



BACKGROUND TO THE MPC DECISIONS ON 4TH NOVEMBER, 2014

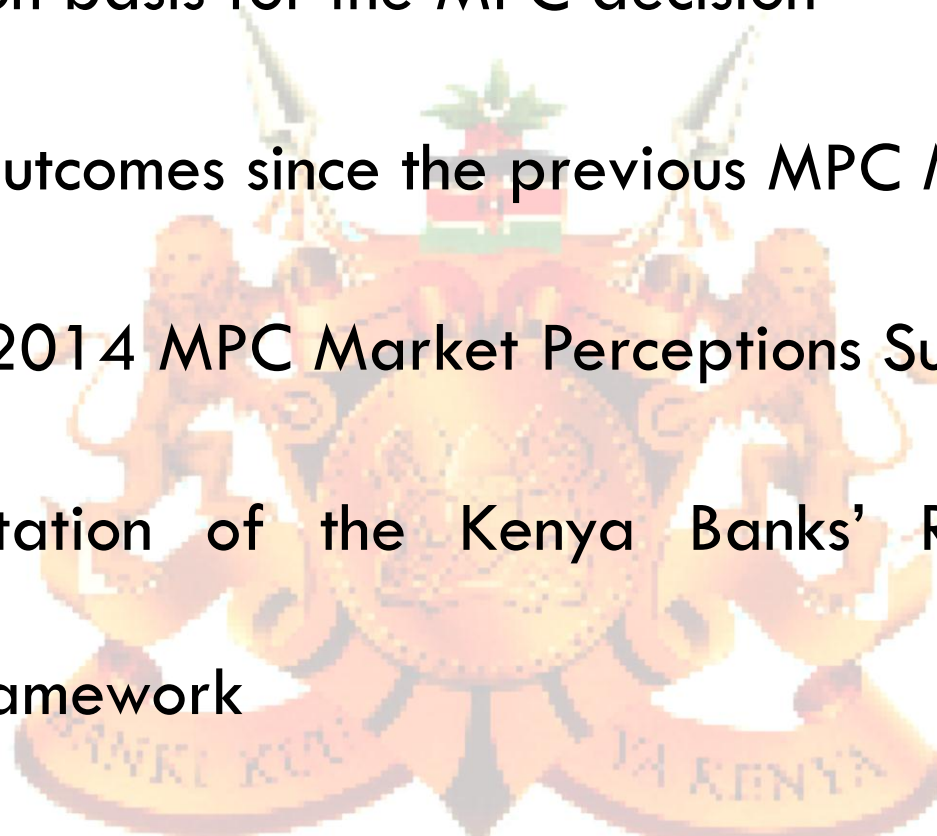
**Presentation to Chief Executive Officers of Commercial
Banks**

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

November 13, 2014



Outline

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



1. Information basis for the MPC Decision

The MPC decided to retain the CBR at 8.50 percent in order to continue anchoring inflationary expectations. The current monetary policy stance coupled with effective liquidity management operations has moderated inflationary pressure.

- Overall month-on-month inflation declined from 6.60 percent in September 2014 to 6.43 percent in October 2014 arising from decreases in the prices of energy and most foodstuffs.
- Month-on-month, non-food-non-fuel inflation, which measures the impact of the monetary policy stance, declined from 3.66 percent to 3.47 percent. Furthermore, the 1-month annualised overall and NFNF inflation also fell during the period, indicating that there was no incipient inflationary pressure.
- The exchange rate remained stable despite short-term pressures arising from the global strengthening of the US Dollar. Resilient foreign exchange inflows through diaspora remittances continued to support the Kenya Shilling.
- The CBK's level of usable foreign exchange reserves increased from USD 6,376.95 million (4.21 months of import cover) at the beginning of September 2014 to USD 7,116.3 million (4.64 months of import cover) at the end of October 2014 – this level of foreign exchange reserves is adequate to cushion the foreign exchange market against short-term shocks.
- The liquidity management by the CBK through Open Market Operations supported the stability of the interbank market.
- Stress tests and data show that the banking sector remains resilient – the increased private sector credit has been distributed towards the productive sectors of the economy while credit risk declined between July and September 2014.

