



# **BACKGROUND TO THE MPC DECISIONS ON 7<sup>TH</sup> JULY, 2015**

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

**Dr. Patrick Njoroge**  
**Governor, Central Bank of Kenya**

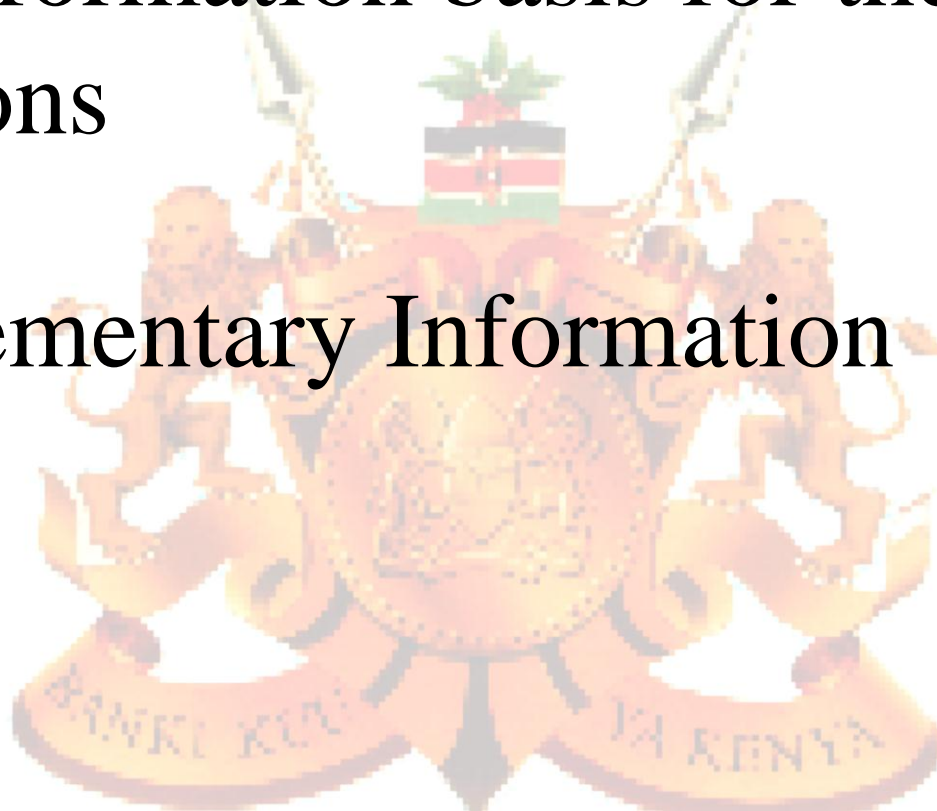
*July 10, 2015*



# Outline

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1. The Information basis for the MPC decisions
2. Supplementary Information





# 1. The Information basis for the MPC Decisions...

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## Monetary Policy Committee Decisions:

- Central Bank Rate (CBR) raised from 10.00 percent to 11.50 percent in order to anchor inflationary expectations.
- Introduced a 3-day Repo in order to augment the instruments for liquidity management.
- Revised the KBRR to 9.87 percent from 8.54 percent.



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

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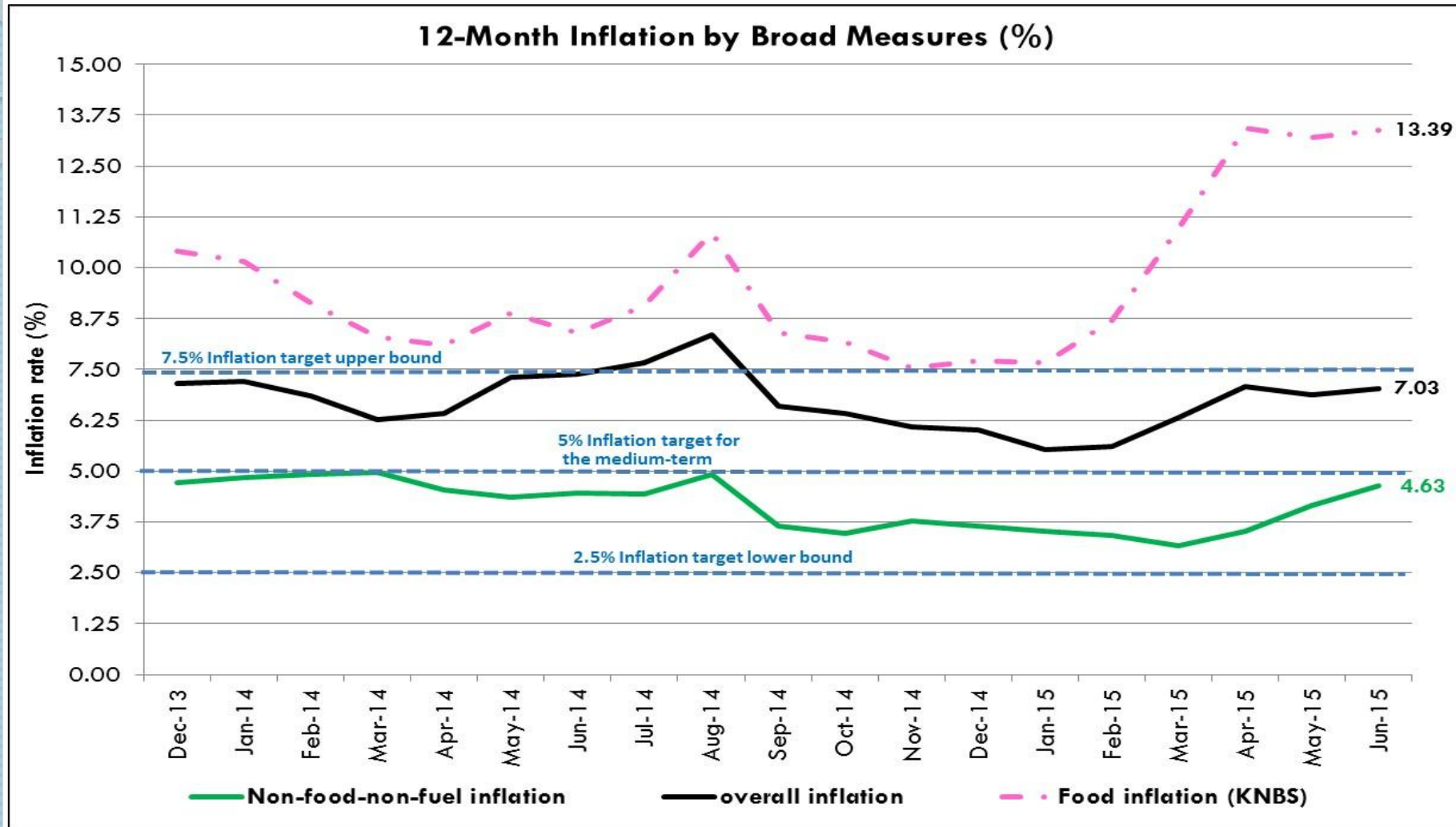
### **There are risks to the inflation outlook**

