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LETTER OF TRANSMITTAL

In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Cabinet Secretary of the National Treasury, the Annual Report of the Central Bank of Kenya for the Fiscal Year 2012/13. The Annual report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Fiscal Year ended June 30, 2013.

Prof. Njuguna Ndung'u

Governor

PREFACE

The global economic growth slowed down to 3.1 percent in 2012 from 3.9 percent in 2011. The slow growth was largely attributed to a weaker domestic demand, indicated by slower growth in several key emerging market economies as well as a more protracted recession in the Euro area.

At the domestic scene, real GDP grew by 4.6 percent in 2012 and amounted to Ksh 1.61 trillion compared with 4.4 percent growth in 2011. The slight improvement in 2012 is attributed to conducive weather conditions, which supported the agricultural sector. The main sectors contributing to growth in 2012 included Agriculture and Forestry (20.9 percent), Transport and Communication (12.3 percent), Wholesale and Retail Trade (11 percent) and Manufacturing (9.5 percent). In the first quarter of 2013, the real GDP growth recovered to 5.2 percent compared with 4.0 percent in a similar quarter of 2012. While agriculture contributed significantly to first quarter of 2013 performance, manufacturing, hotels and restaurants and financial intermediation sectors were adversely affected by politically induced anxiety with respect to the economy prior to the March 2013 elections.

Monetary policy focused on achieving and maintaining low inflation. The twelve month inflation rate slowed down from 10.1 percent in June 2012 to 4.9 percent in June 2013, and the non-food non-fuel inflation from 9.3 percent to 3.9 percent. The slowdown in inflation was on account of reduced fuel inflation and food inflation, stable exchange rate and prudent monetary policy stance in the year to June 2013. Both measures of inflation were largely within the Government medium-term target (± 250 basis points from 5 percent). The Bank adopted a gradual easing of monetary policy since July 2012 following the easing of inflationary pressures. This was partly on account of monetary policy tightening during the January- June 2012 period, and stability in the exchange rate to provide policy space for the private sector to support the programmed recovery of the economy. Both the money supply, M3, and its base (reserve money) recorded marginal slow down compared to target growth.

The Central Bank Rate (CBR) continued to signal the direction of monetary policy. At the beginning of the fiscal year 2012/13, the Monetary Policy Committee (MPC) adopted a gradual easing of monetary policy by lowering the CBR in July 2012 by 150 basis points from 18 percent to 16.5 percent. The CBR was further reduced by 350 basis points to 13.0 percent in September, 2012; by 200 basis points to 11.0 percent in November, 2012, by 150 basis points to 9.50 percent in January, 2013 and by 150 basis points to 8.5 percent May 2013.

Consistent with the easing of the monetary policy, the average interbank rate decreased from 17.09 percent in June 2012 before stabilizing around 7.00 percent in June 2013. The 91-day Treasury bill rate decreased from 10.09 percent in June 2012 to 6.21 percent in June 2013. Average commercial banks' lending rate declined from 20.30 percent in June 2012 to 16.97 percent in June 2013. Similarly, the average commercial banks' deposit rate declined from 7.88 percent in June 2012 to 6.65 percent in June 2013. The spread on commercial bank lending rates narrowed from 12.41 percent in June 2012 to 10.32 in June 2013.

Government budgetary operations in the fiscal year 2012/13 resulted in a budget deficit of 6.8 percent of GDP on a commitment basis, compared with 5.5 percent in a similar period in the fiscal year 2011/12 and the target 8.9 percent for the review period. Both the Government revenues and expenditures increased but less rapidly than projected during the 2011/12 fiscal year. Slow growth of the economy and challenges in passing the VAT Bill were among factors that constrained tax revenue growth. The growth in expenditure is attributed to the implementation of the new Constitution and higher salaries and wages awarded to the civil servants. Kenya's public and publicly guaranteed debt increased from 49.3 percent of GDP in June 2012 to 51.7 percent in June 2013. The increase is attributed to borrowing for infrastructure and a lower than expected growth performance.

The Kenya Shilling exchange rate remained stable against major world trading currencies in the 2012/13 fiscal year. Against the US$, the Shilling weakened marginally to exchange at an average of Ksh 85.5 in June 2013 compared to Ksh 84.8 in June 2012. Exchange rate stability was supported by improved liquidity management in the interbank market, resilient foreign exchange inflows through diaspora remittances, and enhanced investor confidence following the peaceful general elections conducted in March 2013.

