



BACKGROUND TO THE MPC DECISIONS ON 26TH FEBRUARY, 2015

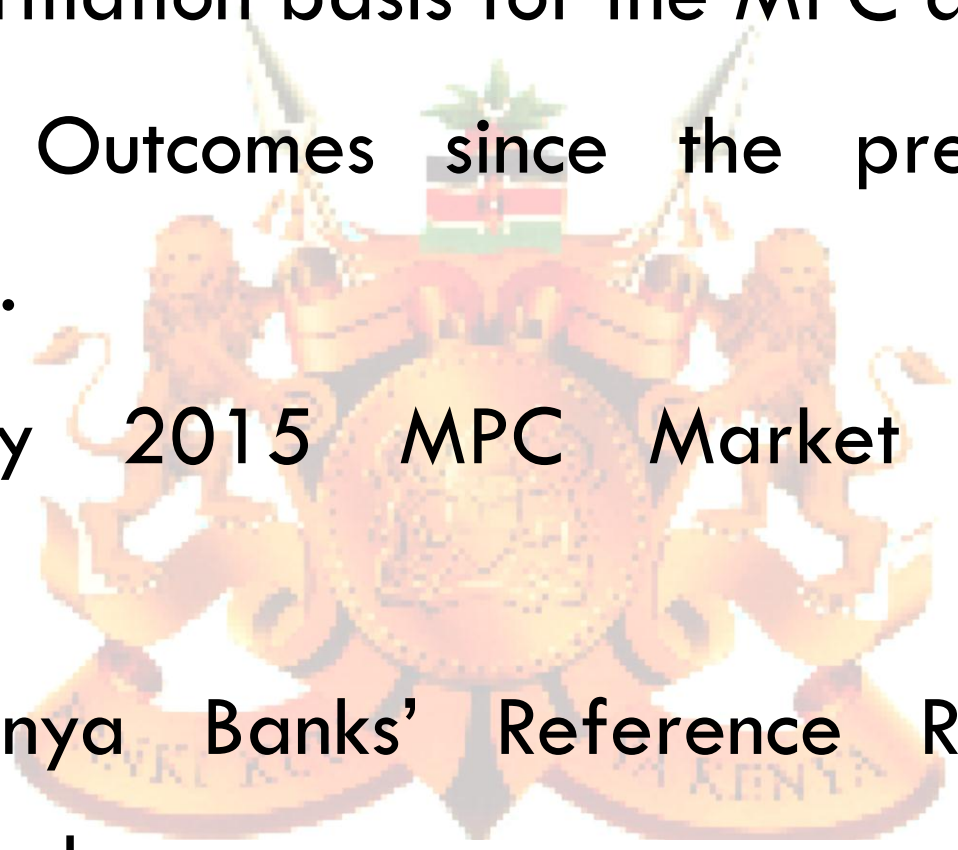
**Presentation to Chief Executive Officers of Commercial and
Microfinance Banks**

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February 27, 2015



Outline

1. The Information basis for the MPC decision
 2. Market Outcomes since the previous MPC Meeting.
 3. February 2015 MPC Market Perceptions Survey.
 4. The Kenya Banks' Reference Rate (KBRR) Framework
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1. The Information basis for the MPC Decision

On the 26th February 2015, the MPC retained the CBR at 8.50 percent. Although overall inflation remained within the Government target range, the divergent monetary policy in major advanced economies present a threat and may cause volatility in the global foreign exchange markets. Any spill-over effects into the domestic foreign exchange market and domestic inflation would therefore need to be monitored.

- Overall month-on-month inflation declined from 6.02 percent in December 2014 to 5.53 percent in January 2015 but rose slightly, as predicted, to 5.61 percent in February 2015 – the decline in fuel prices was partly offset by increases in the prices of some food items.
- The month-on-month non-food-non-fuel inflation declined from 3.65 percent to 3.43 percent during the period, indicating that there were no significant demand-driven inflationary threats to the economy.
- The exchange rate of the Kenya Shilling against the US Dollar maintained its stable trend despite volatility in the global foreign exchange markets – strong investor confidence recently boosted by the approval of the IMF precautionary support facility has provided a further cushion to the Kenya Shilling.
- The CBK's level of usable foreign exchange reserves stood at USD7,224.19 million (equivalent to 4.65 months of import cover) as at 26th February 2015 – this level of foreign exchange reserves coupled with the precautionary IMF support facility is a robust cushion to the exchange rate against short-term shocks that could trigger excess volatility.
- The CBR continued to coordinate movements in the short-term interest rates while liquidity management operations by the CBK sustained the stability of the interbank market interest rate.
- The banking sector remains resilient – the introduction of a capital conservation buffer of 2.5 percent above the minimum regulatory core and total capital ratios from 1st January 2015, has enhanced the resilience of the banking sector.