- The rise in inflation in June 2015 reflected increases in fuel prices, pass-through effects from the weakening Kenya Shilling against the US dollar and moderate demand pressures in the economy.
- Month-on-month overall inflation has persistently remained in the upper bound of the target range – it increased to 7.0 percent in June 2015 from 6.9 percent in May 2015.
- Month-on-month non-food-non-fuel (NFNF) inflation rose to 4.6 percent in June 2015 from 4.2 percent in May 2015.
- Growth in Broad Money (M3) and credit to private sector were above target – credit to private sector grew by 20.9 percent against a target of 18.9 percent in the year to May 2015, while M3 grew by 16.5 percent against a target of 13.4 percent.
- These factors indicate higher risks to the outlook on inflation – pressure on the exchange rate, demand pressure, and possible rise in fuel prices. The MPC Survey of June 2015 also showed increased inflationary expectations.



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

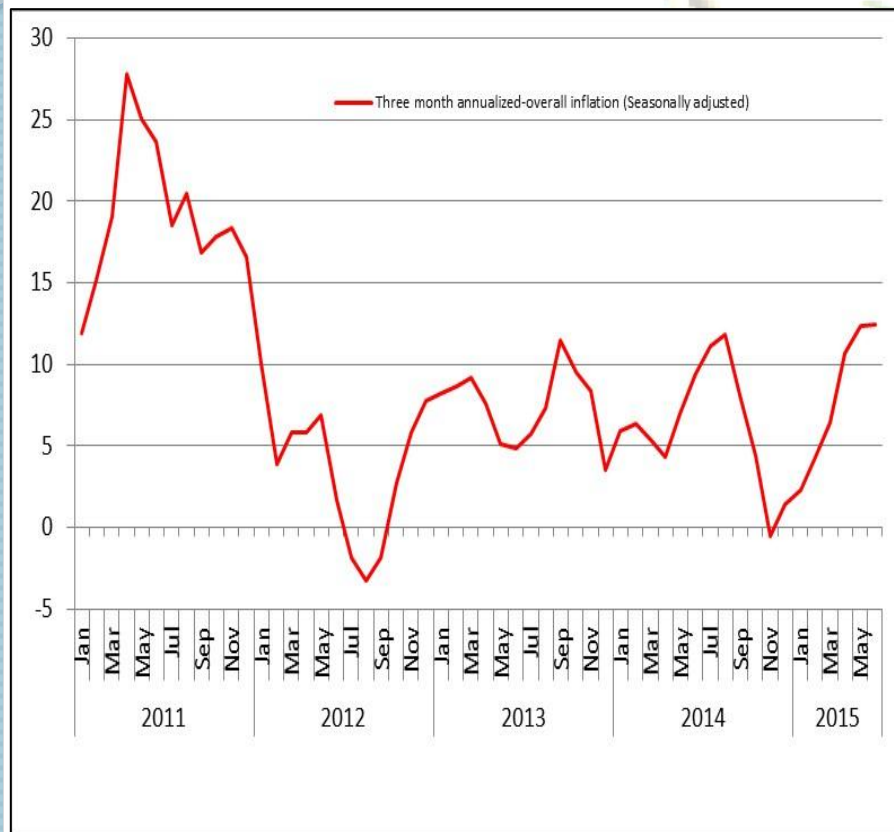
*Overall inflation has persistently remained in the upper bound of the Government target range, while NFNF inflation has been edging up*



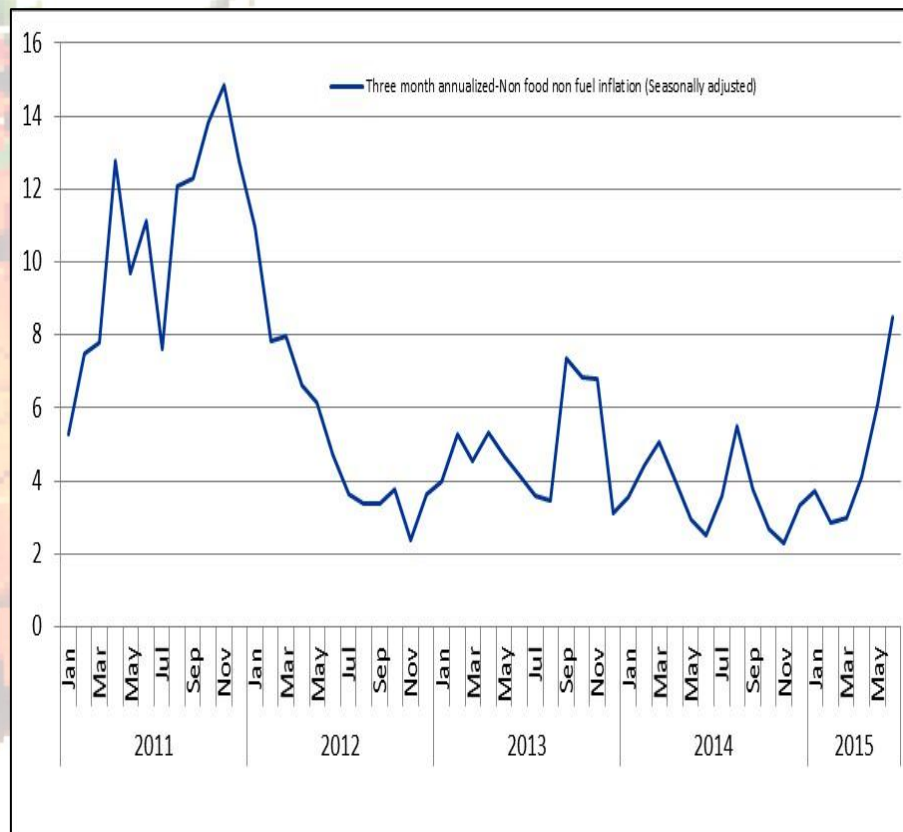
# 1a. The Information basis for the MPC Decision...