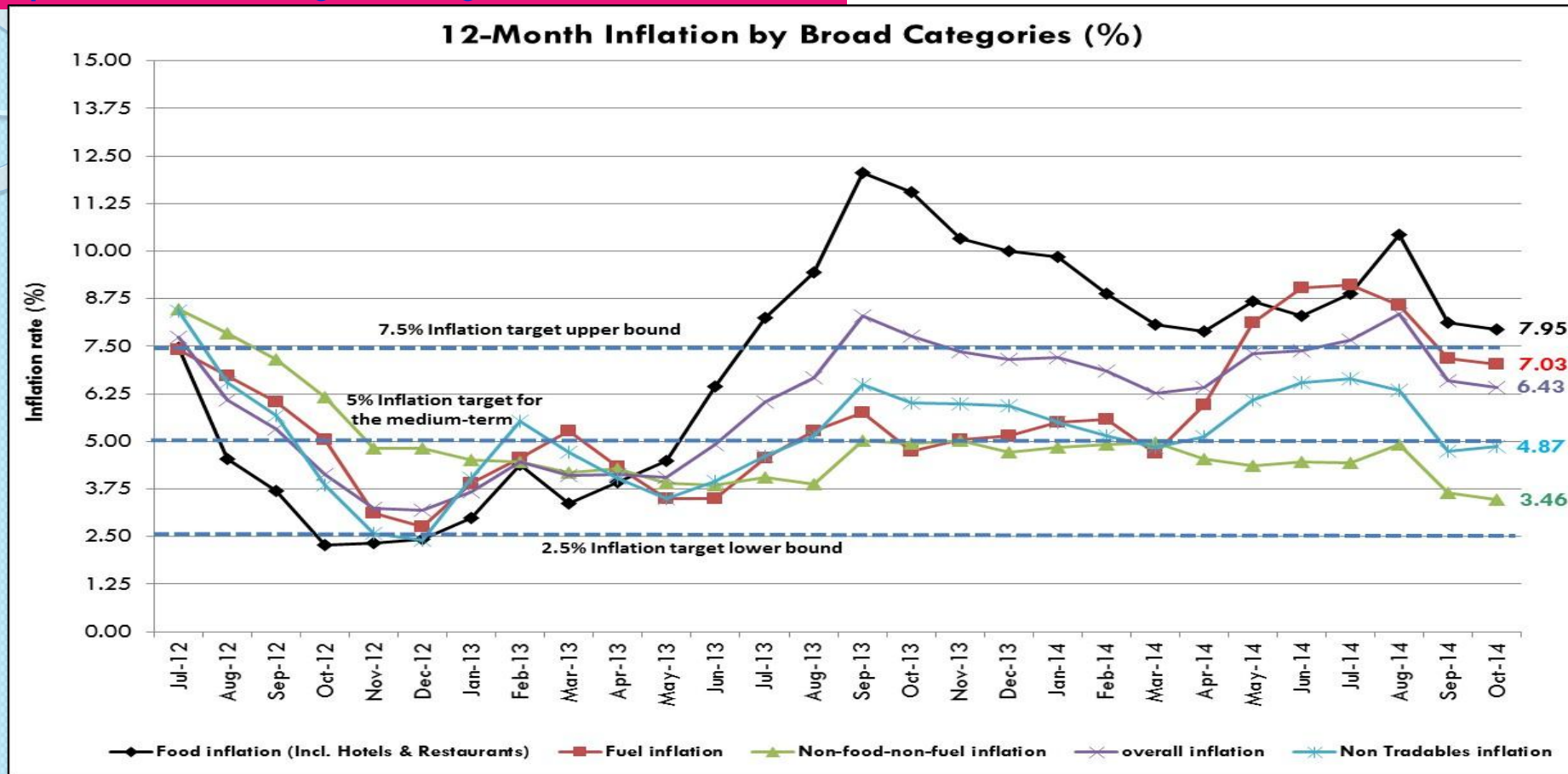


1. Information basis for the MPC Decision...

- **The CBK has been monitoring the implementation of the KBRR framework** – updated data from commercial banks and microfinance banks indicate that new and existing loans amounting to Ksh. 397.24 billion and covering 1,220,756 loan accounts had benefited from the KBRR framework by 19th October, 2014.
- The latest data from KNBS shows that the “financial and insurance” sector continued to contribute significantly to the country’s growth; the sector grew by 8.3 percent in the second quarter of 2014 compared with 11.1 percent in a similar period in 2013.
- **Confidence in the economy remains strong:**
 - Diaspora remittances rose significantly to an all-time high, averaging USD 128.1 million per month in August and September 2014 compared with USD 107.0 million in a similar period of 2013.
 - The MPC Market Perception Survey conducted in October 2014 showed that the private sector expects inflation and the exchange rate to be stable for the remainder of 2014 and that growth will remain resilient.
- The growth of both the global economy and that of Kenya’s main trading partners in the region were projected to gain momentum in 2015 – this should boost exports and support exchange rate stability.
- **But there are risks to the macroeconomic outlook** – Geo-political uncertainties and a decline in international oil prices have contributed to a downward revision of the projection for global growth in 2014.

2a. Market outcomes since the previous MPC Meeting:

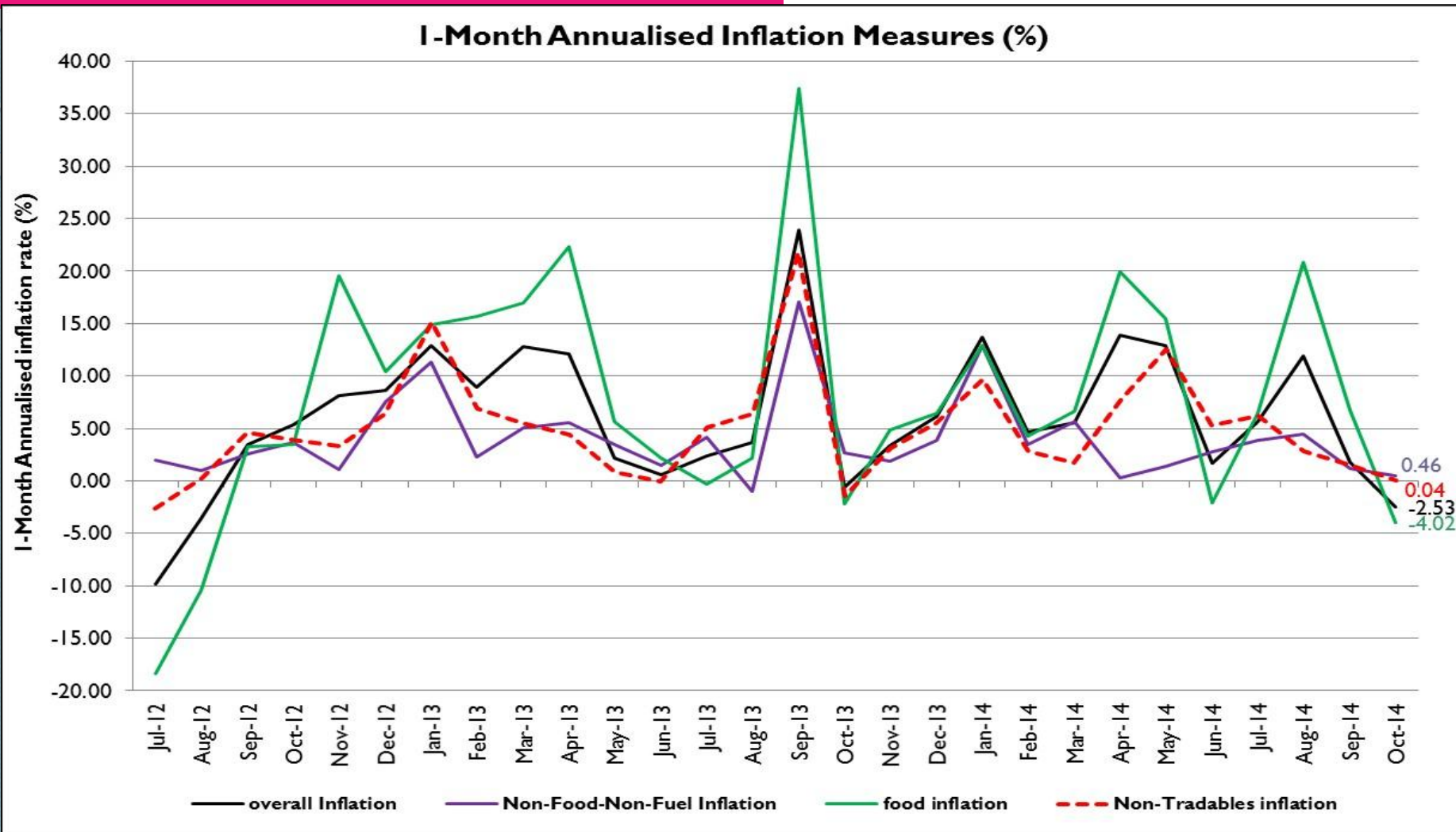
Overall inflation declined in September and October 2014 to be within the prescribed target range