Kenya's overall balance of payments surplus recorded a lower surplus of US$ 597 million in the fiscal year 2012/13 from US$ 841 million in the fiscal year 2011/12. The reduction reflected a draw down to complement the surplus of the capital and financial account in financing a relatively larger current account deficit. The deficit in the current account widened from US$ 3,881 million (or 9.54 percent of GDP) in the fiscal year 2011/12 to US$ 4,621 million (or an estimated 11.35 percent of GDP) in the fiscal year 2012/13. During the year under review, the Central Bank of Kenya increased its foreign exchange reserve holding by 15.3 percent, to US$ 6,089 million (equivalent to 4.4 months of import) in June 2013 from US$ 5,283 million (4.3 months of import cover) in June 2012. The accumulation of official reserves during the period consisted of IMF disbursements under the Extended Credit Facility programme and purchase from the Foreign Exchange market.

The Banking Sector recorded improved performance in the fiscal year 2012/13 with total assets 15 percent higher in June 2013 compared to June 2012. The major components of the balance sheet were loans and advances, government securities and placements, which accounted for 55.7 percent, 22.4 percent and 6.2 percent of total assets, respectively. The stock of gross non-performing loans (NPLs) increased by 34.4 percent to Ksh 77.3 billion in June 2013 thereby raising the ratio of gross NPLs to gross loans from 4.5 percent to 5.3 percent over the period under review although NPLs in the Manufacturing, Tourism, and Restaurants and Hotels sectors declined.

The Bank's operations in the year to June 2013 resulted in a net surplus of Shs 3,652 million compared with Shs 18,356 million deficit in the year to June 2012. The improvement is largely attributed to Shs 5,623 million unrealized foreign exchange gain (attributed to favourable movements in major foreign exchange rates) which wholly offset Shs 1,916 million operating deficit attributed to administrative expenses in staff expenses following introduction of a defined contribution retirement benefit scheme and currency cost attributed to investment in new generation currency in compliance with Constitutional requirements.

Meanwhile, the Central Bank's balance sheet expanded during the review period, with total assets increasing to Shs 590,389 million fostered by favorable exchange rates, compared to the previous year's Shs 509,498 million. Liabilities on the other hand increased by 17.2 percent, to Shs 537,470 million due to higher liquidity as evidenced by higher deposits from banks and government at Shs 191,671 million (2012: 160,642 million) and currency in circulation at Shs 183,047 million (2012: Shs 159,216 million). The Bank instituted excess liquidity mop-up monetary policy measures resulting in investments by banks of Shs 41,589 million (2012: Shs 35,673 million). The increase was further fostered by favorable exchange rates compared to the previous year. Total equity of the Central Bank increased by 4.2 percent, largely in transfers to the general reserve fund.

DIBAJI

Kiwango cha ukuaji wa uchumi wa kimataifa kilishuka hadi asilimia 3.1 mwaka 2012 kutoka kwa asilimia 3.9 mwaka 2011. Hali hii ilichangiwa pakubwa na viwango vya chini vya ukuaji wa uchumi katika baadhi ya nchi zinazochipuza na kudorora kwa uchumi huko bara ulaya.

Humu nchini, pato la Taifa (GDP)liliongezeka kwa asilimia 4.6 mwaka 2012 na kufikia shilingi trilioni 1.61 ikilinganishwa na ukuaji wa asilimia 4.4. mwaka 2011. Ukuaji huo wa mwaka 2012 ulitokana na hali nzuri ya anga ambayo ilipiga jeki sekta ya kilimo. Sekta kuu zilizochangia ukuaji wa uchumi mwaka 2012 zinajumuisha sekta ya kilimo na misitu (ambayo ilichangia asilimia 20.9), sekta ya uchukuzi na mawasiliano (ilichangia asilimia 12.3), sekta ya biashara (ilichangia asilimia 11) huku sekta ya uzalishaji bidhaa (ikichangia asilimia 9.5.). Katika robo ya kwanza ya mwaka 2013 jumla ya pato la taifa ilikua kwa asilimia 5.2 ikilinganishwa na asilimia 4.0 katika robo sawa na hiyo mwaka 2012. Na huku sekta ya kilimo ikichangia pakubwa kwa matokeo ya robo ya kwanza ya mwaka 2013, sekta ya uzalishaji bidhaa, hoteli na mikahawa pamoja na sekta za kifedha ziliathirika pakubwa na wasiwasi wa kiuchumi uliotokana na siasa kabla ya uchaguzi mkuu mwezi Machi mwaka huu.