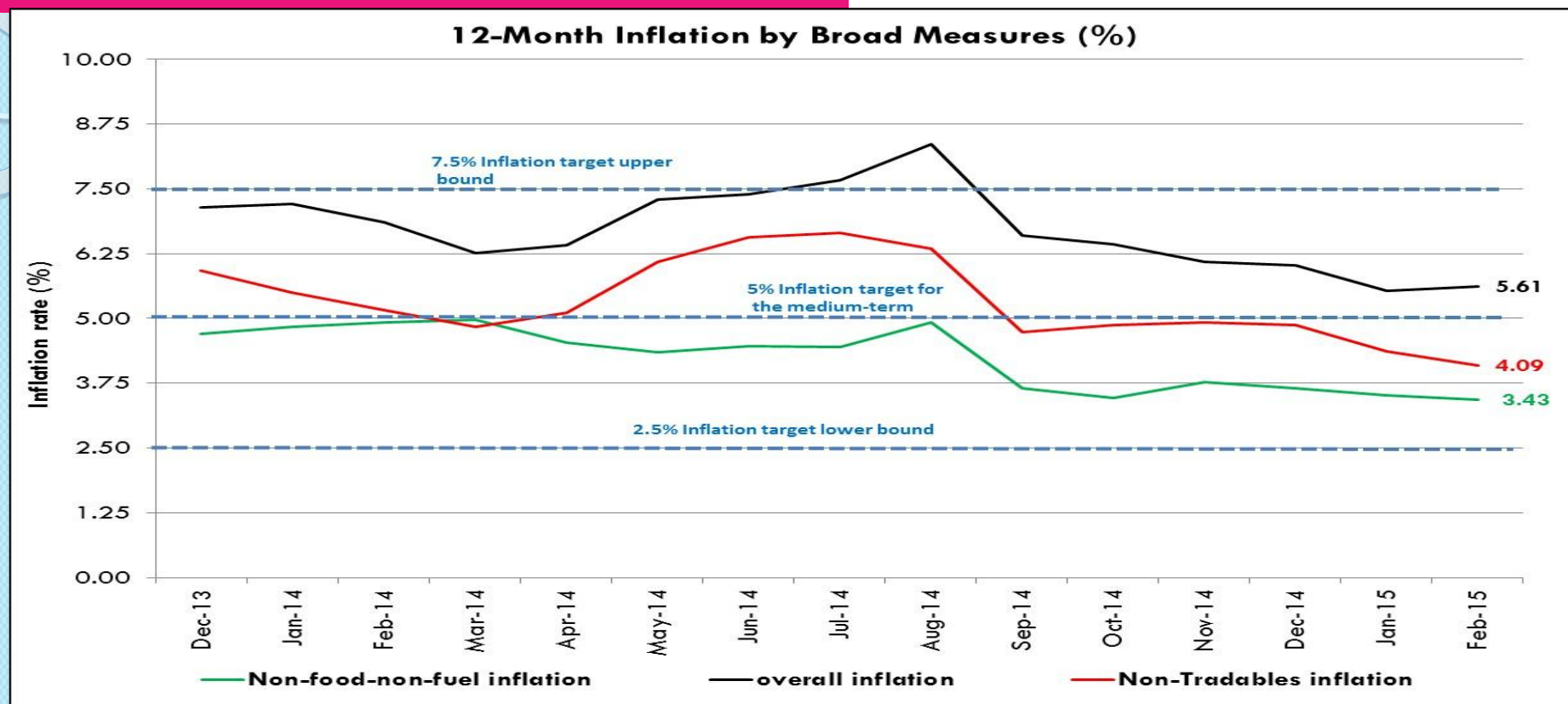


1. The Information basis for the MPC Decision...

- New and existing commercial and microfinance banks' loans amounting to Ksh.719.80 billion, excluding the matured loans, had been converted to the KBRR framework by end of January 2015.
- **Confidence in the economy remains strong:**
 - The 12-month growth in private sector credit stood at 21.8 percent in January 2015. The credit was distributed to the key sectors of the economy.
 - The diaspora remittances have averaged USD122.65 million per month in the six months to January 2015, compared to USD110.84 million per month in a similar period to January 2014.
 - Activity at the NSE remains buoyant; the NSE-20 share index rose from 4,971 at the end of December 2014 to 5,468 as at 25th February 2015.
 - The MPC Market Perception Survey conducted in February 2015 showed that private sector firms expect inflation and the exchange rate to be stable, and growth to be stronger in 2015. The private sector was also optimistic that the business environment would improve in 2015.
- **The outlook for the global economy is mixed** with positive indicators coming from the strong performance of the US economy, lower international oil prices and the QE announced by the ECB in January 2015. Furthermore, Kenya's main trading partners in the region are expected to record strong growth – this should benefit Kenya's exports and support exchange rate stability.

2a. Market outcomes since the previous MPC Meeting:

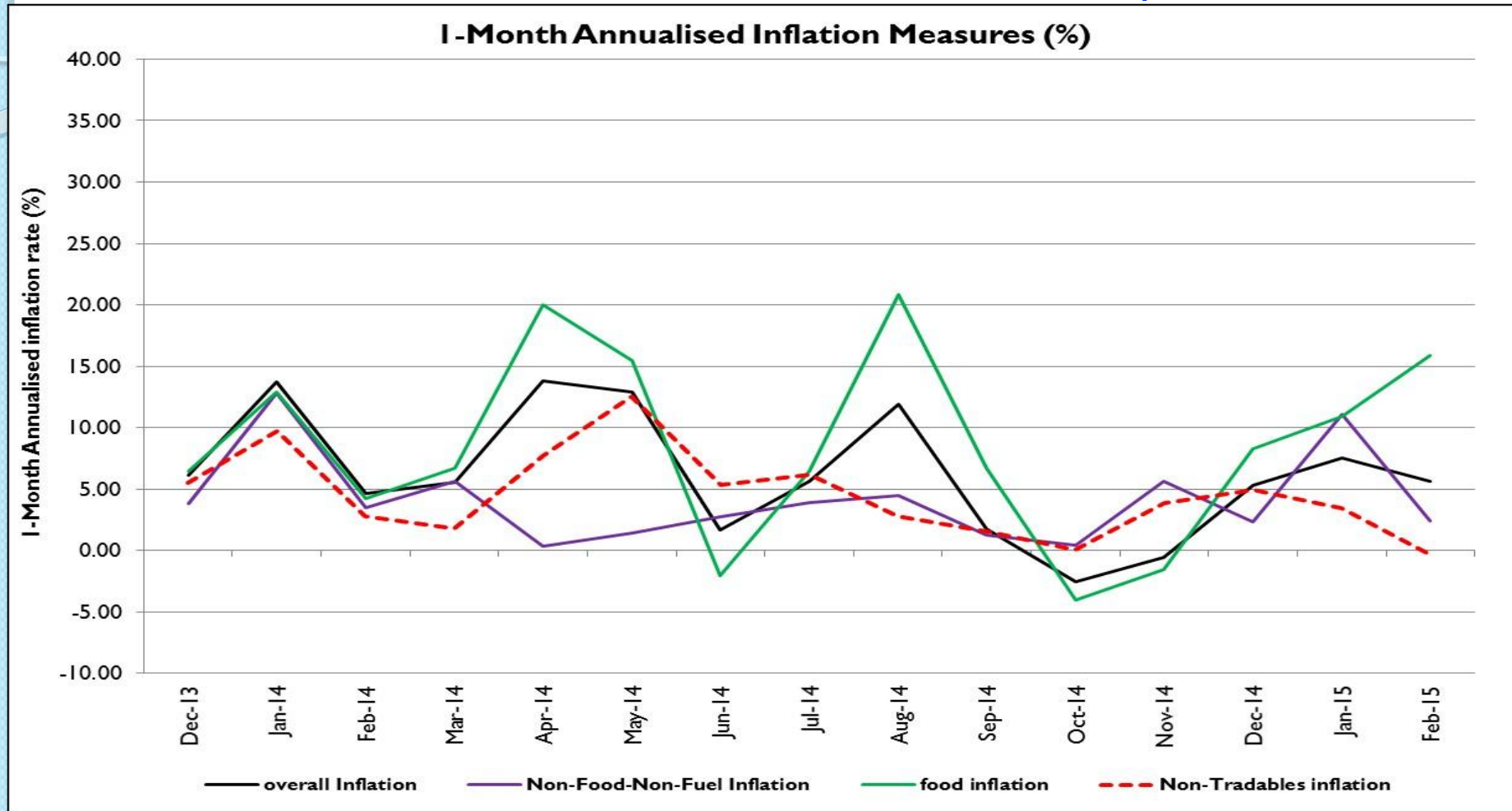
Overall inflation remained within the Government target range in January and February 2015 despite slight pressure from food prices.



- Overall month-on-month inflation declined from 6.02 percent in December 2014 to 5.53 percent in January 2015 mainly reflecting continued moderation in the prices of fuel, but rose slightly to 5.61 percent in February 2015.
- The month-on-month NFNF and Non-tradables inflation rates remained below 5 percent during the period, indicating that there were no significant demand-driven inflationary threats to the economy.

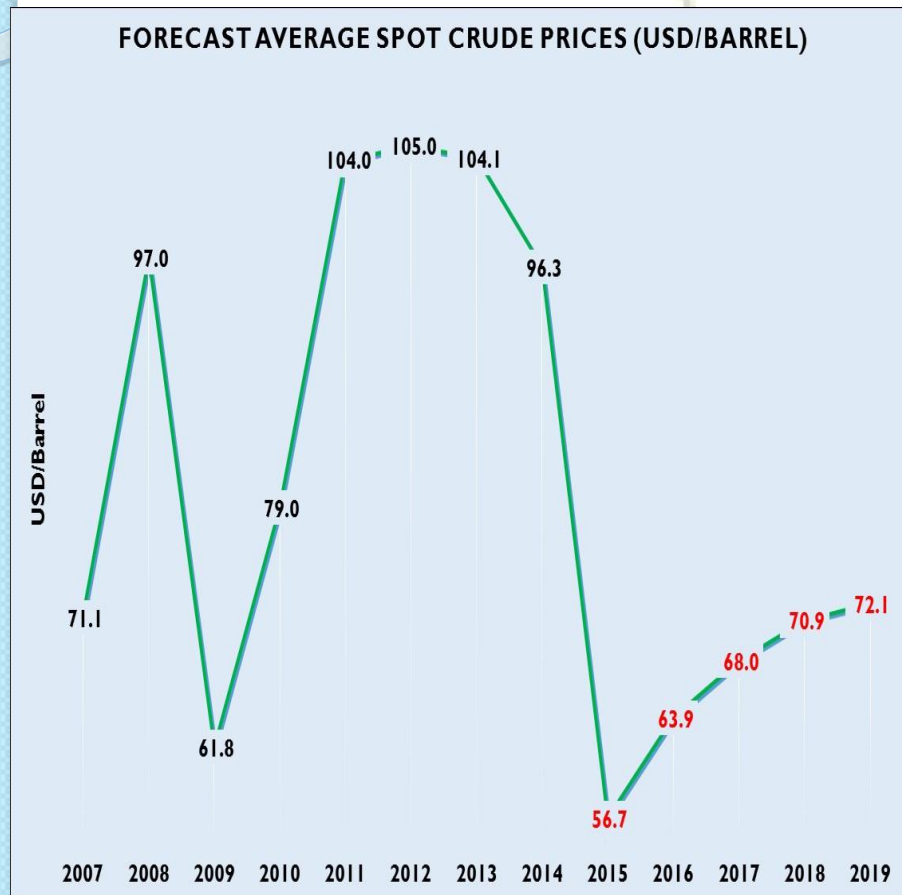
2a. Market outcomes since the previous MPC Meeting:

The 1-month annualised inflation measures show that pressure on food prices in February 2015 resulted in the slight increase in overall inflation. However, similar measures for NFNF and non-tradable inflation declined in February 2015...