- Overall inflation declined in September and October 2014 to the target range mainly reflecting declines in food and energy prices. Similarly, NFNF and non-tradables inflation remained below 5 percent in the period – an outcome of the monetary policy stance adopted.

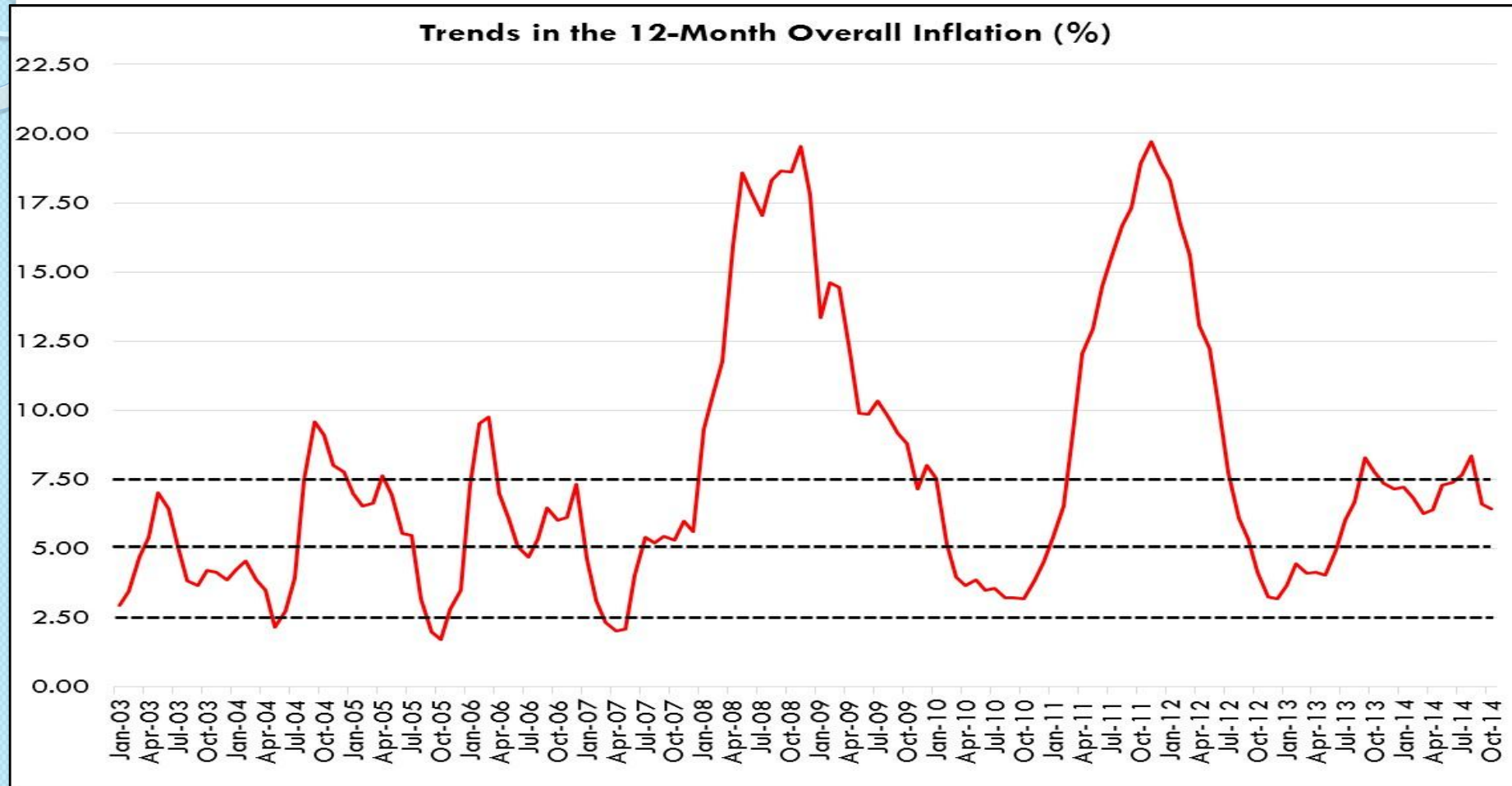
2a. Market outcomes since the previous MPC Meeting:

The 1-month annualised overall and NFNF inflation rates declined in September and October 2014, indicating that there was no incipient inflationary pressure...