*The seasonally adjusted 3-month annualized overall and NFNF inflation measures continued trending up in June 2015 signaling emerging inflationary pressures in the near term.*

**Seasonally adjusted 3-month annualized overall inflation (%)**

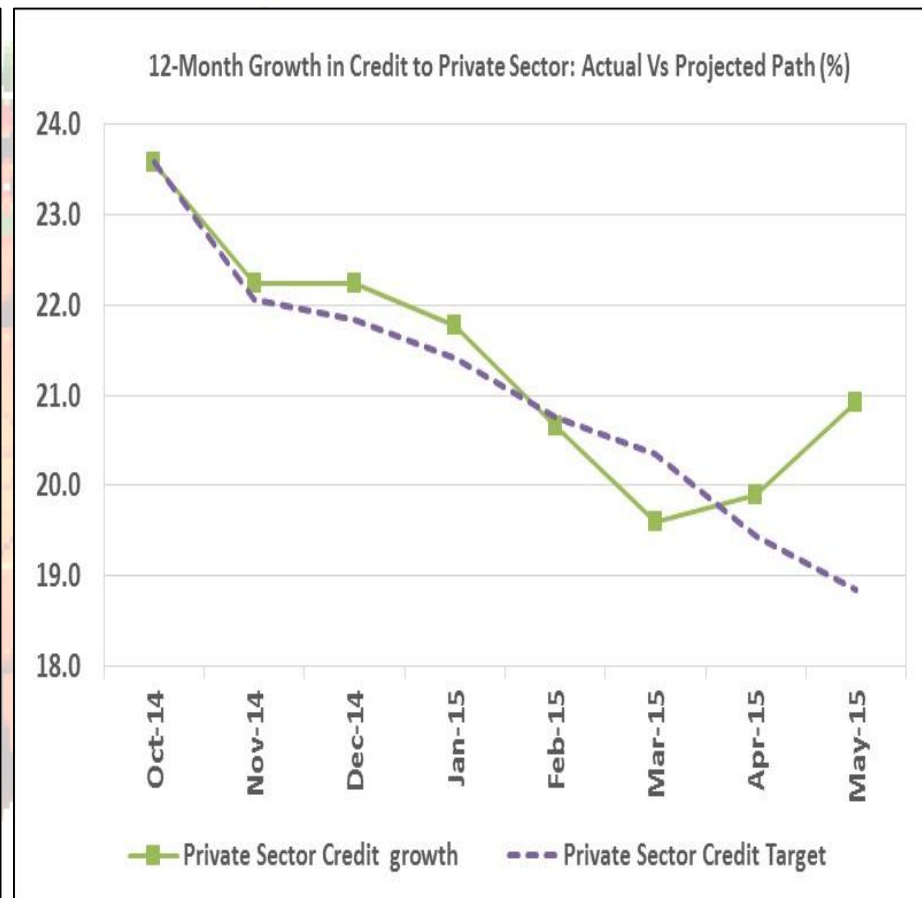
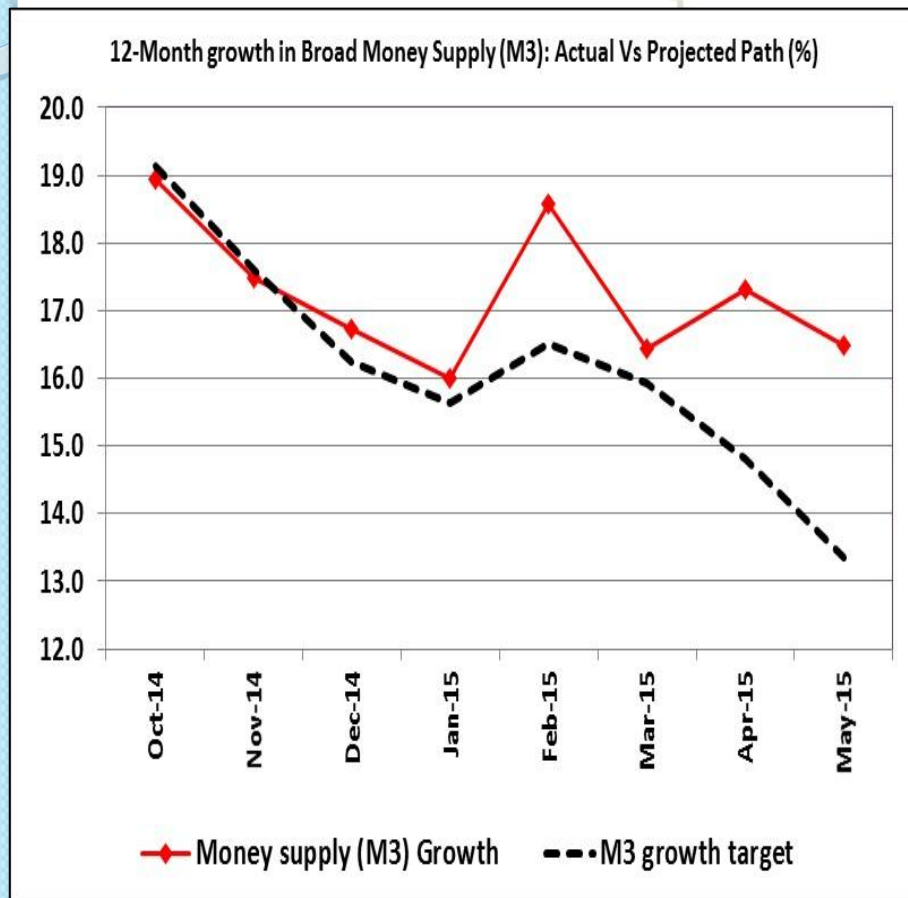