Sera za kifedha zililenga kuafikia na kudumisha kiwango cha chini cha mfumuko wa bei. Kwa ujumla kiwango cha mfumko wa bei za bidhaa kilipungua kutoka asilimia 10.1 mwezi juni mwaka 2012 na kufikia asilimia 4.9 mwezi juni mwaka huu. Kupungua kwa mfumko wa bei za bidhaa kulitokana na kushuka kwa bei ya mafuta na vyakula pamoja na kuimarika kwa bei ya ubadilishanaji wa sarafu za kigeni na sera maalum ya kusimamia fedha katika mwaka uliokamilika mwezi juni mwaka 2013. Mikakati yote iliyolenga mfumko wa bei za bidhaa iliambatana na malengo ya serikali (ambayo yalikuwa kuongeza au kupunguza mfumko kwa alama 250 kutoka kwa asilimia 5.) Benki kuu ilianza kulegeza sera ya usimamizi wa fedha tangu mwezi julai mwaka 2012 kufuatia kupungua kwa misukumo inayoathiri mfumko wa bei za bidhaa. Hili haswa lilitokana na kuimarishwa kwa sera za kifedha katika kipindi cha kati ya mwezi Januari na mwezi Juni mwaka 2012 pamoja na udhabiti katika ubadilishanaji wa sarafu za kigeni ili kuiwezeshasekta ya kibinafsi kuchangia kufufua uchumi. Kwa ujumla usambazaji wa fedha nchini, M3 na hifadhi ya fedhailiandikisha kushuka kwa kiwango kidogo ikilinganishwa na ukuaji uliokuwa umetarajiwa.

Kiwango cha riba cha Benki Kuu ya Kenya (CBR) kiliendelea kuashiria mwelekeo wa sera za kifedha. Katika mwanzo wa mwaka wa kifedha wa 2012/2013/ kamati inayosimamia sera za kifedha(MPC) ilianza kulegeza sera za fedha kwa kupunguza kiwango cha CBR mwezi Julai mwaka 2012 kwa alama 150 kutoka kwa asilimia 18 hadi asilimia 16.5.Kiwango cha cha riba cha Benki Kuu ya Kenya (CBR) kilipunguzwa zaidi kwa alama 350 na kufikia asilimia 13.0 mwezi Septemba mwaka 2012. Mwezi Novemba mwaka jana kiwango hicho pia kilipunguzwa kwa alama 200 na kufikia asilimia 11.0 kabla ya kupunguzwa zaidi kwa alama 150 mwezi Januari mwaka 2013 na kufikia asilimia 9.50. Aidha mwezi Mei mwaka huu kiwango cha CBR kilipunguzwa zaidi kwa alama 150 na hivyo kufikia asilimia 8.5.

Kuambatana na kulegezwa kwa sera za fedha, kiwango cha wastani cha riba kati ya mabenki kilishuka kutoka asilimia 17.09 mwezi Juni mwaka 2012 hadi asilimia 7.00 mwezi Juni mwaka 2013. Kiwango cha utoaji wa bill ya wizara ya fedha ya siku 91 kilipungua kutoka asilimia 10.09 mwezi Juni mwaka 2012 hadi asilimia 6.21 mwezi Juni mwaka 2013. Viwango vya ukopeshaji vilipungua kutoka asilimia 20.30 katika mwezi wa June 2012 hadi asilimia 16.97 katika mwezi wa Juni 2013. Kadhalika kiwango wastani cha kuweka fedha katika benki nchini kilishuka kutoka asilimia 7.88 mwezi Juni mwaka 2012 hadi asilimia 6.65 mwezi Juni mwaka 2013. Tofauti kati ya riba za mikopo na amana ilishuka kutoka kwa asilimia 12.41 mwezi Juni mwaka 2012 hadi asilimia 10.32 mwezi Juni mwaka 2013.