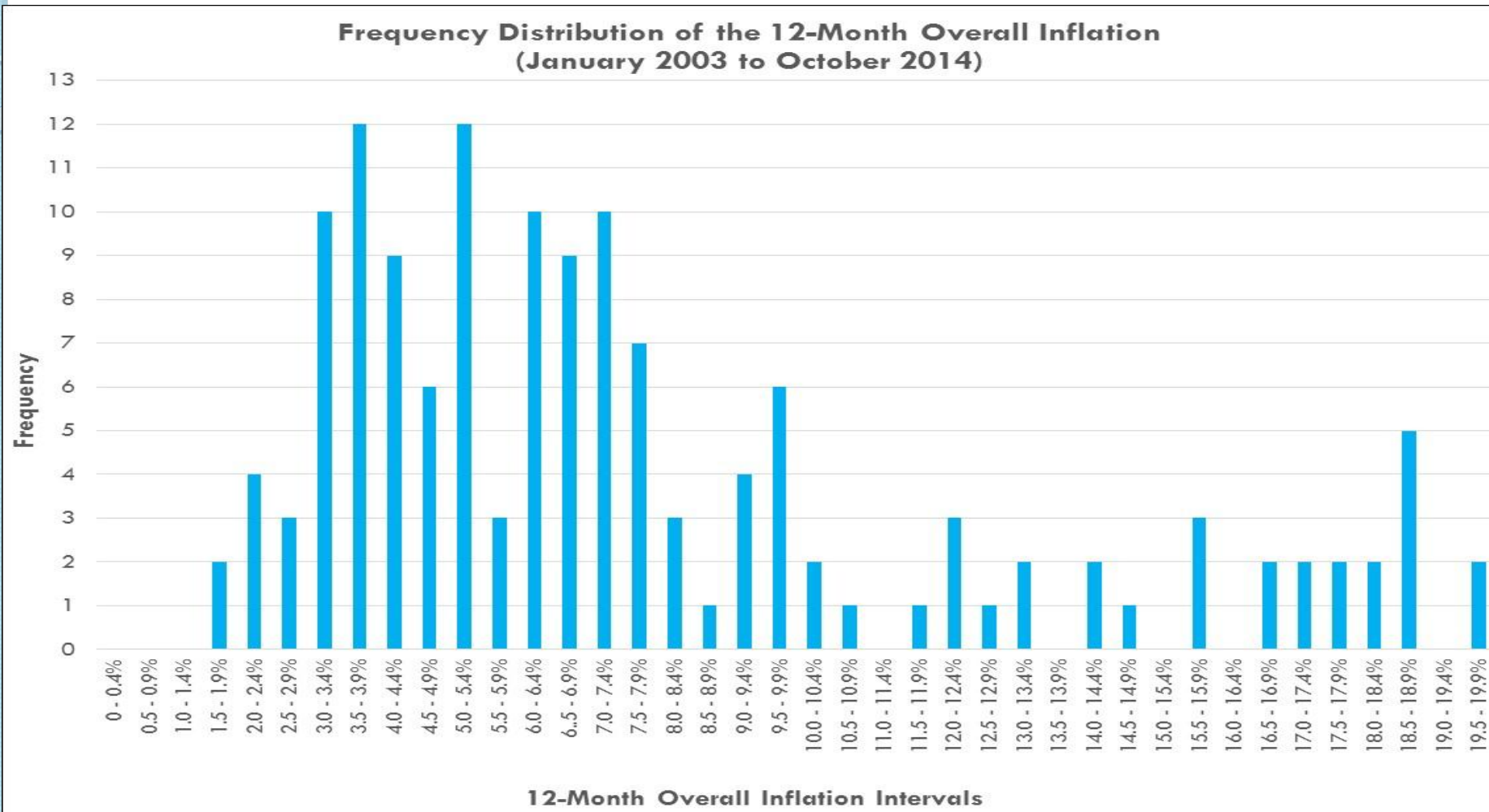
2a. Market outcomes since the previous MPC Meeting:

Despite the impact of sporadic supply and external shocks on food and fuel prices, overall inflation has been mean reverting since 2003, reflecting the impact of monetary policy measures...



2a. Market outcomes since the previous MPC Meeting:

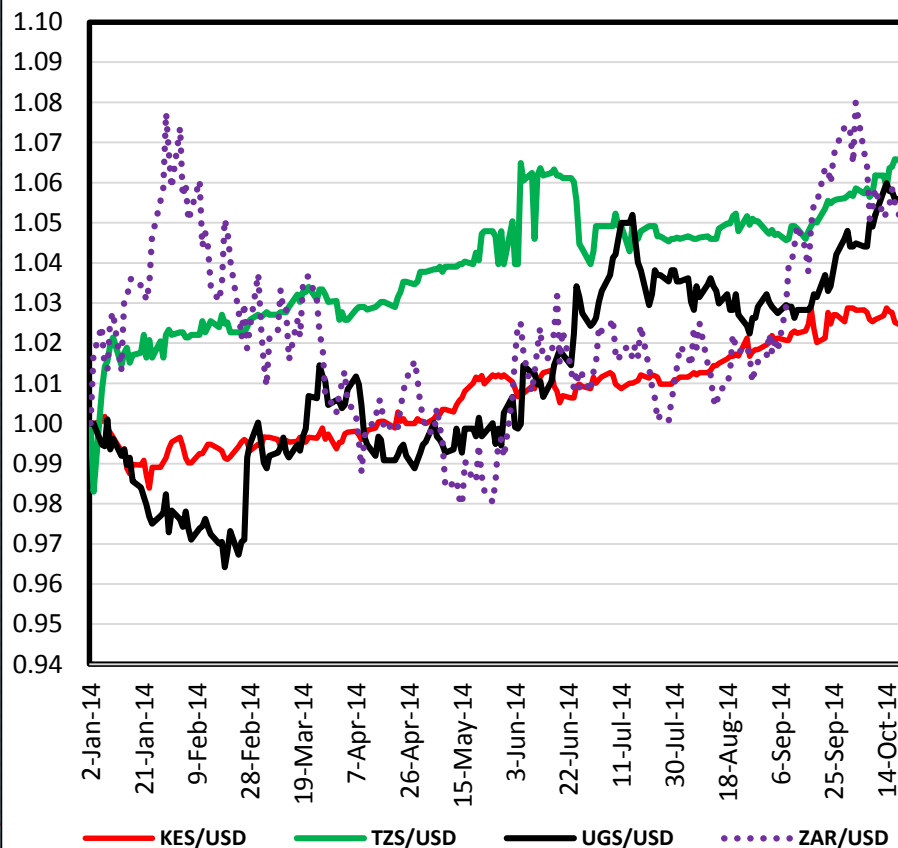
The frequency distribution of the 12-month overall inflation shows clustering of inflation around the medium-term target since 2003...



