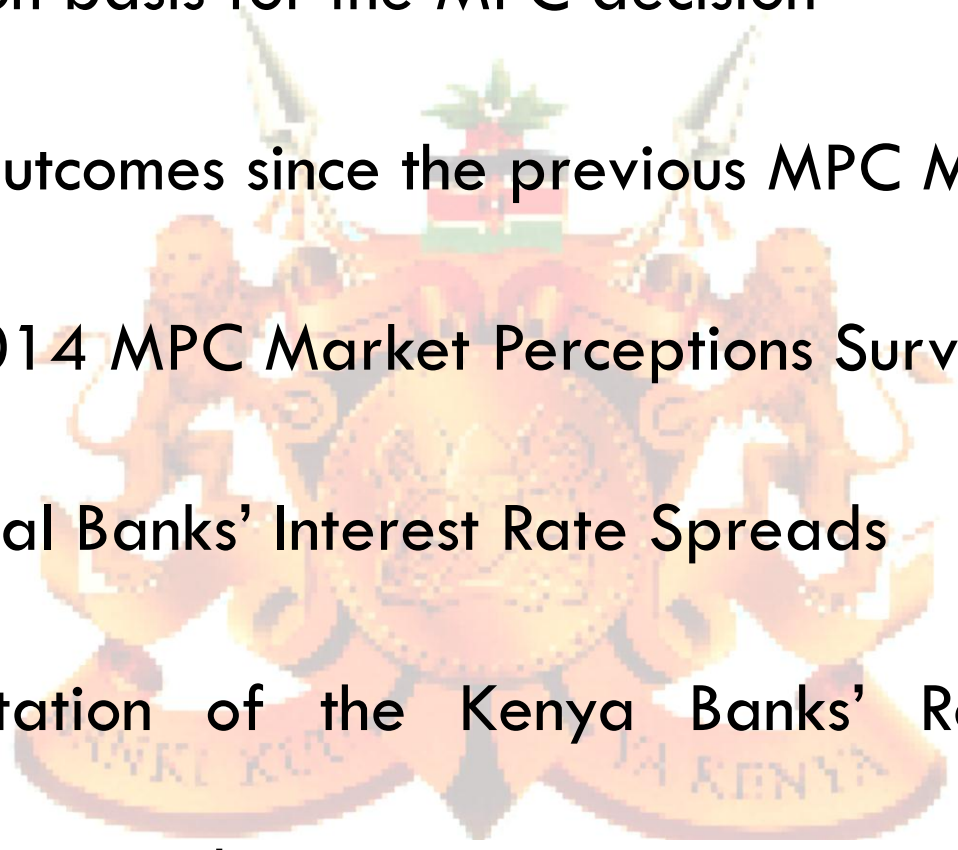
**Presentation to Chief Executive Officers of Commercial
Banks**

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Outline

1. Information basis for the MPC decision
 2. Market Outcomes since the previous MPC Meeting.
 3. August 2014 MPC Market Perceptions Survey.
 4. Commercial Banks' Interest Rate Spreads
 5. Implementation of the Kenya Banks' Reference Rate (KBRR) Framework
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1. Information basis for the MPC Decision

The MPC decided to retain the CBR at 8.50 percent given that there was no fundamental structural pressure on inflation, but CBK will pursue a tightening bias in the money market through monetary policy operations in order to continue to anchor inflationary expectations.

- The overall month-on-month inflation rose from 7.67 percent in July 2014 to 8.36 percent in August 2014 which was above the upper bound of the prescribed range – this reflected the base effect and increases in the prices of some food and energy items.
- Month-on-month non-food-non-fuel (NFnF) inflation which measures the impact of monetary policy increased slightly from 4.45 percent to 4.92 percent.
- The exchange rate has maintained a stable trend despite the global strengthening of the US Dollar – it has been supported by resilient foreign exchange inflows through diaspora remittances and foreign investor participation in the NSE.
- The CBK level of usable foreign exchange reserves stood at USD 6,376.95 million (equivalent to 4.21 months of import cover) as at 3rd September, 2014 – this level is adequate to cushion the foreign exchange market against any temporary shocks.
- Interest rates on Treasury bills have been declining but the market continued to show an appetite for long-term Government paper.
- Stress tests and data show that the banking sector remains resilient – private sector credit growth has been towards the productive sectors of the economy while credit risk declined in July 2014.