**Seasonally adjusted 3-month annualized NFNF inflation (%)**



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

*Growth in M3 and credit to private sector were above their respective targets in May 2015, an indication of demand pressure in the economy.*



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

*The June 2015 MPC Survey shows increased inflationary expectations in the remainder of 2015*

***Expected 12-month overall inflation rate in the remainder of the year***

Survey Month	Large banks	Medium banks	Small banks	All banks	Microfinance banks	Non-bank private firms
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 ↓
Apr-2015	6.37	6.52	6.56	6.52 ↑	6.60 ↑	6.40 ↑
<b>Jun-2015</b>	<b>7.50</b>	<b>7.29</b>	<b>7.17</b>	<b>7.26</b> ↑	<b>6.70</b> ↑	<b>7.18</b> ↑

- ⊙ The June 2015 Survey shows an increase in inflationary expectations across banks and non-bank private firms for the remainder of 2015 due to: expected increase in imported inflation following the recent depreciation of the Kenya Shilling against the US Dollar coupled with increased demand for imports; expected increase in fuel prices due to the proposed taxation measures in the FY 2015/16 and expected rebound of international oil prices with pickup in global demand; and expected increase in Government expenditure in FY 2015/16 due to the comparatively expansionary fiscal stance relative to that in FY 2014/15.
- ⊙ However, banks and non-bank private firms expect the inflation rate to benefit from the tight monetary policy stance adopted by the MPC, easing of food prices following the recent long rains and decline in international food prices, expected reduction in electricity prices, and pickup in economic growth.





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

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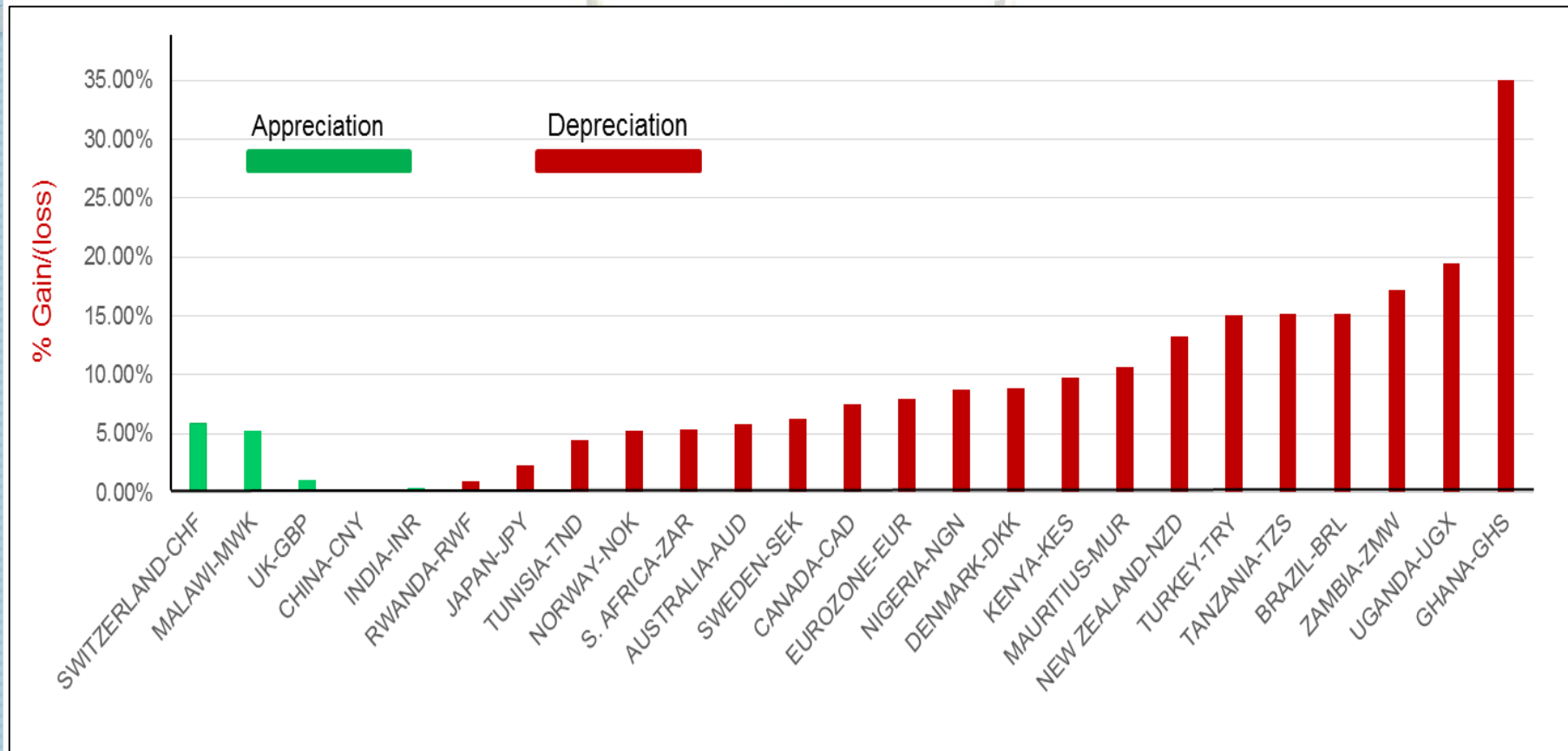
### Exchange rate pressures

- The strengthening US dollar internationally continues to exert pressure on the Kenya Shilling.
  - The current account deficit was estimated at 9.8 percent of GDP in the year to May 2015, reflect increased imports of capital goods coupled with weak exports.
  - There are also risks of turbulence in the global markets – recent developments in Greece, and uncertainty around the timing of normalisation of US monetary policy.
  - Nevertheless, the CBK's foreign reserves and the precautionary facility with the IMF provide a cushion to the Kenya Shilling.
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## 1b. The Information basis for the MPC Decision...