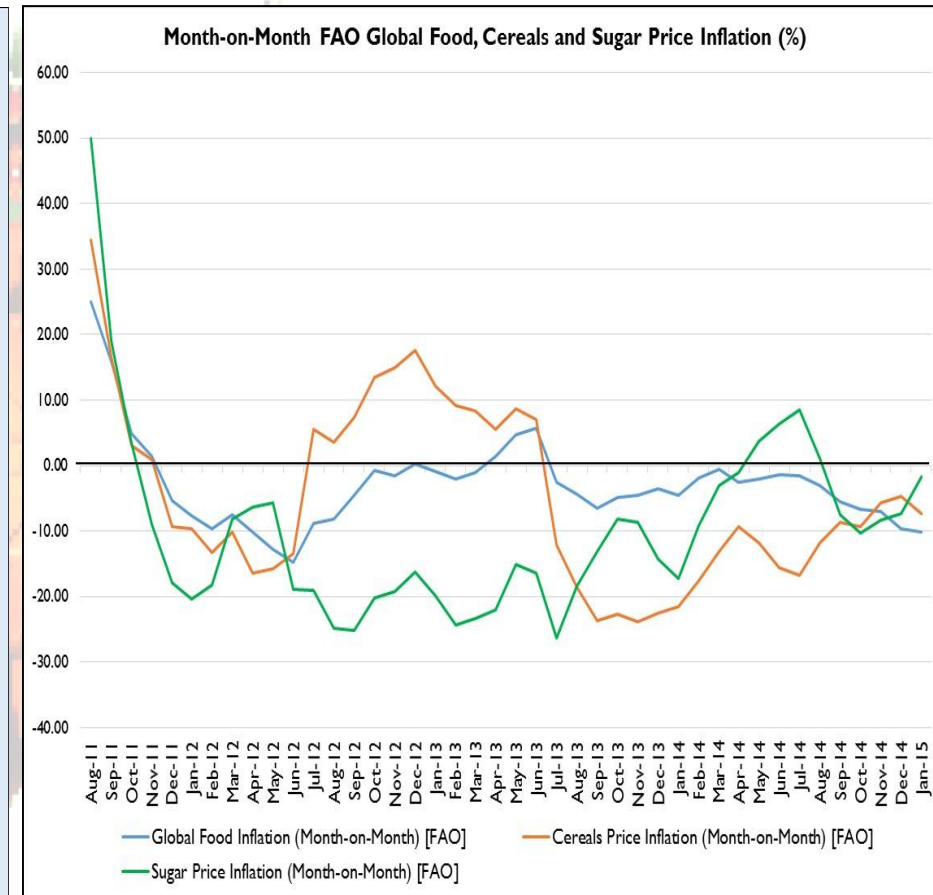


2a. Market outcomes since the previous MPC meeting:

The average international prices of crude and refined petroleum products are projected to decline in 2015 and stabilise from 2016. In addition, the declining international food prices buoyed by abundant export supplies have continued to dampen any upside risks to domestic food prices in the case of food imports. These developments indicate a stable outlook for inflation in the medium-term...