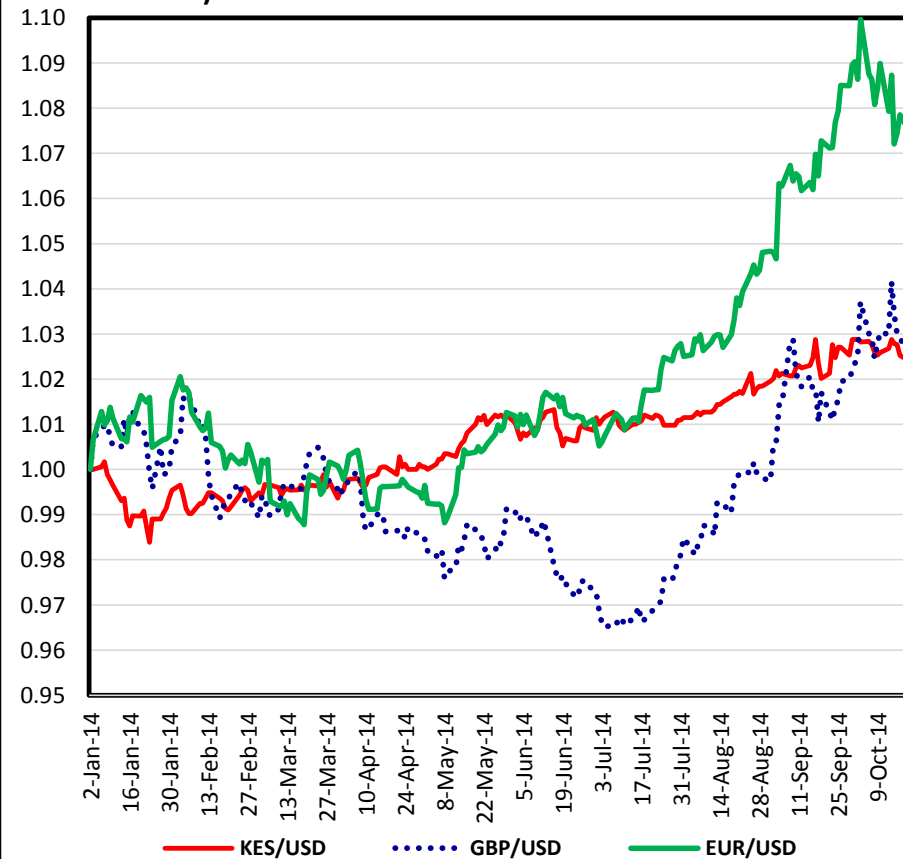
2b. Market outcomes since the previous MPC Meeting:

The exchange rate of the Kenya Shilling against the US Dollar has remained on its stable trend despite short-term pressures attributed to the strengthening of the US Dollar globally.

Normalised Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (2nd Jan 2014 =1)

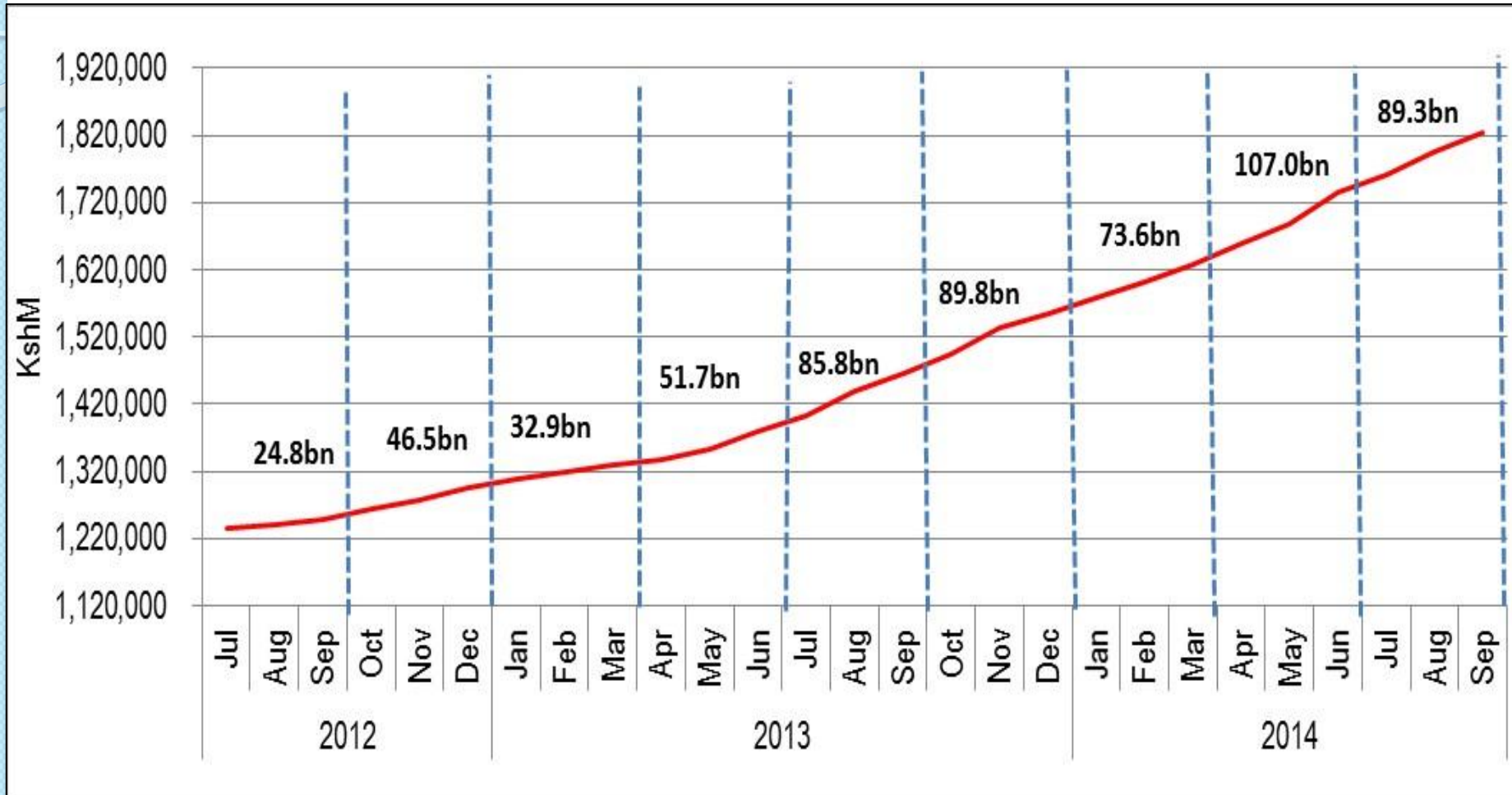


Normalised Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (2nd Jan 2014=1)