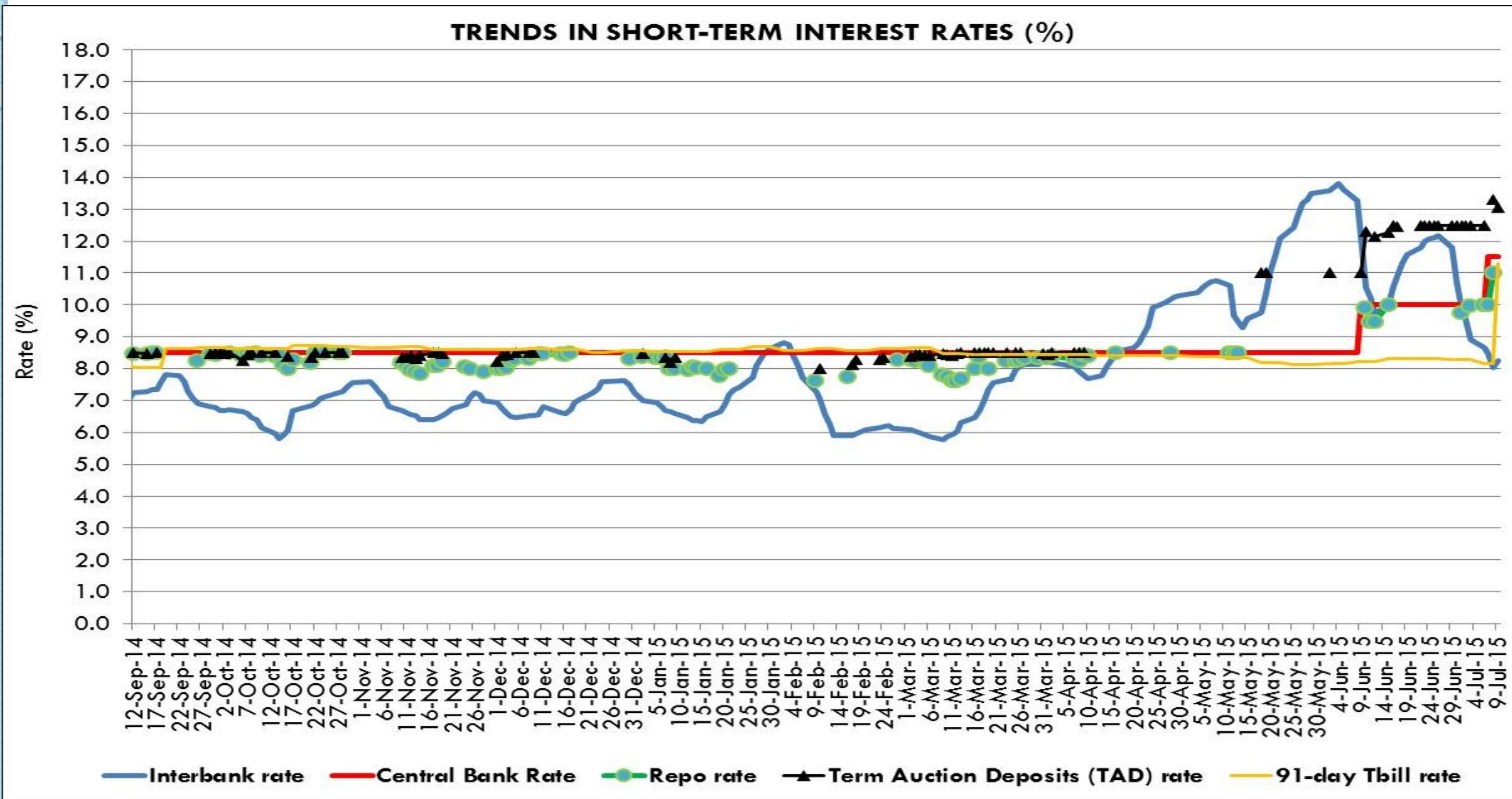
*The US Dollar has been strengthening against most currencies.  
There are risks of turbulence in the global markets*

**Performance of selected currencies against the US Dollar (January to June 2015)**



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

*Liquidity conditions in the interbank market changed in the course of the month reflecting drawdown of Government deposits towards the end of the Fiscal Year 2014/15.*





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

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**Growth is expected to be robust, but there remain significant downside risks**

- The MPC Survey of June 2015 shows increased optimism for an improved business environment in the remainder of 2015.
- There are positive developments in agriculture, tourism, and investment in infrastructure.
- Measures to bolster security have improved confidence in the economy.
- Downside risks.



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

*The June 2015 MPC Survey shows that private sector firms expect a stronger growth in 2015 relative to 2014*

***Expected average economic growth in the year (%)***

Survey Month	Large banks	Medium banks	Small banks	All banks	Microfinance banks	Non-bank private firms
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
Apr-2015	5.78	5.84	5.85	5.84	6.33	6.20
<b>Jun-2015</b>	<b>6.01</b>	<b>5.43</b>	<b>5.90</b>	<b>5.79</b>	<b>6.00</b>	<b>6.27</b>









- ⊙ The June 2015 Survey shows that banks and non-bank private firms expect a higher growth in 2015 relative to 2014 on account of: increased foreign direct investment and public investment in infrastructure; increased investor confidence due to political stability and enhanced security which is expected to support recovery of the tourism sector; credit growth to key sectors of the economy; lower electricity prices; boom in the construction, communications and financial sectors; positive effects of the long-rains on agriculture production; recovery of the global economy which will benefit exports; and, the impact of increased funding of devolution which will spur growth in Counties.
- ⊙ However, banks have revised downward their expected growth in 2015 on account of various risks including: inflationary pressure attributed to depreciation of the exchange rate, expected rise in fuel prices due to taxation measures, sluggish recovery of the global economy and possible spillover of risks in Greece to the Eurozone which could slowdown recovery of the Eurozone economy thereby affecting horticultural exports and tourism.