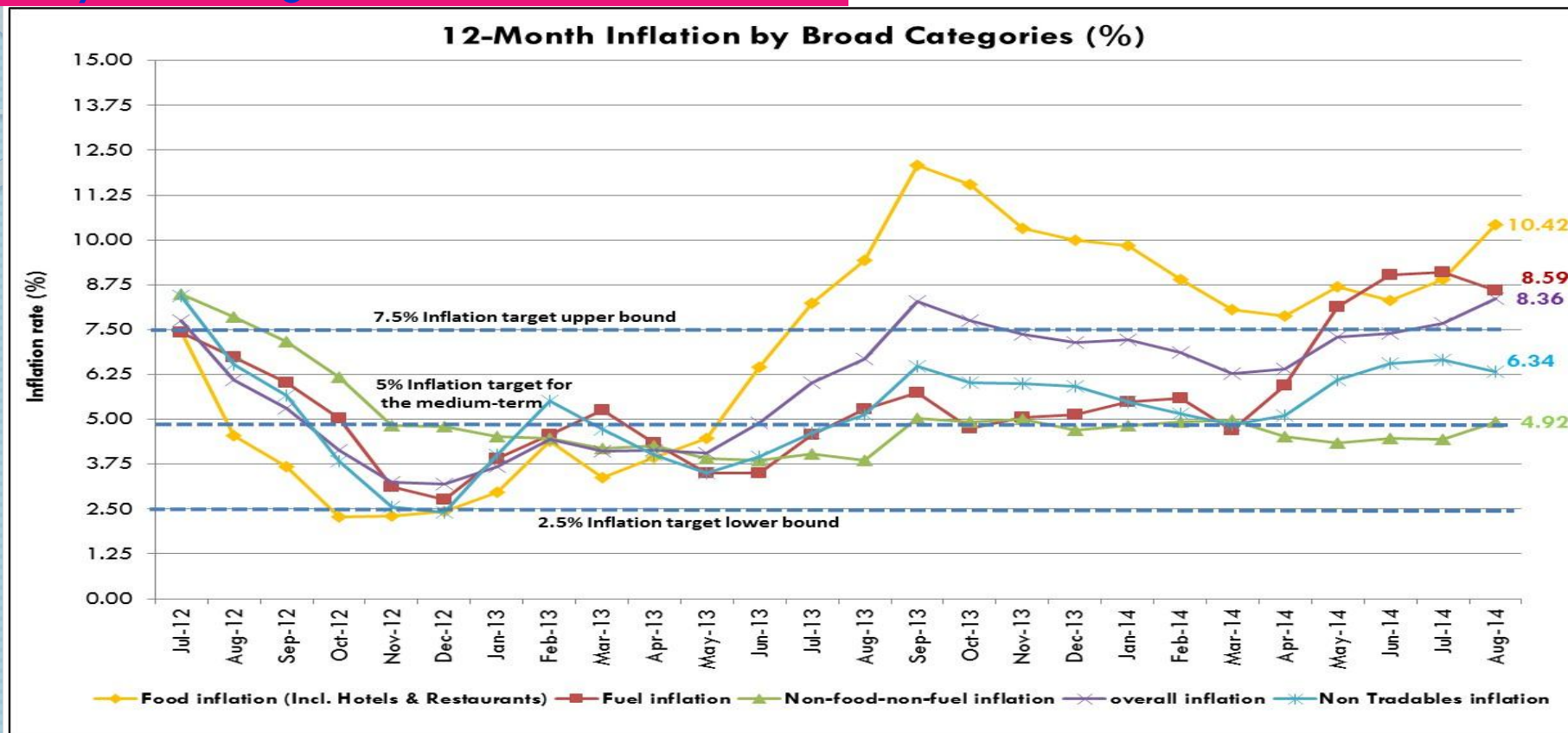


1. Information basis for the MPC Decision...

- The CBK has been monitoring the implementation of the KBRR framework – initial data for commercial and microfinance banks indicates that new and existing loans amounting to Ksh.43 billion and covering 182,731 loan accounts had benefited by end of August 2014.
- **Confidence in the economy remains strong:**
 - Purchases of equity at the NSE by foreign investors remain high while the NSE-20 share index rose from 4,885.04 points on 30th June 2014 to 5,139.39 on 29th August, 2014.
 - Diaspora remittances averaged USD115.32 million per month between January and July 2014 compared with USD105.22 per month in a similar period of 2013.
 - The MPC Market Perception Survey conducted in August 2014 showed that the private sector expects inflation and the exchange rate to be stable in the remainder of 2014 and that growth will be stronger in 2014.
- The growth momentum for the global economy and that of Kenya's main trading partners is projected to pick up in the second half of 2014 – this will boost exports and support exchange rate stability.
- **But there are risks to the macroeconomic outlook** – the instability in the Middle East and North African region as well as in Ukraine remains a risk 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:

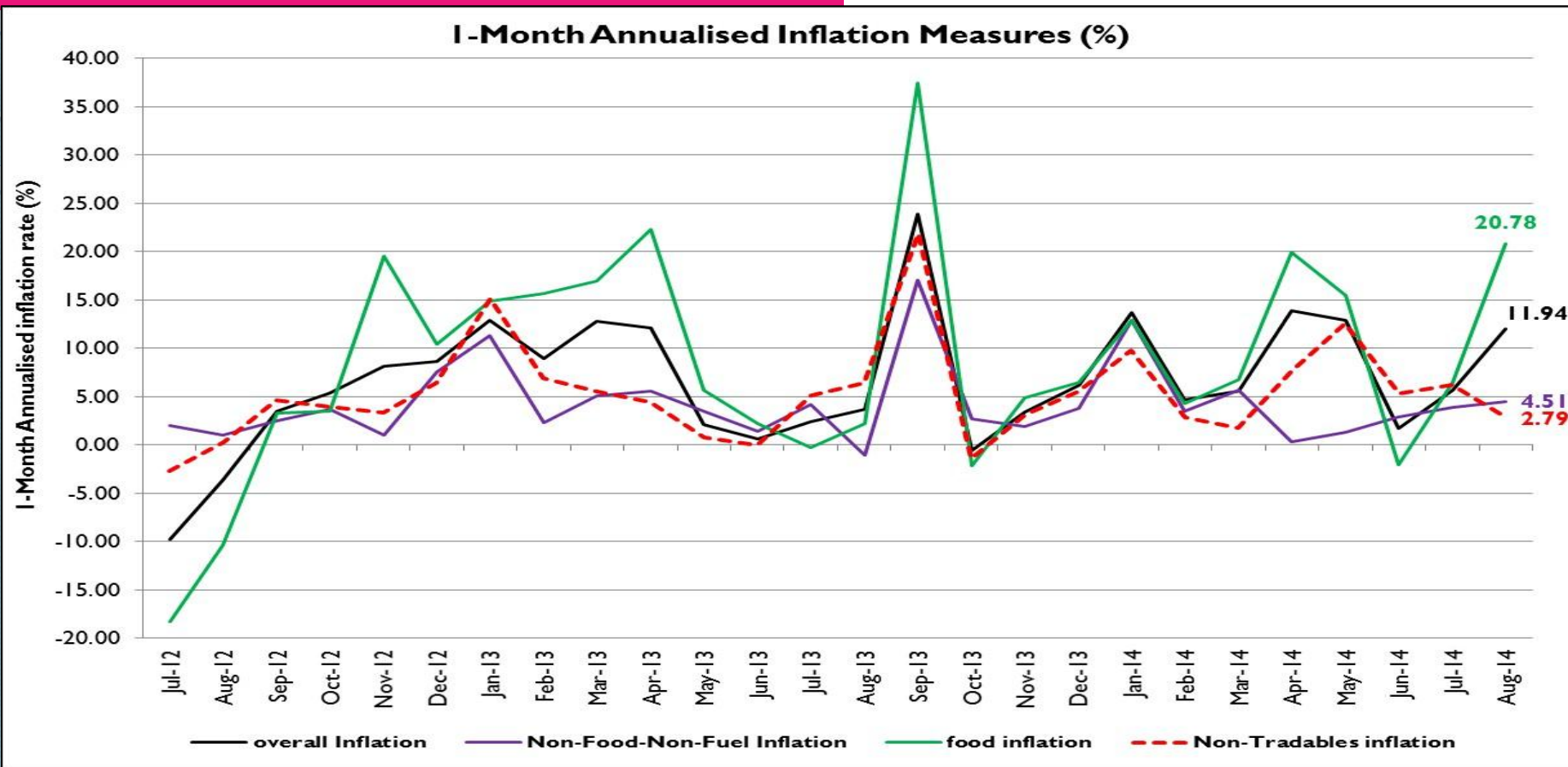
Food and fuel prices were the dominant drivers of overall inflation in July and August 2014



- Overall inflation exceeded the upper bound of the prescribed range of the medium-term target of 5 percent in both July and August 2014 driven largely by food prices and the base effect.
- Month-on-month NFNF inflation increased slightly from 4.45 percent in July 2014 to 4.92 percent in August 2014.

2a. Market outcomes since the previous MPC Meeting:

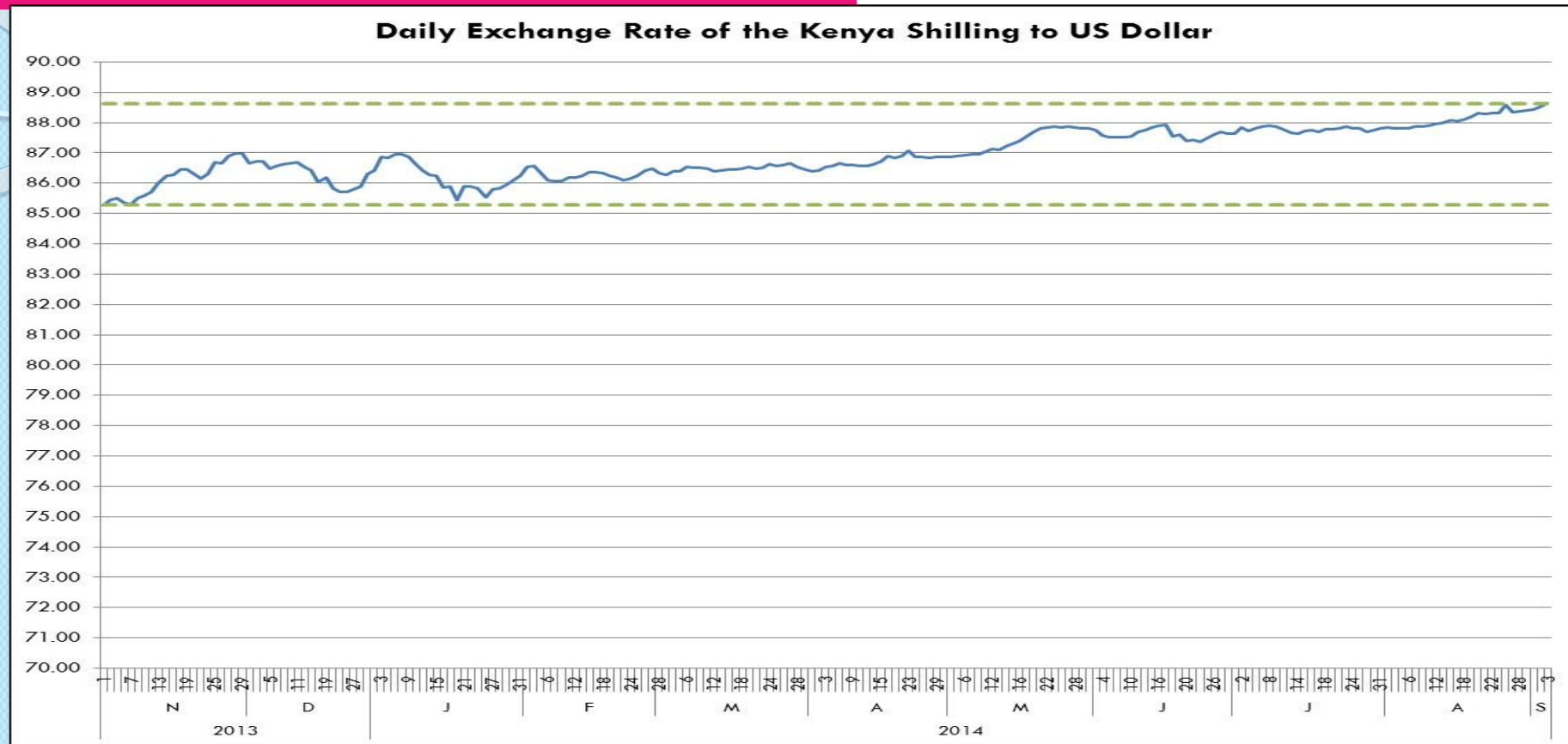
The 1-month annualised inflation measures show that food prices pulled up overall inflation in August 2014...



- The significant impact of the base effect in September 2013 on inflation will dissipate from September 2014.

2b. Market outcomes since the previous MPC Meeting:

The exchange rate has maintained a stable trend despite the recent short-term seasonal pressures



- The Kenya shilling exchange rate is supported by resilient Diaspora remittances and increased foreign investor participation in the NSE. The stability of the Kenya Shilling exchange rate has moderated any potential impact of imported inflation.

2b. Market outcomes since the previous MPC Meeting:

The global strengthening of the USD has contributed to movements in international and regional currencies against USD in 2014...