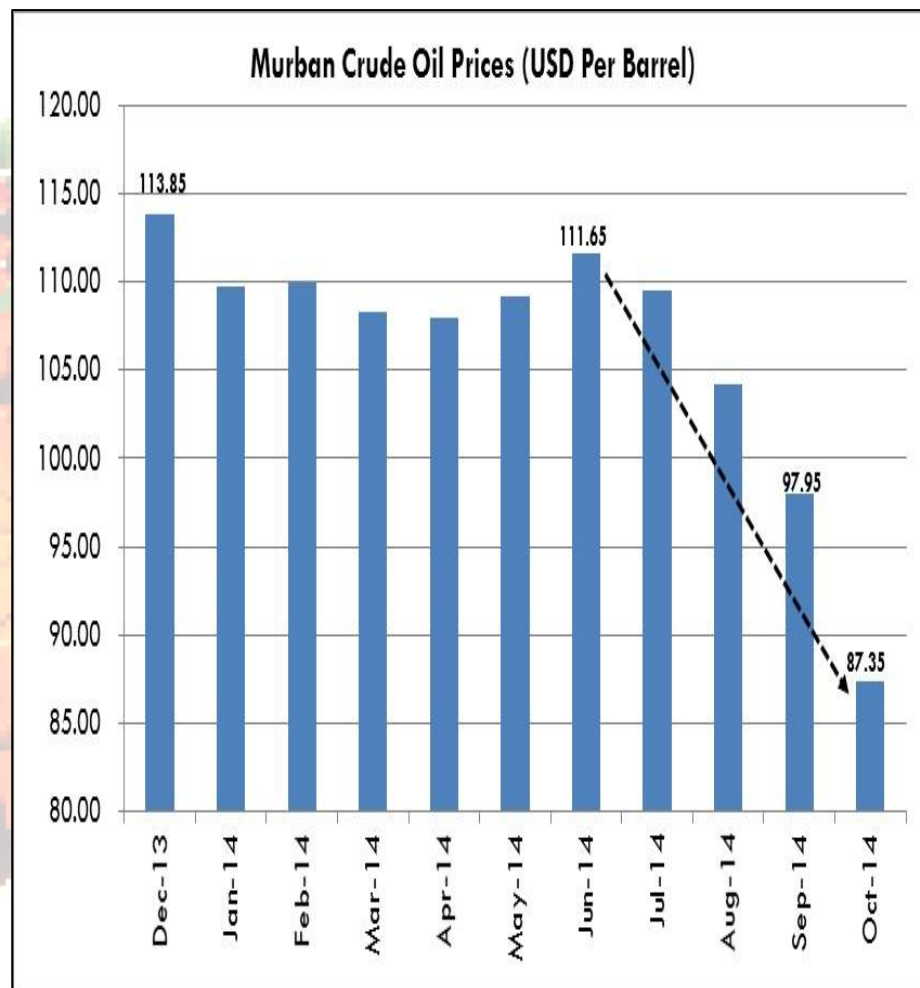
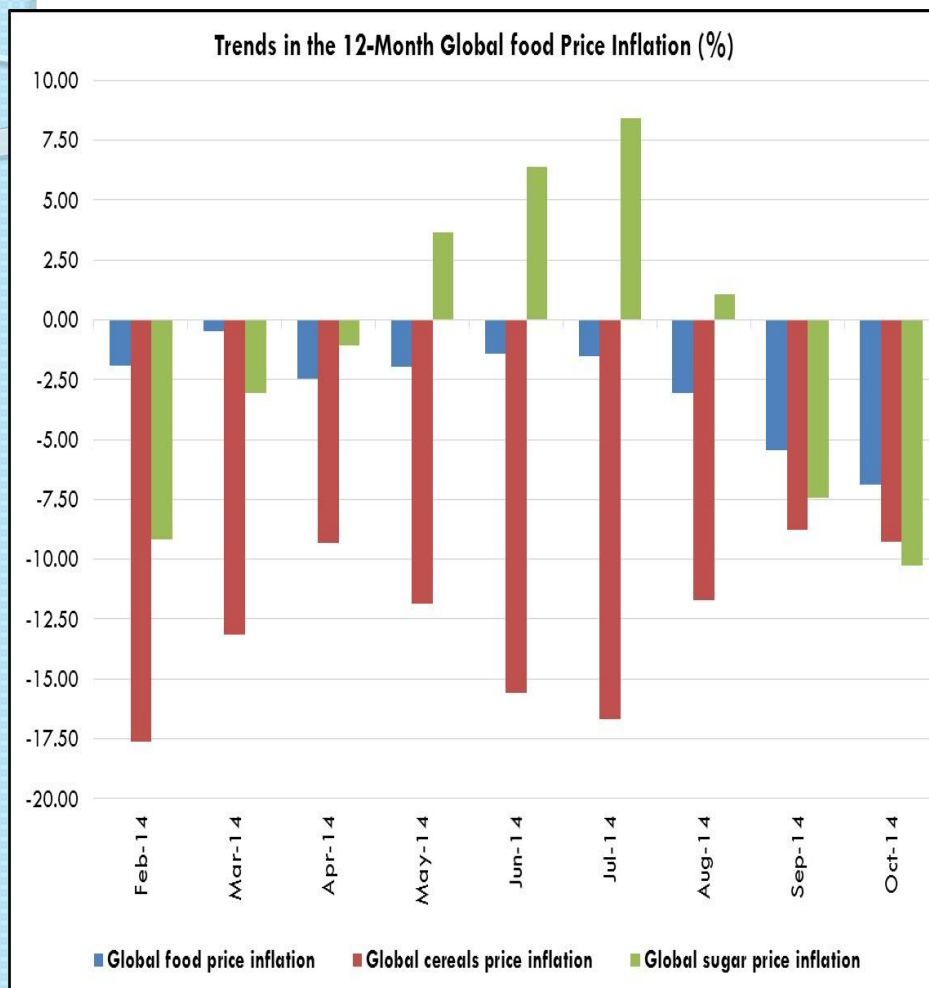
2c. Market outcomes since the previous MPC meeting:

Private sector credit was channelled towards productive sectors of the economy and was non-inflationary. The annual growth in private sector credit slowed down slightly from 25.54 percent in July 2014 to 24.49 percent in September 2014. However, the ratio of gross non-performing loans to gross loans decreased from 5.6 percent in July 2014 to 5.4 percent in September 2014, indicating a lower credit risk.