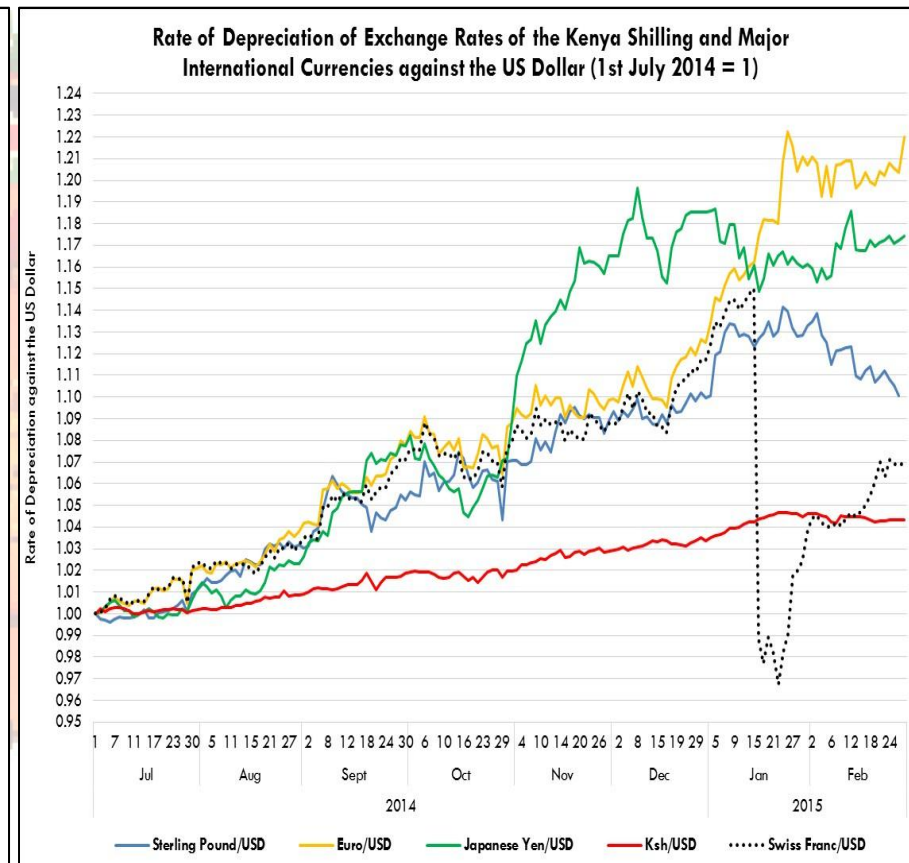
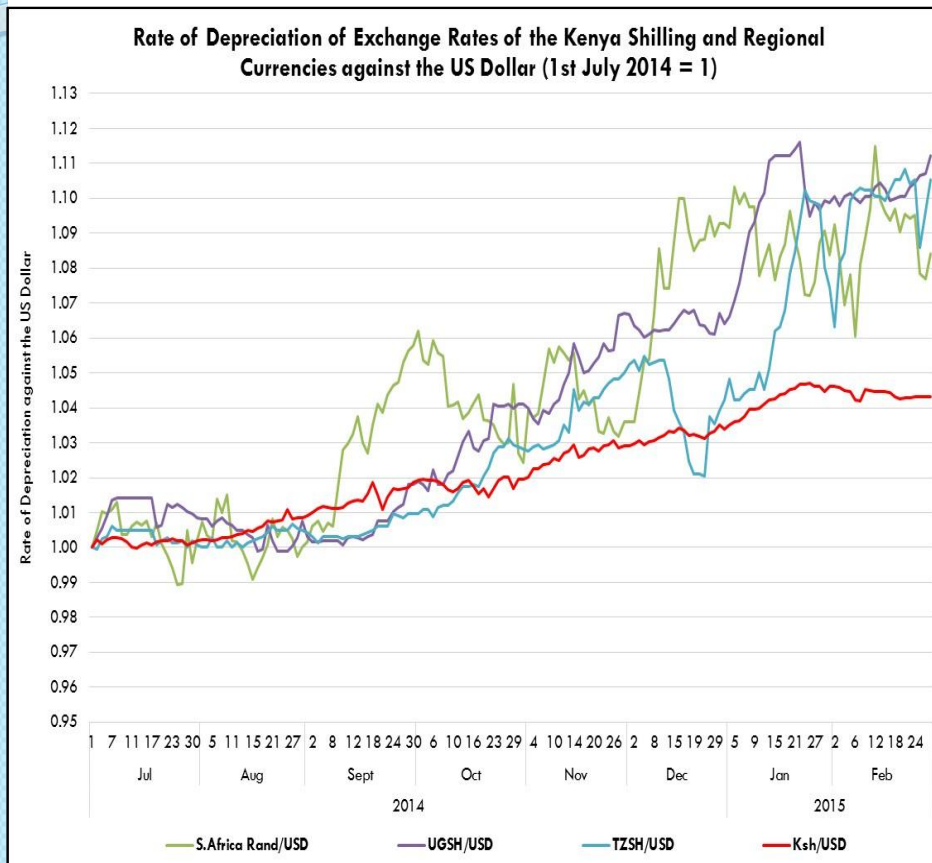
Source: IMF Commodity Forecasts, January 2015.
Petroleum price is average for UK, Brent, Dubai and West Texas intermediate



Source: FAO

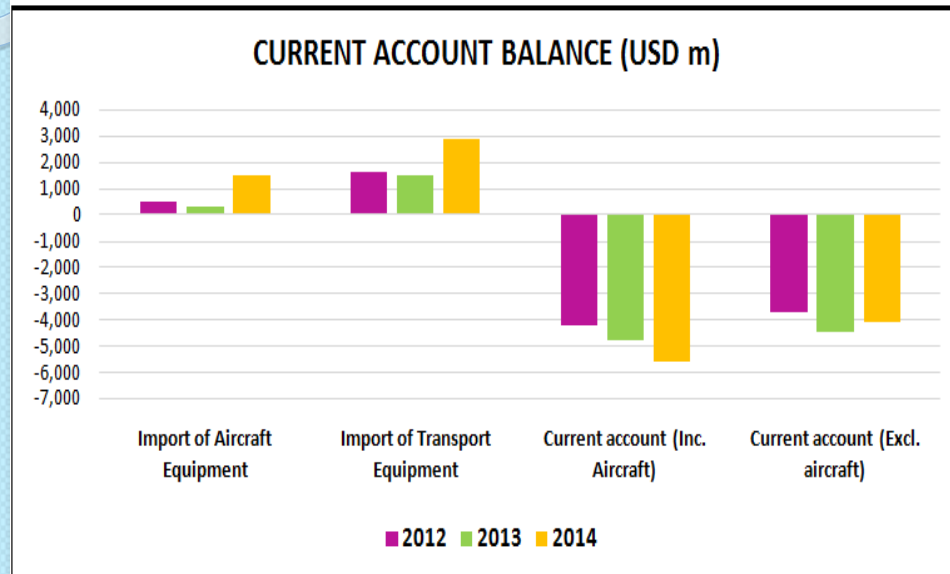
2b. Market outcomes since the previous MPC Meeting:

The exchange rate of the Kenya Shilling against the US Dollar maintained its stable trend despite volatility in the global foreign exchange markets partly occasioned by anticipation of further lowering of interest rates in the Eurozone following the introduction of Quantitative Easing (QE) by the European Central Bank (ECB) and the ending of the Swiss Franc cap against the Euro.