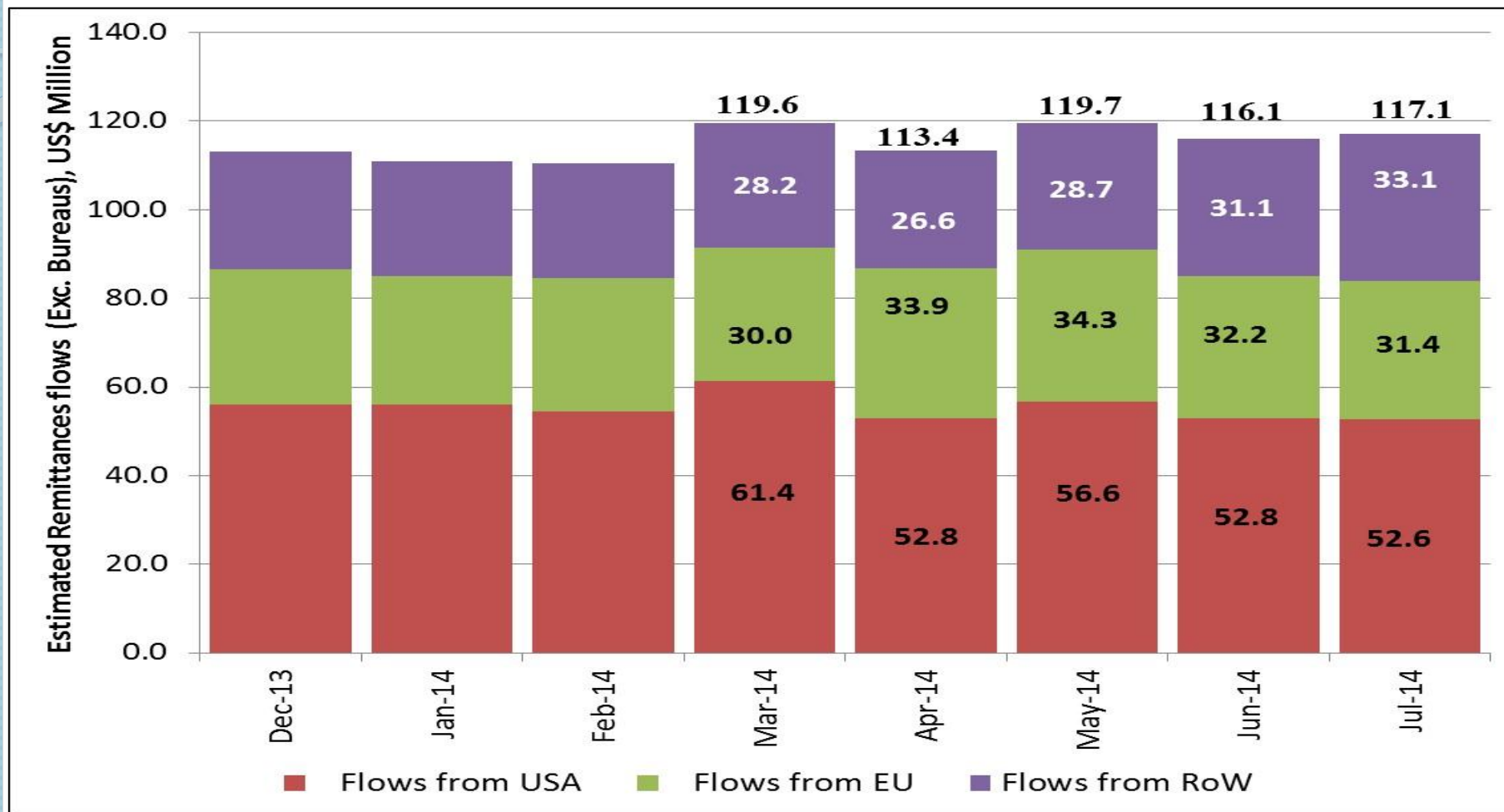
	COUNTRY	CURRENCY	Exchange Rate		% change
			2-Jan-14	27-Aug-14	
1	GHANA	GHS	2.365	3.85	-38.57%
2	ZAMBIA	ZMW	5.5423	6.03	-8.09%
3	SWEDEN	SEK	6.4399	6.9449	-7.27%
4	TUNISIA	TND	1.6474	1.7361	-5.11%
5	AUSTRALIA	AUD	0.8886	0.933	-4.76%
6	TANZANIA	TZS	1,587.0	1,665.0	-4.68%
7	EUROZONE	EUR	1.3763	1.3183	-4.21%
8	DENMARK	DKK	5.4207	5.6546	-4.14%
9	UGANDA	UGX	2533.35	2610	-2.94%
10	SWITZERLAND	CHF	0.8916	0.9157	-2.63%
11	CANADA	CAD	1.0644	1.0904	-2.38%
12	NEW ZEALAND	NZD	0.8194	0.8373	-2.14%
13	NIGERIA	NGN	158.9	162.13	-1.99%
14	NORWAY	NOK	6.0666	6.1734	-1.73%
15	KENYA	KES	86.85	88.35	-1.70%
16	RWANDA	RWF	676.00	686.315	-1.50%
17	CHINA	CNY	6.0552	6.1466	-1.49%
18	TURKEY	TRY	2.1483	2.1617	-0.62%
19	SOUTH AFRICA	ZAR	10.6832	10.6521	-0.29%
20	UNITED KINGDOM	GBP	1.6566	1.654	-0.16%
21	JAPAN	JPY	105.25	103.93	1.27%
22	INDIA	INR	61.905	60.4538	2.40%
23	BRAZIL	BRL	2.3878	2.2617	5.58%
24	MALAWI	MWK	430.00	396.74	8.38%

A negative sign implies a depreciation and vice versa

2b. Market outcomes since the previous MPC Meeting:

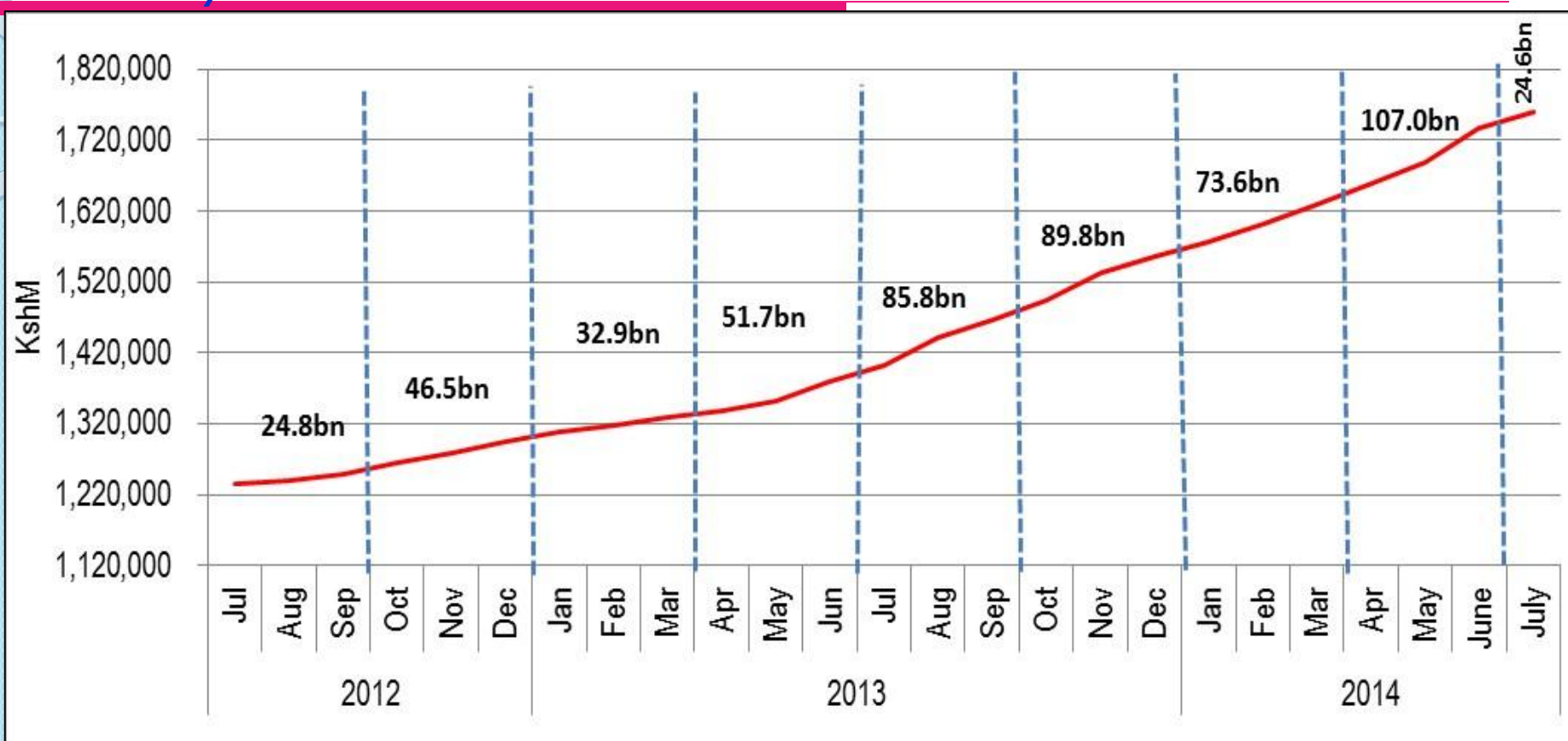
Exchange rate stability supported by resilient Diaspora remittances...

Monthly Diaspora Remittances by Source (USD Million)



2c. Market outcomes since the previous MPC meeting:

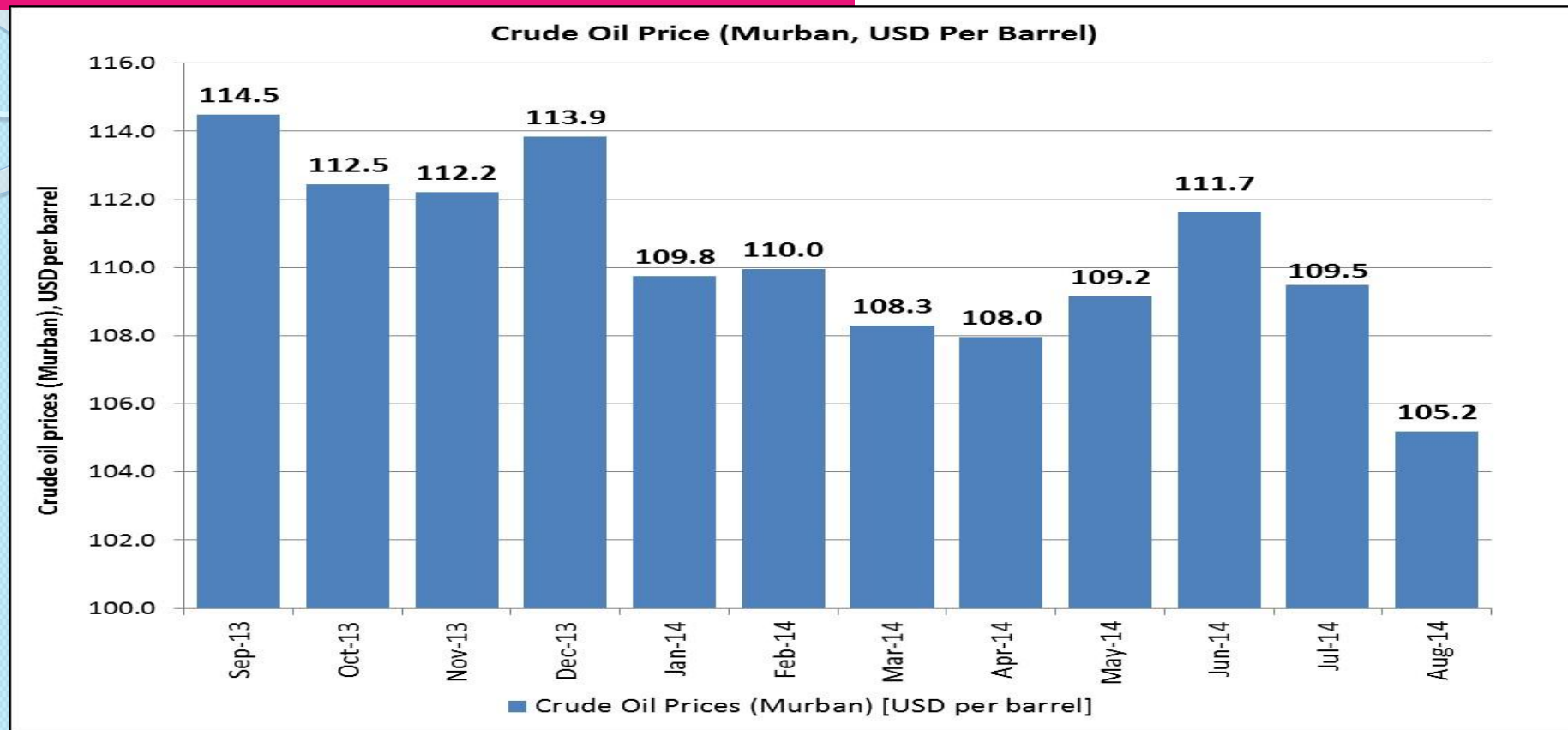
Private sector credit growth has been towards productive sectors of the economy



