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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 5TH NOVEMBER, 2013

ANCHORING INFLATIONARY EXPECTATIONS

The Monetary Policy Committee met on 5th November, 2013 to review market developments and the outcomes of the monetary policy stance since its September 2013 meeting. The Committee noted that overall inflation had declined in October 2013 but remained above the 7.5 percent upper bound for the Government medium-term target. In addition, the strengthening of the Kenya Shilling against major currencies in October 2013 moderated any impact of the pass-through effect of imported inflation. In particular, the Committee noted the following positive outcomes in the market since its previous meeting:

- The overall month-on-month inflation declined from 8.29 percent in September 2013 to 7.76 percent in October 2013. The decline in inflation in October 2013 largely reflected a fall in the prices of all energy items as well as some food items and the stable exchange rate that also contributed to the relative prices declining. Consequently, the 1-month annualised overall inflation declined to -0.63 percent in October 2013. Similarly, the non-food-non-fuel month-on-month inflation decreased from 5.02 percent to 4.94 percent in the same period. The results are an indication of a moderation of inflationary pressure in the economy that also reflects the fact that inflationary expectations have not changed even after implementation of the VAT Act in September 2013.
- The exchange rate strengthened during the period, supported by foreign exchange inflows and liquidity management. It fluctuated within a range of Ksh.84.72 and Ksh.86.79 against the USD in October 2013 compared to a range of Ksh.86.65 and Ksh.87.58 in September 2013. The CBK level of usable foreign exchange reserves stood at USD5,892.0 million (equivalent to 4.13 months of import cover) at the end of October 2013 compared to USD5,751.11 million (equivalent to 4.11 months of import cover) at the end of August 2013.
- The CBK has been working with the Kenya National Bureau of Statistics and the IMF to improve the quality and speed of delivery of the balance of payments data. Arising from this, a recomputed series of the current account deficit shows that the 12-month cumulative deficit (as percentage of GDP) improved from 10.45 percent in December 2012 to an estimated level of 7.5 percent by September 2013. This is within the internationally accepted range of sustainable current account deficits.
- The CBK's pursuit of price stability during the period continued to be supported by close collaboration with The National Treasury. This has ensured that fiscal and monetary policies support macroeconomic stability.

- The Central Bank Rate (CBR) continued to coordinate movements in the short-term interest rates during the period. The current tightness in the interbank market resulting in short-term increases in the interbank rate is attributed to a skewed distribution of liquidity in the market. Consistent with the current monetary policy stance, commercial banks' average lending interest rates maintained the downward trend since April to stand at 16.32 percent in September 2013.
- The latest stress tests and data showed that the banking sector remains solvent and resilient. In addition, the 2013 Financial Access Survey shows that access to financial services in Kenya has increased and now stands amongst the highest in Africa. This will enhance the transmission of monetary policy to the real sector. The number of loan applications remained buoyant and was distributed across key sectors of the economy. As a result, private sector credit grew by 17.36 percent in September 2013 compared to 16.17 percent in August 2013. The ratio of non-performing loans to total loans declined from 5.3 percent in August 2013 to 5.2 percent in September 2013, an indication of low credit risk.
- The Committee noted that confidence in the economy has been sustained. Activity at the Nairobi Securities Exchange (NSE) remains buoyant with rising foreign investor participation. In particular, the NSE-20 index rose from 4,793.2 in September 2013 to 4,992.9 in October 2013. Diaspora remittances have averaged USD107 million per month in the last six months. In addition, the MPC Market Perceptions Survey conducted in October 2013 showed that the private sector expects inflation and the exchange rate to remain stable, and growth to be strong in 2013.

Despite the above developments, the Committee noted that the projected weak recovery in the global economy and the instability in the Middle East and North Africa continue to pose risks to the macroeconomic outlook. The recession in the Eurozone has slowed down export earnings from tourism while the temporary partial shutdown of the US government in October 2013 could affect Diaspora remittances from North America in the short-term. These developments coupled with the volatile international oil prices remain a threat to price stability.

In view of these developments, the Committee concluded that the new VAT measures had a one-off impact on inflation. In particular, the 1-month annualised overall inflation was negative in October 2013, a clear indication that inflationary expectations had not changed relative to the pre-VAT Act period. There were also no demand-driven inflationary pressures which would require a revision of the current monetary policy stance. The Committee therefore decided to retain the CBR at 8.50 percent and will also continue to work with stakeholders in order to improve the mechanisms for liquidity management. In addition, the CBK will continue to monitor the key macroeconomic aggregates and any emergent risks that may impact on price stability.

PROF. NJUGUNA NDUNG'U, CBS
CHAIRMAN, MONETARY POLICY COMMITTEE

5th November, 2013