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

*The June 2015 MPC Survey shows increased optimism by private sector firms for an improved business environment in the remainder of 2015 relative to 2014*

*Optimism for an improved business environment in remainder of year relative to the previous year (% of respondents)*

	Commercial Banks and MFBs			Non-Banks		
Survey month	Low	Same	High	Low	Same	High
Dec-2014	3	22	75 	6	29	65 
Feb-2015	0	23	77 	5	28	67 
Apr-2015	15	35	50 	30	29	41 
<b>Jun-2015</b>	<b>0</b>	<b>46</b>	<b>54</b> 	<b>13</b>	<b>37</b>	<b>50</b> 

⊙ The June 2015 Survey shows increased optimism across banks and non-bank private for an improved business environment in the remainder of 2015 on account of: favourable tax measures in the FY2015/16 Budget and expected decline in electricity prices which are expected to benefit the manufacturing sector; increased budget allocations to key sectors of the economy; increase in credit to private sector; wide ranging measures in the Budget to bolster security and support recovery of tourism; sustained public investment in infrastructure will lower the cost of doing business; Government efforts to encourage investors and address governance; increased financial inclusion and access to credit; improved spending in the Counties; and political stability.

⊙ However, the main risks to the business environment in the remainder of 2015 were cited as insecurity, exchange rate depreciation and rising inflation.



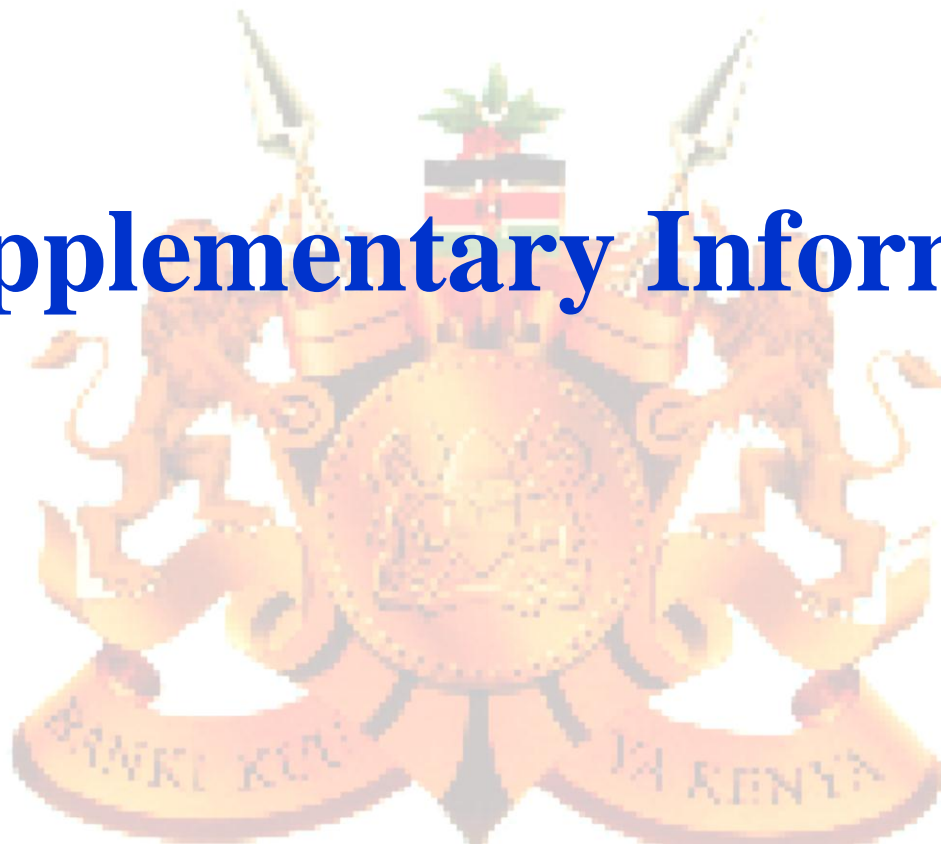
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# Thank You



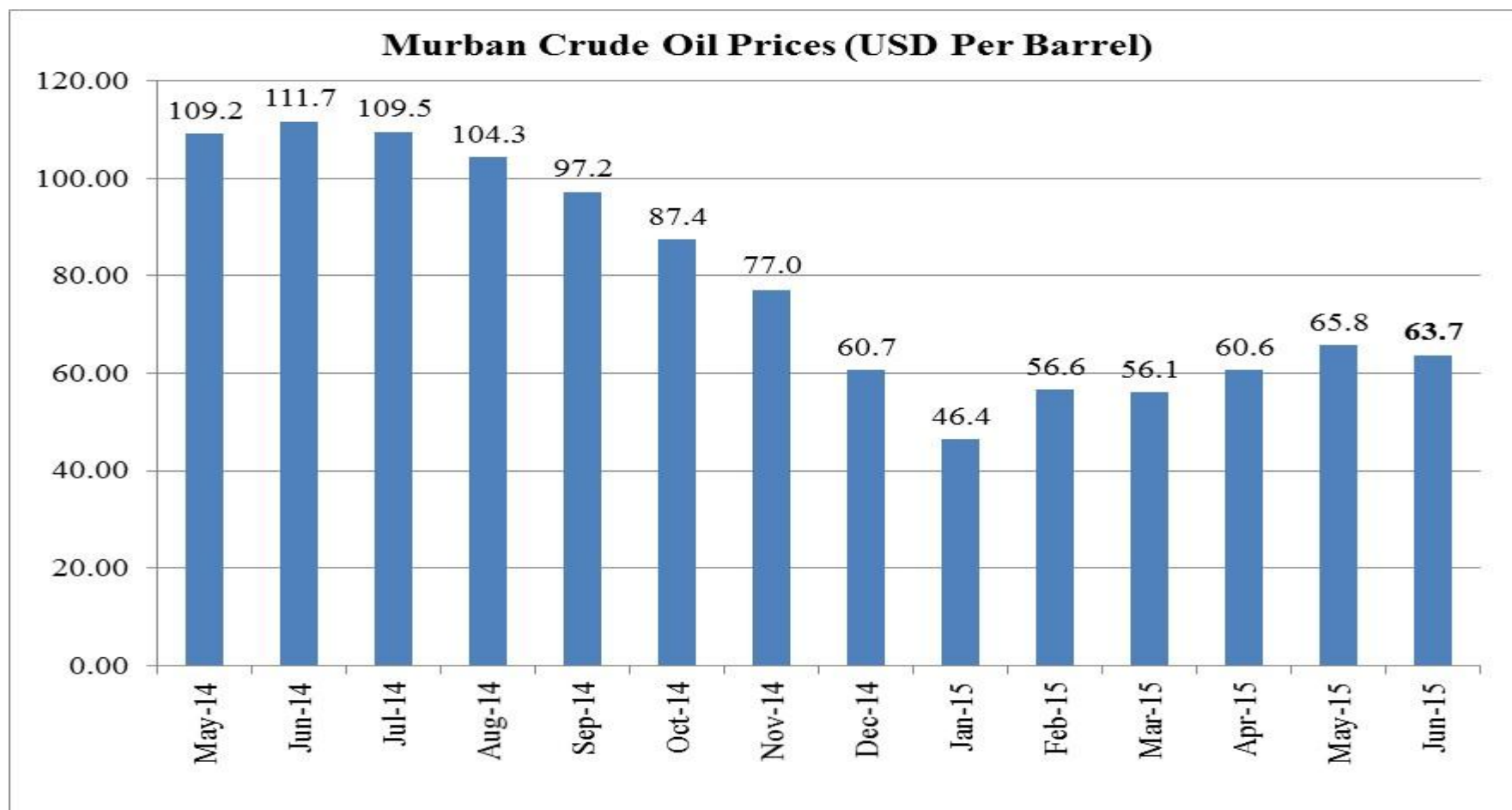
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## 2. Supplementary Information