- Bank credit to private sector has remained strong – the annual growth was 25.54 percent in July 2014 compared with 25.79 percent in June 2014. This has been non-inflationary as the NFNF inflation remained below 5 percent target.

2d. Market outcomes since the previous MPC meeting:

International murban crude oil prices have declined but remain volatile



- International crude oil prices have declined but remain volatile largely reflecting the instability in the Middle East and North Africa. This remains a threat to inflation

3a. August 2014 MPC Market Perceptions Survey:

Survey shows inflation is expected to increase slightly on average

Expected overall inflation rate in the next 12-month (%)

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
Aug- 2014	7.40	7.82	7.83	7.76	7.65	7.34

- The August 2014 Survey shows an upward revision in inflationary expectations relative to the June 2014 Survey.
- The increase in inflationary expectations was attributed to: expected increase in food prices due to inadequate rains and drought conditions in some parts of the country; higher energy prices due to volatility in international oil prices; and a likely rise in imported inflation following the slight weakening of the exchange rate.
- However, the monetary policy measures in place, expected food imports, and expected reduction in electricity tariffs are expected to support a lower inflation rate

3b. August 2014 MPC Market Perceptions Survey:

Survey shows exchange rate expected to remain relatively stable

Survey month	Banks Ksh/USD Exchange rate			Non-Banks Ksh/USD Exchange rate		
	Strengthen	Remain the same	Weaken	Strengthen	Remain the same	Weaken
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
Aug-2014	20	26	54	35	44	21

- The August 2014 Survey shows mixed expectations by banks and non-bank private firms.
- 80 percent of banks expect the exchange rate to remain stable or weaken slightly on average in the remainder of 2014 on account of: reduced foreign exchange inflows from tourism attributed to insecurity and threat of Ebola; decline in tea prices; expected increase in import demand with pick-up in economic activity; and, political noise.
- In contrast 79 percent of non-bank firms expect the exchange rate to remain stable or strengthen in the remainder of the year on account of: sustained confidence in the economy which is expected to boost foreign direct investment; expected increase in foreign exchange inflows from Diaspora remittances and exports with the recovery of the global economy; the monetary policy measures in place; and expected increase in foreign exchange as the Government spends the proceeds of the Sovereign Bond.

3c. August 2014 MPC Market Perceptions Survey:

Sustained expectations for a stronger 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
Aug-2014	5.26	5.00	5.28	5.18	5.50	4.95

- The August 2014 Survey shows that banks, MFIs and non-bank private firms sustained their optimism for a stronger growth in 2014.
- The expected growth performance in 2014 is attributed to: a stable macroeconomic environment; recovery of the global economy and strong growth projections for regional economies which could boost exports; increased foreign direct investment in infrastructure and energy sectors of the economy; increase in private sector credit growth towards productive sectors in the economy; expected decline in lending rates which could spur credit growth; and, expected increase in the County governments' spending which is expected to spur growth.
- But the main risks to the growth outlook cited as the slowdown in the tourism sector, decline in tea prices, and depressed rainfall which could affect agricultural production.