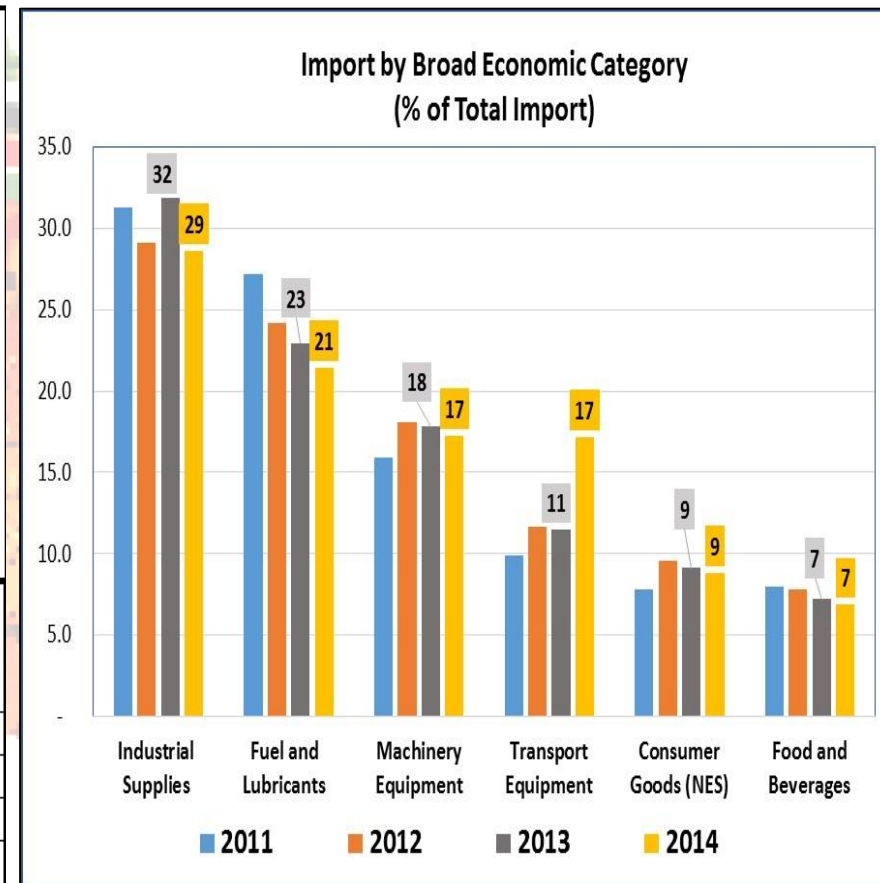


2b. Market outcomes since the previous MPC Meeting:

The continued decline in international oil prices has resulted in a lower petroleum product import bill and eased pressure on the exchange rate. Imports of machinery and equipment for infrastructure development, and transport equipment continue to account for a significant proportion of the current account deficit; they have enhanced the future growth potential...