2d. Market outcomes since the previous MPC meeting:

The declining international oil and food prices indicate a stable outlook for inflation. This, coupled with a broadly stable exchange rate, has dampened any upside risks to domestic food prices.



3a. August 2014 MPC Market Perceptions Survey:

The October 2014 Survey shows a revision of inflation expectations downward to below 7 percent

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

| Survey Month | Large banks | Medium banks | Small banks | All banks | MFIs | Non-bank private firms |
|------------------|-------------|--------------|-------------|-------------|-------------|------------------------|
| 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 |
| Oct- 2014 | 6.55 | 6.66 | 6.82 | 6.73 | 6.93 | 6.66 |

- The downward revision in inflationary expectations was attributed mainly to: lower energy costs following declines in electricity and international oil prices; expected short rains which should moderate food prices; and the monetary policy measures adopted by the CBK.
- The main risks to inflation were cited as: expected increase expenditure around the festive season; possibility of imported inflation due to recent movements in the exchange rate; and, erratic weather conditions which could exert pressure on food prices.

3b. August 2014 MPC Market Perceptions Survey:

October 2014 Survey shows exchange rate expected to be stable on average

| Survey month | Banks Ksh/USD Exchange rate | | | Non-Banks Ksh/USD Exchange rate | | |
|--------------|--------------------------------|-----------------|--------|------------------------------------|-----------------|--------|
| | Strengthen | Remain the same | Weaken | Strengthen | Remain the same | Weaken |
| 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 |
| Oct-2014 | 23 | 40 | 37 | 32 | 46 | 22 |

- The October 2014 Survey shows that most banks and non-bank private firms expect the exchange rate to be stable in the remainder of 2014 on account of: increasing investor confidence in the economy which is expected to boost foreign direct investment; rising foreign exchange inflows from diaspora remittances and exports with pickup of the US and overall global economy; lower political risk; the monetary policy measures in place; and build-up in foreign exchange reserves which has increased the CBK capacity to intervene during periods of instability.
- The main risks to the exchange rate cited as: 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, reduced inflows from tea exports due to declining tea prices.

3c. August 2014 MPC Market Perceptions Survey:

The October 2014 MPC Survey shows Sustained Optimism for a resilient 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 |
|-----------------|-------------|--------------|-------------|-------------|-------------|------------------------|
| 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 |
| Oct-2014 | 5.48 | 5.19 | 5.49 | 5.38 | 5.37 | 5.49 |

- The October 2014 Survey shows that banks, MFIs and non-bank private firms maintained their optimism for a strong growth in 2014 on account of: decreasing energy cost which will reduce manufacturing costs; macroeconomic stability; recovery of the global and regional economies which will boost exports; increased public and foreign direct investment in infrastructure and energy sectors; declining lending rates which could spur credit growth; political stability and increased investor confidence; improving security; expected short-rains which will boost agricultural production; rebasing of the economy which has introduced new sectors; and, the expected impact of the devolved spending which is expected to spur growth.
- But the main risks to the growth outlook cited as the slowdown in the tourism sector, and decline in tea price.

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

Provisional data shows that new and existing loan accounts have continued to benefit from the KBRR framework

| | 8 th Jul to 25 th Aug 2014 | 26 th Aug to 19 th Oct 2014 | 8 th Jul to 19 th Oct 2014 |
|--|---|--|--|
| 1. Total value of loans on KBRR (Ksh Bn) | 43.10 | 354.14 | 397.24 |
| 1.1 Total value of loans on KBRR in commercial banks (Ksh Bn) | 39.75 | 341.64 | 381.39 |
| 1.2 Total value of loans on KBRR in microfinance banks (Ksh Bn) | 3.35 | 12.50 | 15.85 |
| 2. Total number of loan accounts on KBRR | 175,095 | 1,045,661 | 1,220,756 |
| 2.1 Number of loan accounts on KBRR in commercial banks | 95,734 | 1,044,104 | 1,139,838 |
| 2.2 Number of loan accounts on KBRR in microfinance banks | 79,361 | 1,557 | 80,918 |
| 3. Total value of existing loans converted to KBRR (Ksh Bn) | 11.93 | 255.44 | 267.37 |
| 3.1 Value of existing loan accounts converted to KBRR in commercial banks (Ksh Bn) | 9.63 | 243.66 | 253.29 |
| 3.2 Value of existing loan accounts converted to KBRR in microfinance banks (Ksh Bn) | 2.30 | 11.78 | 14.08 |
| 4. Total number of existing loans converted to KBRR | 144,384 | 964,298 | 1,108,682 |
| 4.1 Number of existing loan accounts converted to KBRR in commercial banks | 68,132 | 964,198 | 1,032,330 |
| 4.2 Number of existing loan accounts converted to KBRR in microfinance banks | 76,252 | 100 | 76,352 |

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

Provisional data shows a decline in the weighted average premium K in the two reporting periods since the introduction of KBRR on 8th July 2014. This partly reflects the increased number of reporting institutions as well as improved data capture. The CBK is working with the institutions to clean-up the data and will shortly start publishing it on the CBK website.

| | 8 th Jul to 25 th Aug 2014 | 26 th Aug to 19 th Oct 2014 | 8 th Jul to 19 th Oct 2014 |
|--|---|--|---|
| 1. Value of new loans issued by commercial banks (Ksh Billion) | 30.11 | 97.99 | 128.10 |
| 2. Weighted Average premium K on new loans issued by commercial banks (%) | 7.49 | 6.76 | 6.84 |
| 3. Number of new loan accounts in commercial banks | 27,602 | 79,906 | 107,508 |
| 4. Value of new loans issued by microfinance banks (Ksh Billion) | 1.05 | 0.72 | 1.77 |
| 5. Weighted Average premium K on New Loans issued by microfinance banks (%) | 13.73 | 10.91 | 12.54 |
| 6. Number of new loan accounts in microfinance banks | 3,109 | 1,457 | 4,566 |

Note: weighted average premium K is by the loan value

5a. Commercial Banks Interest Rate Spreads:

Ex ante average lending interest rates have declined (on average) in 2014 relative to 2013 but 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 | 15.32 | 14.19 | 15.60 | 7.78 | 7.13 | 3.48 | 6.94 |
| Mar-14 | 15.92 | 15.30 | 14.19 | 15.45 | 7.61 | 7.05 | 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 | 15.94 | 15.33 | 14.13 | 15.46 | 7.57 | 6.97 | 3.47 | 6.77 |
| Jul-14 | 15.82 | 15.49 | 14.06 | 15.45 | 7.47 | 7.03 | 3.72 | 6.78 |
| Aug-14 | 15.80 | 15.50 | 13.89 | 15.42 | 7.49 | 7.14 | 3.75 | 6.84 |
| Sep-14 | 15.86 | 15.25 | 13.64 | 15.33 | 7.44 | 7.06 | 3.93 | 6.81 |
| Average 2013 | 17.07 | 16.02 | 15.00 | 16.39 | 7.44 | 6.71 | 3.21 | 6.58 |
| Average 2014 | 15.99 | 15.39 | 14.09 | 15.50 | 7.60 | 7.05 | 3.53 | 6.82 |
| Change 2013/14 | -1.08 | -0.63 | -0.91 | -0.89 | 0.16 | 0.34 | 0.33 | 0.25 |

5b. Commercial Banks Interest Rate Spreads:

Ex post average lending interest rates declined on average in 2014 across all bank categories while average deposit rates increased (on average) 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 | 15.70 | 15.29 | 15.91 | 7.23 | 7.06 | 2.55 | 6.51 |
| 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 | 15.12 | 15.03 | 13.59 | 14.87 | 7.04 | 7.18 | 2.60 | 6.47 |
| Jul-14 | 15.36 | 15.30 | 14.00 | 15.15 | 7.24 | 7.38 | 2.69 | 6.65 |
| Aug-14 | 15.37 | 15.42 | 13.95 | 15.19 | 7.25 | 7.35 | 2.83 | 6.67 |
| Sep-14 | 15.44 | 14.92 | 13.70 | 15.00 | 7.31 | 7.47 | 2.85 | 6.75 |
| Average 2013 | 16.32 | 15.89 | 14.71 | 15.94 | 7.19 | 6.89 | 2.61 | 6.44 |
| Average 2014 | 15.53 | 15.18 | 13.96 | 15.18 | 7.19 | 7.30 | 2.70 | 6.60 |
| Change 2013/14 | -0.79 | -0.71 | -0.75 | -0.76 | -0.01 | 0.41 | 0.09 | 0.16 |

5c. Commercial Banks Interest Rate Spreads:

Both ex ante and ex post spreads declined on average in 2014 and was reflected across all bank categories.

| | 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 | 8.64 | 12.74 | 9.40 |
| 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 | 8.19 | 10.71 | 8.66 | 8.32 | 7.90 | 11.22 | 8.57 |
| Mar-14 | 8.31 | 8.25 | 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 | 8.37 | 8.36 | 10.67 | 8.69 | 8.08 | 7.85 | 10.99 | 8.40 |
| Jul-14 | 8.35 | 8.46 | 10.34 | 8.67 | 8.12 | 7.93 | 11.31 | 8.49 |
| Aug-14 | 8.31 | 8.36 | 10.13 | 8.58 | 8.12 | 8.07 | 11.13 | 8.52 |
| Sep-14 | 8.42 | 8.19 | 9.71 | 8.52 | 8.12 | 7.45 | 10.86 | 8.25 |
| Average 2013 | 9.63 | 9.32 | 11.79 | 9.81 | 9.13 | 9.01 | 12.10 | 9.50 |
| Average 2014 | 8.39 | 8.34 | 10.56 | 8.68 | 8.35 | 7.88 | 11.26 | 8.58 |
| Change 2013/14 | -1.24 | -0.97 | -1.24 | -1.14 | -0.79 | -1.13 | -0.84 | -0.92 |

5d. Microfinance banks' (MFBs) Overall Interest Rates:

Average ex post and ex ante overall lending rates for MFBs have declined on average in 2014.

Average ex ante and ex post deposit rates have increased on average. MFBs overall interest rates remain above those of commercial banks.

| | Overall Ex Ante Average Rates | | | Overall Ex Post Average Rates | | |
|-----------------------|-------------------------------|-------------------|--------------|-------------------------------|-------------------|--------------|
| | Avg Lending Rates | Avg Deposit Rates | Spread | Avg Lending Rates | Avg Deposit Rates | Spread |
| Jan-13 | 22.61 | 8.38 | 14.22 | 24.02 | 8.14 | 15.88 |
| Mar-13 | 22.52 | 8.52 | 14.00 | 23.69 | 7.94 | 15.74 |
| Jun-13 | 21.87 | 8.07 | 13.79 | 23.04 | 7.72 | 15.32 |
| Sep-13 | 21.68 | 8.25 | 13.43 | 22.07 | 7.72 | 14.35 |
| Dec-13 | 21.61 | 8.37 | 13.23 | 22.86 | 7.90 | 14.96 |
| Jan-14 | 21.77 | 9.27 | 12.50 | 22.75 | 9.32 | 13.43 |
| Feb-14 | 21.73 | 9.37 | 12.36 | 22.24 | 9.11 | 13.13 |
| Mar-14 | 21.87 | 9.12 | 12.75 | 22.48 | 9.12 | 13.36 |
| Apr-14 | 22.01 | 8.84 | 13.16 | 24.00 | 9.34 | 14.65 |
| May-14 | 21.98 | 8.84 | 13.14 | 23.99 | 8.92 | 15.07 |
| Jun-14 | 22.06 | 8.93 | 13.13 | 23.26 | 8.95 | 14.31 |
| Jul-14 | 21.84 | 8.96 | 12.88 | 23.33 | 9.00 | 14.33 |
| Aug-14 | 20.22 | 8.89 | 11.33 | 22.40 | 9.23 | 13.17 |
| Sep-14 | 20.80 | 8.99 | 11.81 | 22.85 | 9.43 | 13.42 |
| Average 2013 | 22.05 | 8.29 | 13.76 | 23.13 | 7.80 | 15.33 |
| Average 2014 | 21.59 | 9.02 | 12.56 | 23.03 | 9.16 | 13.87 |
| Change 2013/14 | -0.46 | 0.74 | -1.20 | -0.10 | 1.36 | -1.46 |