## 2a. International Crude Oil Prices:

*The average crude oil prices have generally been trending up since February 2015, indicating risks to the inflation outlook...*



## 2b. The Kenya Banks' Reference Rate Framework:

*Updated data from all commercial and microfinance banks shows that new and existing loans amounting to Ksh.933.66 billion had been converted to the Kenya Banks' Reference Rate (KBRR) framework by end of May 2015 compared with Ksh.877.45 billion by the end of April 2015.*

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

#### (a) Commercial banks

	Apr-2015	May-2015
<b>New Loans Issued under KBRR</b>		
No. of Loan Accounts	594,880	<b>646,018</b>
Value of loans (Ksh Bn)	506.56	<b>564.46</b>
<b>Existing Loans Converted to KBRR</b>		
No. of Loan Accounts	300,251	<b>287,608</b>
Value of loans (Ksh Bn)	361.60	<b>358.96</b>
<b>Total Loans on KBRR</b>		
No. of Loan Accounts	895,131	<b>933,626</b>
Value of loans (Ksh Bn)	868.16	<b>923.42</b>

#### (b) Microfinance banks

	Apr-2015	May-2015
<b>New Loans Issued under KBRR</b>		
No. of Loan Accounts	8,564	<b>9,205</b>
Value of loans (Ksh Bn)	6.47	<b>7.10</b>
<b>Existing Loans Converted to KBRR</b>		
No. of Loan Accounts	1,064	<b>1,042</b>
Value of loans (Ksh Bn)	2.82	<b>3.14</b>
<b>Total Loans on KBRR</b>		
No. of Loan Accounts	9,628	<b>10,247</b>
Value of loans (Ksh Bn)	9.29	<b>10.24</b>



## 2c. June 2015 MPC Market Perceptions Survey:

*The June 2015 Survey shows expectations for a tendency of the exchange rate to depreciate in the remainder of 2015*

	Commercial Banks Ksh/USD Exchange rate			Non-Banks Ksh/USD Exchange rate		
Survey month	Strengthen	Remain the same	Weaken	Strengthen	Remain the same	Weaken
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
Apr-2015	11	7	82	18	20	62
<b>Jun-2015</b>	<b>23</b>	<b>28</b>	<b>49</b>	<b>14</b>	<b>38</b>	<b>48</b>

- ⊙ The June 2015 Survey shows that most banks and non-banks expect the Kenya Shilling to weaken against the US Dollar in the remainder of 2015 on account of: a stronger US Dollar in the global currency markets; widening current account deficit with increased demand for imports of capital goods; reduced supply of foreign exchange from tourism due to sluggish pickup of the global economy; and lower export earnings from horticultural exports due to weak demand mainly from the Eurozone.
- ⊙ However, the proportion of firms expecting the Shilling to stabilise or even strengthen has increased due to: the recent increase in the CBR which is expected to boost capital inflows through a rise in interest rates; resilient diaspora remittances; easing of demand pressures from multinationals seeking to repatriate profits; lifting of travel bans by UK coupled with the GOK measures in the FY2015/16 Budget to bolster tourism and security which will support recovery of tourism; resilient diaspora remittances; and the foreign exchange reserves position and the IMF precautionary facility which have enhanced the CBK capacity to intervene during periods of volatility.

## 2d. Average Commercial Banks' Interest Rates:

*Average lending interest rates declined on average between 2014 and the first five months of 2015 reflecting the lowering of the KBRR. However, average deposit rates have increased slightly for small and medium bank categories.*

	Average Lending rates (%)				Average Deposit rates (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jul-14	17.10	15.87	18.06	16.91	5.86	6.14	4.85	6.59
Aug-14	16.97	15.69	16.95	16.26	5.95	6.36	4.87	6.51
Sep-14	16.91	15.51	16.87	16.04	6.28	6.25	4.92	6.64
Oct-14	16.77	15.52	16.84	16.00	6.41	6.28	4.94	6.64
Nov-14	16.70	15.27	16.83	15.94	6.36	6.16	4.88	6.72
Dec-14	16.92	15.37	16.82	15.99	6.12	6.29	4.95	6.81
Jan-15	16.85	15.35	16.80	15.93	6.33	6.30	4.96	6.65
Feb-15	16.72	15.16	16.38	15.47	6.27	6.35	4.80	6.68
Mar-15	16.60	15.31	16.29	15.46	6.20	6.45	4.76	6.63
Apr-15	16.54	15.12	16.49	15.40	6.46	6.23	4.97	6.60
May-15	16.54	14.96	16.44	15.26	6.49	6.42	4.65	6.55
<b>Average 2014*</b>	<b>16.89</b>	<b>15.54</b>	<b>17.06</b>	<b>16.19</b>	<b>6.16</b>	<b>6.25</b>	<b>4.90</b>	<b>6.65</b>
<b>Average 2015**</b>	<b>16.65</b>	<b>15.18</b>	<b>16.48</b>	<b>15.50</b>	<b>6.35</b>	<b>6.35</b>	<b>4.83</b>	<b>6.62</b>
<b>Change 2014/15</b>	<b>-0.24</b>	<b>-0.36</b>	<b>-0.58</b>	<b>-0.69</b>	<b>0.19</b>	<b>0.10</b>	<b>-0.07</b>	<b>-0.03</b>