Shughuli ya Bajeti ya serikali katika mwaka wa kifedha wa 2012/2013 ilipelekea kuwepo kwa uhaba wa bajeti wa asilimia 6.8 katika jumla ya pato la taifa ikilinganishwa na asilimia 5.5 katika muda sawa na huo mwaka 2011/2012 kinyume na makadirio ya asilimia 8.9 katika muda huo unaoangaziwa. Kwa ujumla matumizi na mapato ya serikali yaliongezeka lakini kwa kasi ya chini kinyume na ilivyokadiriwa katika mwaka wa kifedha wa 2011/2012. Ukuaji wa kiwango cha chini wa uchumi na changamoto za kupasishwa kwa sheria ya kutoza bidhaa ushuru yaani VAT zilikuwa baadhi ya maswala yaliyoathiri ukusanyaji ushuru. Kuongezeka kwa matumizi ya serikali kumetokana na kutekelezwa kwa katiba mpya pamoja na mishahara na marupurupu ya juu kwa wafanyikazi wa umma. Madeni ya umma ya Kenya yaliongezeka kutoka asilimia 49.3 ya Pato la Taifa mwezi Juni mwaka 2012 hadi asilimia 51.7 mwezi Juni mwaka 2013. Ongezeko hili limetokana na ukopaji kufanikisha miundo msingi mbali na ukuaji wa chini kuliko ulivyotarajiwa.

Kiwango cha ubadilishanaji wa sarafu za kigeni dhidi ya shilingi ya Kenya kilisalia imara ikilinganishwa na sarafu zingine za ulimwengu katika mwaka wa kifedha wa 2012/2013. Dhidi ya dola ya Marekani, shilingi ya Kenya ilidorora na kubadilishwa kwa kiwango wastan cha shilingi 85.5 mwezi Juni mwaka 2013 ikilinganishwa na shilingi 84.8 mwezi Juni mwaka 2012. Udhabiti wa ubadilishanaji wa sarafu za kigeni ulitokana na usimamizi bora wa uyeyushaji wa fedha katika soko la benki nchini, kusalia imara kwa ubadilishanaji wa sarufu za kigeni haswa kupitia kwa fedha zinazotumwa nchini na wakenya walioko kwenye mataifa ya kigeni pamoja na kuongezeka kwa imani ya wawekezaji kutokana na uchaguzi wa amani mwezi Machi mwaka 2013.

Kwa ujumla masalio ya malipo ya ziada ya Kenya yalishuka hadi dola milioni 597 za marekani katika mwaka wa kifedha wa 2012/2013 kutoka dola milioni 841 za marekani mwaka wa kifedha wa 2011/2012. Kupungua huko kulishiria kiasi kamili cha fedha za ziada kilichotumiwa kuangazia nakisi (upungufu) kwenye akaunti ya sasa. Nakisi ya fedha kwenye akaunti iliongezeka kutoka dola milioni 3,881 za marekani (au asilimia 9.54 ya mapato ya taifa) katika mwaka wa kifedha wa 2011/12 hadi dola milioni 4,621 (inayokadiriwa kuwa asilimia 11.35 ya mapato ya mataifa) katika mwaka wa kifedha wa 2012/13. Katika mwaka husika, Benki Kuu ya Kenya iliongeza akiba ya fedha zake za kigeni kwa asilimia 15.3, hadi dola milioni 6,089 za marekani (sawa na miezi 4.4 za uagizaji) mwezi Juni mwaka 2013, kutoka dola milioni 5,283 za marekani (ikiwa ni miezi 4.3 ya uagizaji) mwezi Juni mwaka 2012. Jumla ya umiliki wa hazina ya fedha za kigeni katika kipindi hicho ulijumuisha zile zilizotolewa na shirika la kimataifa la fedha IMF, kupitia mpango wake maalum wa kutoa mikopo na zile zilizonunuliwa kutoka soko la ubadilishanaji wa fedha za kigeni hapa nchini.

Sekta ya benki iliandikisha matokeo bora katika mwaka wa kifedha wa 2012/2013 ikiwa na kiwango cha juu cha mali cha asilimia 15 mwezi Juni mwaka 2013 ikilinganishwa na mwezi Juni mwaka 2012. Kwa ujumla kwenye hesabu ya fedha, mikopo na advansi, dhamana za serikali na uuzaji dhamana ilichukua sehemu kubwa, ikichangia asilimia 55.7, asilimia 22.4 na asilimia 6.2 ya mali yake. Mikopo ambayo huenda isilipiwe iliongezeka kwa asilimia 34.4 hadi shilingi bilioni 77.3 mwezi Juni mwaka 2013 hivyo kuongeza uwiano kati yake na mikopo ya jumla kutoka asilimia 4.5 hadi asilimia 5.3. Hata hivyo, aina hiyo ya mikopo ilipungua katika sekta za viwanda, utalii na hoteli.