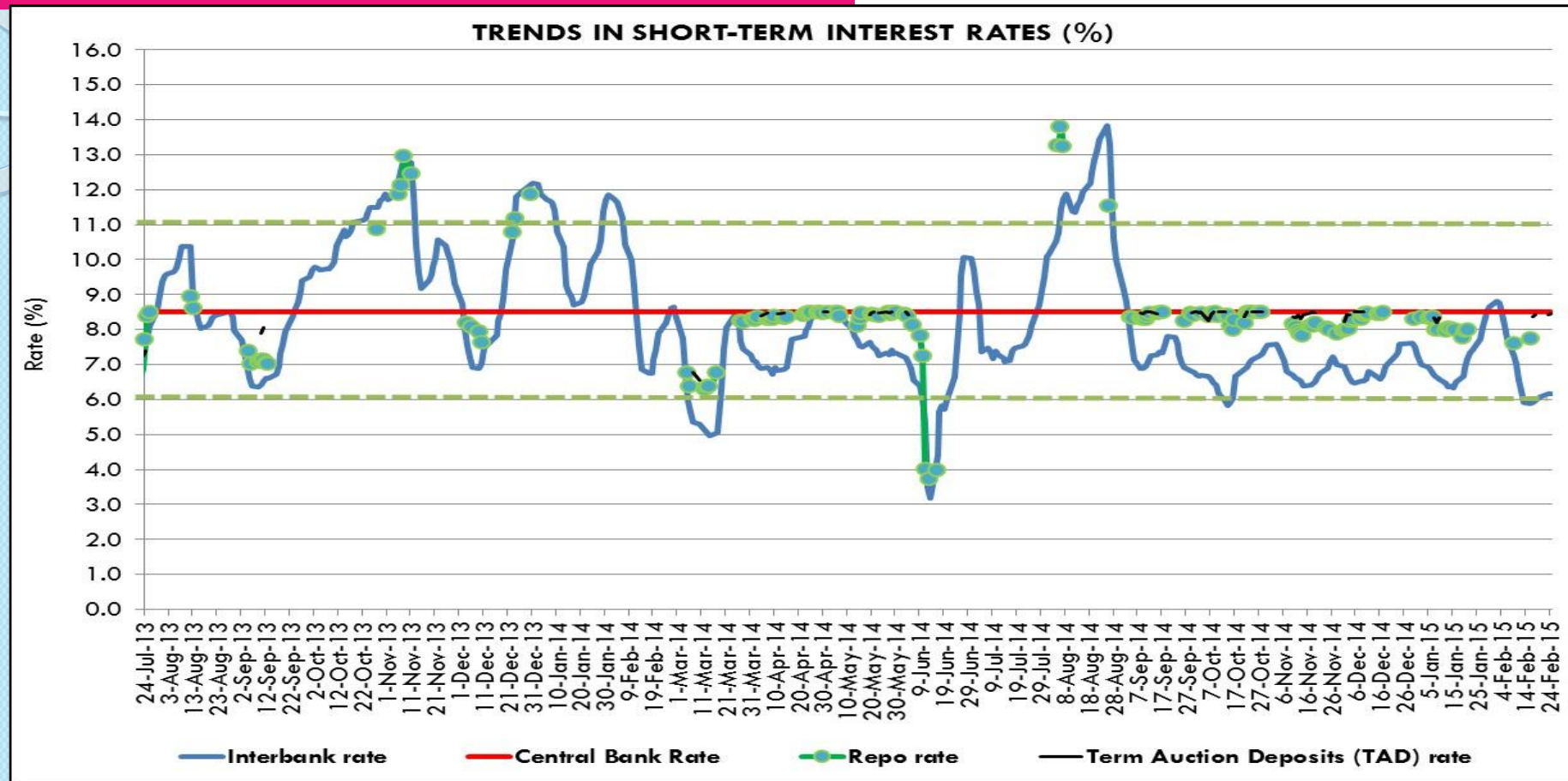


	Import of Aircraft Equipment	Import of Transport Equipment	Current account (Including Aircraft)		Current account (Excluding Aircraft)	
	USD M	USD M	USD M	% of GDP	USD M	% of GDP
2012	509	1583	-4253	-8.4	-3744	-7.4
2013	296	1487	-4786	-8.7	-4490	-8.1
2014	1468	2899	-5604	-9.2	-4137	-6.8



2c. Market outcomes since the previous MPC Meeting:

The liquidity management operations by the CBK through Open Market Operations sustained the stability of the interbank interest rate.

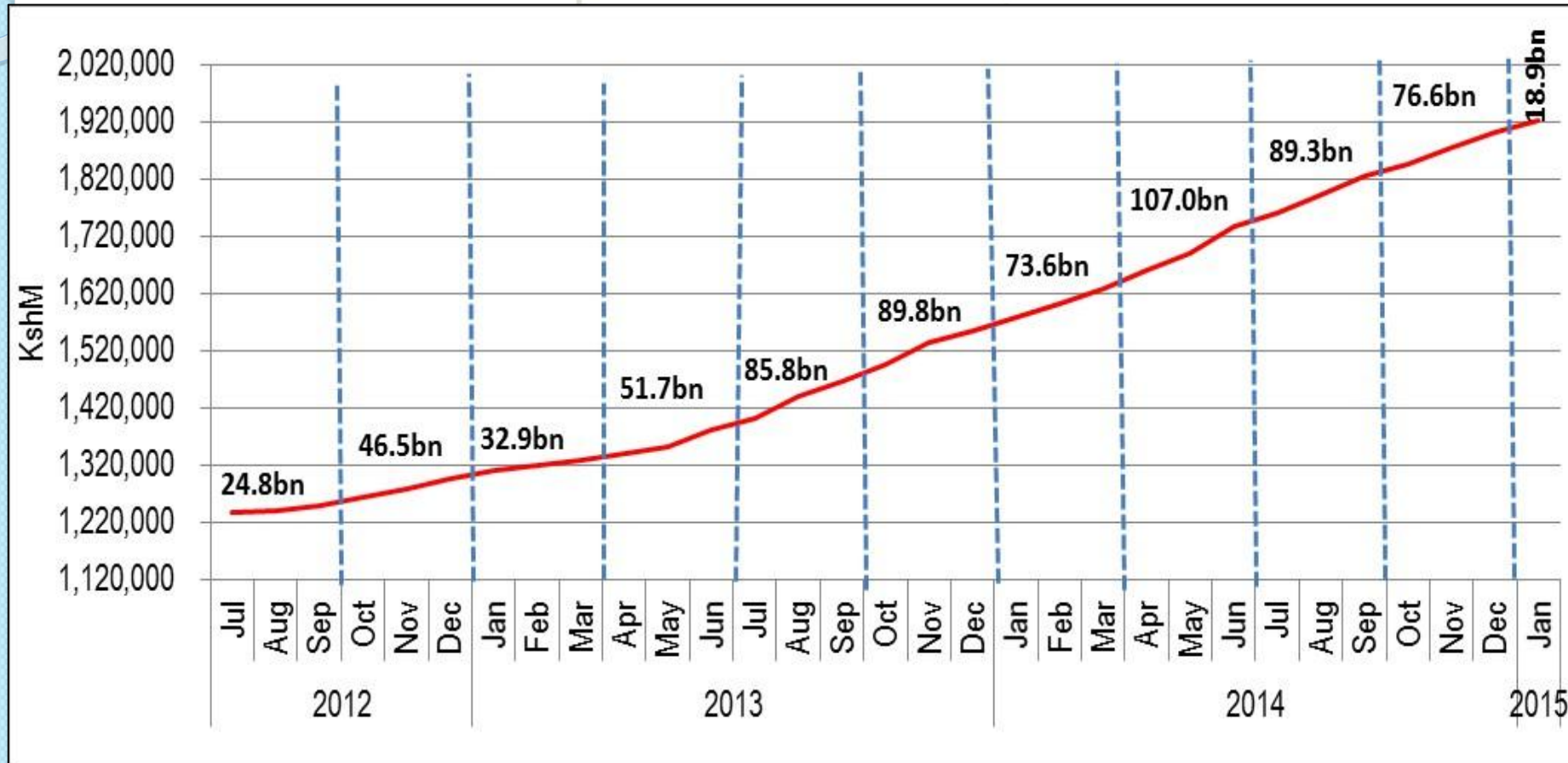


- The Central Bank Rate (CBR) continued to coordinate movements in the short-term interest rates during the period.