\* July to December \*\* January to May

## 2e. Average Commercial Banks' Interest Rate Spreads:

*Interest rate spreads declined on average across all bank categories between 2014 and the first five months of 2015. Large banks have higher spreads due to lower deposit rates as large proportion of deposits is in demand deposits*

	Average Spread (%)			
	Small	Medium	Large	Overall
Jul-14	11.24	9.73	13.21	10.33
Aug-14	11.01	9.33	12.08	9.75
Sep-14	10.85	9.82	11.95	9.40
Oct-14	10.33	9.23	11.91	9.36
Nov-14	10.31	9.10	11.95	9.22
Dec-14	11.09	9.08	11.87	9.18
Jan-15	10.52	9.05	11.84	9.28
Feb-15	10.45	8.82	11.58	8.78
Mar-15	10.40	8.85	11.53	8.82
Apr-15	10.08	8.83	11.52	8.80
May-15	10.05	8.50	11.80	8.70
<b>Average 2014*</b>	<b>10.81</b>	<b>9.38</b>	<b>12.16</b>	<b>9.54</b>
<b>Average 2015**</b>	<b>10.30</b>	<b>8.81</b>	<b>11.65</b>	<b>8.88</b>
<b>Change 2014/15</b>	<b>-0.50</b>	<b>-0.57</b>	<b>-0.51</b>	<b>-0.66</b>

\* July to December \*\* January to May

## 2f. Commercial Banks Interest Rates to SMEs:

*Average commercial banks' lending rates to SMEs declined on average between 2014 and the first five months of 2015, but remain higher than those for the personal, business and corporate segments. The deposit rates to SMEs also decreased on average across all bank categories.*

	SMEs Average Lending rates (%)				SMEs Average Deposit rates (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jul-14	17.53	16.99	17.13	17.22	7.43	7.35	3.92	6.23
Aug-14	17.60	17.10	17.11	17.27	7.42	7.44	4.08	6.31
Sep-14	17.64	16.68	17.01	17.11	7.28	7.43	4.43	6.38
Oct-14	17.43	16.49	17.25	17.06	7.18	7.52	3.56	6.08
Nov-14	17.34	16.34	17.12	16.93	7.18	7.45	3.99	6.21
Dec-14	17.89	16.48	16.93	17.10	7.22	7.39	3.53	6.05
Jan-15	17.15	16.48	16.93	16.85	7.19	7.40	3.38	5.99
Feb-15	17.26	16.02	17.41	16.90	6.90	7.32	3.46	5.89
Mar-15	17.06	16.23	16.57	16.62	6.99	7.39	3.39	5.92
Apr-15	17.00	15.99	16.89	16.63	6.82	7.19	3.44	5.82
May-15	17.04	15.96	16.70	16.57	6.88	7.16	3.39	5.81
<b>Average 2014</b>	<b>17.57</b>	<b>16.68</b>	<b>17.09</b>	<b>17.11</b>	<b>7.28</b>	<b>7.43</b>	<b>3.92</b>	<b>6.21</b>
<b>Average 2015</b>	<b>17.10</b>	<b>16.13</b>	<b>16.90</b>	<b>16.71</b>	<b>6.96</b>	<b>7.29</b>	<b>3.41</b>	<b>5.89</b>
<b>Change 2014/15</b>	<b>-0.47</b>	<b>-0.55</b>	<b>-0.19</b>	<b>-0.40</b>	<b>-0.33</b>	<b>-0.14</b>	<b>-0.51</b>	<b>-0.32</b>

Note: \* July to December \*\* January to May

## 2g. Microfinance banks' (MFBs) Overall Interest Rates:

*Average overall lending rates for MFBs decreased on average between 2014 and the first five months of 2015, but average deposit rates have slightly increased. MFBs overall interest rates remain above those of commercial banks.*

	Overall Average Rates		
	Avg Lending Rates	Avg Deposit Rates	Spread
Jul-14	20.82	8.36	12.46
Aug-14	19.38	8.30	11.08
Sep-14	19.98	8.39	11.59
Oct-14	20.07	8.20	11.87
Nov-14	20.06	8.35	11.71
Dec-14	20.30	8.43	11.87
Jan-15	20.18	8.51	11.66
Feb-15	20.08	8.66	11.42
Mar-15	20.17	8.66	11.51
Apr-15	18.95	8.37	10.59
May-15	18.97	8.36	10.61
<b>Average 2014</b>	<b>20.10</b>	<b>8.34</b>	<b>11.76</b>
<b>Average 2015</b>	<b>19.67</b>	<b>8.51</b>	<b>11.16</b>
<b>Change 2014/15</b>	<b>-0.43</b>	<b>0.18</b>	<b>-0.61</b>

Note: \* July to December \*\* January to May



## 2h. Microfinance banks' (MFBs) Interest Rates to SMEs:

*Average MFBs lending rates to SMEs have declined on average between 2014 and the first five months of 2015, but remain above those of commercial banks. Average deposits rates have slightly increased in similar period.*

	SMEs Average Rates		
	Avg Lending Rates	Avg Deposit Rates	Spread
Jul-14	19.58	8.88	10.71
Aug-14	19.31	8.90	10.41
Sep-14	19.34	8.80	10.54
Oct-14	19.29	8.70	10.59
Nov-14	19.31	8.69	10.62
Dec-14	19.34	8.68	10.66
Jan-15	19.29	9.03	10.77
Feb-15	19.29	8.68	10.88
Mar-15	19.28	9.02	10.55
Apr-15	19.28	8.78	10.55
May-15	19.29	9.02	10.56
<b>Average 2014</b>	<b>19.36</b>	<b>8.77</b>	<b>10.59</b>
<b>Average 2015</b>	<b>19.29</b>	<b>8.90</b>	<b>10.66</b>
<b>Change 2014/15</b>	<b>-0.08</b>	<b>0.13</b>	<b>0.07</b>

Note: \* July to December \*\* January to May