4a. Commercial banks' interest rates:

Ex ante average lending interest rates have declined (on average) in 2014 relative to 2013 while 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
Mar-13	17.17	16.09	15.31	16.51	7.16	6.87	3.29	6.51
Jun-13	17.10	16.13	14.87	16.43	7.35	6.80	3.03	6.54
Sep-13	16.79	15.80	14.50	16.10	7.29	6.35	2.94	6.33
Dec-13	16.37	15.53	14.23	15.76	7.86	6.66	3.84	6.86
Jan-14	16.37	15.46	14.15	15.72	7.75	7.02	3.48	6.88
Feb-14	16.22	15.24	14.19	15.57	7.78	7.21	3.48	6.97
Mar-14	15.92	15.29	14.19	15.45	7.61	7.06	3.27	6.80
Apr-14	15.91	15.37	14.18	15.47	7.54	6.93	3.33	6.72
May-14	16.03	15.51	14.35	15.60	7.71	7.09	3.35	6.87
Jun-14	16.03	15.33	14.13	15.13	7.48	6.97	3.47	6.56
Jul-14	15.91	15.30	14.06	15.05	7.34	7.23	3.72	6.62
Average 2013	17.07	16.02	15.00	16.39	7.44	6.71	3.21	6.58
Average 2014	16.06	15.36	14.18	15.43	7.60	7.07	3.44	6.78
Change 2013/14	-1.01	-0.67	-0.82	-0.96	0.16	0.37	0.24	0.20

4b. Commercial banks' interest rates:

Similarly, ex post average lending interest rates declined on average so far in 2014 relative to 2013 across all bank categories but average deposit rates increased for medium and large banks.

	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
Mar-13	16.25	15.67	15.29	15.90	7.23	7.09	2.55	6.53
Jun-13	16.08	16.12	14.36	15.85	7.06	7.17	2.54	6.47
Sep-13	16.15	15.86	14.29	15.79	7.01	6.48	2.45	6.17
Dec-13	16.20	15.53	14.31	15.69	7.32	7.13	2.46	6.57
Jan-14	15.85	14.99	14.02	15.28	7.23	7.24	2.59	6.59
Feb-14	15.46	15.26	13.81	15.15	7.13	7.37	2.58	6.59
Mar-14	15.78	15.27	14.44	15.40	7.20	7.39	2.59	6.63
Apr-14	15.48	15.06	14.01	15.12	7.05	7.11	2.94	6.50
May-14	15.93	15.37	14.15	15.47	7.22	7.21	2.64	6.58
Jun-14	15.18	15.03	13.59	14.55	6.96	7.21	2.60	6.29
Jul-14	15.43	15.30	14.00	14.83	7.25	7.45	2.69	6.52
Average 2013	16.32	15.89	14.71	15.94	7.19	6.89	2.61	6.44
Average 2014	15.59	15.18	14.00	15.11	7.15	7.28	2.66	6.52
Change 2013/14	-0.74	-0.71	-0.71	-0.82	-0.04	0.39	0.05	0.09

4c. Commercial banks' interest rates:

Overall spreads declined on average in 2014, and was reflected across all bank categories. However, ex post spread for medium and large bank increased marginally between June and July 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
Mar-13	10.01	9.22	12.02	10.00	9.02	8.57	12.74	9.37
Jun-13	9.75	9.34	11.84	9.89	9.01	8.94	11.82	9.38
Sep-13	9.50	9.45	11.56	9.77	9.14	9.39	11.84	9.61
Dec-13	8.50	8.86	10.39	8.90	8.88	8.40	11.85	9.11
Jan-14	8.62	8.44	10.67	8.84	8.62	7.76	11.43	8.69
Feb-14	8.44	8.03	10.71	8.60	8.32	7.90	11.22	8.57
Mar-14	8.31	8.23	10.91	8.65	8.58	7.88	11.85	8.78
Apr-14	8.38	8.44	10.85	8.74	8.43	7.95	11.06	8.62
May-14	8.32	8.41	11.00	8.73	8.71	8.16	11.51	8.90
Jun-14	8.55	8.36	10.67	8.58	8.22	7.81	10.99	8.26
Jul-14	8.57	8.07	10.34	8.43	8.19	7.86	11.31	8.31
Average 2013	9.63	9.31	11.79	9.81	9.13	9.00	12.10	9.50
Average 2014	8.45	8.28	10.74	8.65	8.44	7.90	11.34	8.59
Change 2013/14	-1.17	-1.03	-1.06	-1.16	-0.69	-1.10	-0.76	-0.91



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

- The CBK and KBA have been monitoring the implementation of the KBRR and the Annual Percentage Rate (APR) frameworks by commercial banks that were introduced in July 2014.
- Initial data from 22 commercial banks and 6 microfinance banks indicate that new and existing loans amounting to Ksh.43 billion and covering 182,731 loan accounts had benefited from the KBRR framework by end of August 2014 – data for other banks are being processed.
- Examples of outcomes are: the average premium that commercial banks charged above the KBRR on commercial mortgages was 3.05 percent while that on corporate loans (1–5 years) was 4.09 percent.
- These frameworks are designed to improve transparency in credit pricing and promote full disclosure of bank charges on new loans thereby supporting an increase in the supply of affordable credit to support investment.
- **Next Steps:**
 - Publication of K values in the mass media (Website, newspapers) to be done after completion of data clean-up exercise.
 - The CBK will work with banks to build capacity to generate clean data.
 - The CBK will conduct a sensitization of the banking sector on how to implement the requirements of the KBRR circular.