2d. Market outcomes since the previous MPC meeting:

The 12-month growth in private sector credit stood at 21.8 percent in January 2015. The credit was distributed to the key sectors of the economy.

Trend in Private Sector Credit



3a. December 2014 MPC Market Perceptions Survey:

The February 2015 Survey shows a continued decline in expected inflation

Expected overall inflation rate in the next 12-months

Survey Month	Large banks	Medium banks	Small banks	All banks	MFIs	Non-bank private firms
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
Dec- 2014	6.20	5.92	6.08	6.04	5.75	5.90
Feb-2015	5.20	5.16	5.45	5.30	5.68	5.48

- Banks and non-bank private firms expect inflation to decline on account of: lower fuel prices following the decline in international oil prices; expected decline in electricity prices; pickup in economic growth; and, the monetary policy measures adopted by the CBK.
- The main risk to inflation cited as the prevailing dry weather which could exert pressure on food prices, and a possibility of imported inflation due to recent movements in the exchange rate.

3b. December 2014 MPC Market Perceptions Survey:

February 2015 Survey shows exchange rate, on average, is expected to be stable

Survey month	Commercial Banks Ksh/USD Exchange rate			Non-Banks Ksh/USD Exchange rate		
	Strengthen	Remain the same	Weaken	Strengthen	Remain the same	Weaken
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
Dec-2014	12	43	45	31	44	25
Feb-2015	3	51	46	36	45	19

○ The February 2015 Survey shows that the exchange rate is expected to be stable in the remainder of 2015 on account of: an improved investment environment with low inflation which will enhance foreign direct investment; expected revival of the tourism sector with pickup of the global economy and improving security; lower pressure on the oil import bill due to lower international oil prices; increased diaspora remittances with recovery of the global economy; build-up in foreign exchange reserves and approval of the precautionary balance of payments facility by the IMF which has enhanced the CBK capacity to intervene during periods of volatility; and the monetary policy measures in place.

○ However, a notable proportion of banks expect some pressure on the exchange rate from the: strong US Dollar in the global currency markets; widening current account deficit with increased imports; slow pickup of tourism from effects of global economic slowdown and insecurity; and lower export earnings from horticultural exports due to weak demand mainly from the Eurozone.

3c. December 2014 MPC Market Perceptions Survey:

The February 2015 Survey shows more widespread optimism for a stronger growth in 2015

Expected average economic growth in the year (%)

Survey Month	Large banks	Medium banks	Small banks	All banks	MFIs	Non-bank private firms
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
Dec-2014	5.86	5.77	5.84	5.85	6.13	6.26
Feb-2015	5.93	5.92	6.00	5.99	6.50	6.15

- ⊙ The February 2015 Survey shows optimism for a stronger growth in 2015 on account of: an improved macroeconomic environment with lower inflation; lower crude oil and electricity prices which are expected to reduce production costs and consumer prices; increased public and foreign direct investment in infrastructure and energy sectors; improved security which is expected to stimulate a recovery of the tourism sector; recovery of the global and regional economies which will boost exports; declining lending rates which could spur credit growth; increased investor confidence; and, the expected impact of devolution which is expected to spur growth in Counties.
- ⊙ But the main risks to the growth outlook cited as the slowdown in horticulture exports and the tourism, expected weak recovery in the Eurozone, and insecurity.

4. The Kenya Banks' Reference Rate (KBRR) Framework:

Updated data from all commercial and microfinance banks show that new and existing loans amounting to Ksh.719.80 billion, excluding maturities, had been converted to the KBRR framework by end of January 2015.

SUMMARY OF LOAN NUMBERS AND VALUES REPORTED UNDER KBRR BY END JANUARY 2015

(a) Commercial banks

	Dec-2014	Jan-2015
New Loans Issued under KBRR		
No. of Loan Accounts	402,226	446,328
Value of loans (Ksh '000)	345,395,364	374,225,913
Existing Loans Converted to KBRR		
No. of Loan Accounts	410,708	367,595
Value of loans (Ksh '000)	366,839,491	326,550,978
Total Loans on KBRR		
No. of Loan Accounts	812,934	813,923
Value of loans (Ksh '000)	712,234,855	700,776,892

(b) Microfinance banks

	Dec-2014	Jan-2015
New Loans Issued under KBRR		
No. of Loan Accounts	6,144	15,717
Value of loans (Ksh '000)	4,063,922	10,094,563
Existing Loans Converted to KBRR		
No. of Loan Accounts	68,933	22,714
Value of loans (Ksh '000)	15,853,677	8,927,868
Total Loans on KBRR		
No. of Loan Accounts	75,077	38,431
Value of loans (Ksh '000)	19,917,599	19,022,431