Shughuli za Benki Kuu kufikia mwaka wa kifedha Juni 2013 zilichochea faida ya mapato ya shilingi milioni 3,652 ikilinganishwa na nakisi (upungufu) ya shilingi milioni 18, 356 mwaka wa kifedha Juni 2012. Ongezeko hili limehusishwa na shilingi milioni 5,623 faida kutoka ubadilishanaji wa fedha za kigeni ambayo inafidia nakisi ya shilingi milioni 1,916 iliyotokana na matumizi ya fedha kwa ajili ya kugharamia mahitaji ya wafanyikazi kufuatia kuanzishwa kwa mpango wa kufaidi baada ya kustaafu na pia kuekeza katika sarafu ya kisasa kuambatana na katiba mpya.

Wakati huo huo hesabu ya Benki Kuu iliendelea kuongezeka huku jumla ya mali ikiongezea hadi shilingi milioni 590,389 kutokana na mazingira bora katika ubadilishanaji wa sarafu za kigeni ikilinganishwa na mwaka jana ambapo kwa ujumla mali ya Benki Kuu ilikuwa shilingi milioni 537,489. Kwa upande mwingine madeni yaliongezeka kwa asilimia 17.2 na kufikia shilingi milioni 537,470 kutokana na uwezo wa juu wa kubadilishwa kwayo kuwa fedha ilivyodhihirika kutokana na uwekaji wa pesa kwa kiwango kikubwa kutoka kwa mabenki na serikali kwa shilingi milioni 191,671 (mwaka wa 2012 kiwango hiki kilikuwa milioni 160,642) na usambazaji sarufi ulikuwa shilingi milioni 183,047 (mwaka wa 2012 ilikuwa milioni 159,673). Ongezeko hili lilitokana na usawa katika ubadilishanaji wa sarafu za kigeni ikilinganishwa na mwaka jana. Kwa sasa jumla ya mali ya Benki Kuu iliongekeza kwa asilimia 4.2.

THE CENTRAL BANK OF KENYA ACHIEVEMENTS AND CHALLENGES DURING THE YEAR TO JUNE 2013

The Central Bank's principal mandates includes: price stability; financial system stability and solvency; and an effective and efficient payments system. In terms of its relation with the Government, the Central Bank is the banker, domestic debt manager while it supports the growth objective of the Government. The Central Bank supports and contributes to, the Government's development agenda by raising domestic financing requirements for the Government budget and nurturing innovations to enhance financial inclusion and deepening of the financial market and providing an enabling macroeconomic environment for private sector access to bank credit and investment. The performance of the Central Bank in all these areas is enumerated below.

Achievements

- **Prudent Monetary Policy Stance.** In the period under review, the Central Bank's monetary policy was consistent with the price stability function. Following the easing of inflation from a high of 19.7 percent in November 2011 to 10.05 percent in June 2012 partly on account of tightening monetary policy, the Central Bank reverted to monetary policy easing complemented by prudent management of interbank liquidity. To signal the policy regime shift during the year to June 2013, the Central Bank gradually reduced its policy rate (the Central Bank Rate-CBR) from 18 percent in June 2012 to 8.5 percent in May 2013.

  Reflecting a combination of prudent monetary policy, favorable weather which supported food production, declining international prices of crude oil and exchange rate stability, **overall twelve month inflation declined to 4.56 percent in June 2013**, while the non-food non fuel inflation (that reflect demand pressure) decelerated from 9.31 percent in June 2012 to 3.86 percent in June 2013. Inflation was thus within Government's medium term target of 5 percent (with an allowance to fluctuate by 2.5 percentage points on either side of the target).

  In tandem with the downward trend of the CBR which signals the monetary policy direction and stance, **the interbank rate declined from 17.09 percent in June 2012 to 7.14 percent in June 2013**. Consistent with the direction of the CBR, both commercial banks' lending interest rates and interest rates for Government securities also declined signaling lower cost for accessing credit by the private sector and Government. While credit to the private sector increased by less than projected during the year to June 2013, the uptake accelerated from a 12 month low of 8.5 percent growth in February 2013 to 12.7 percent in June 2013. The Central Bank therefore **continued providing the required policy space for recovery of private sector borrowing.**

  The **Shilling exchange rate stabilized with respect to the US Dollar.** It recorded a marginal depreciation from Ksh 84.8 in June 2012 to Ksh 85.5 in June 2013. The implicit stability reflected a combination of effective management of interbank liquidity, public confidence in the peaceful conduct of the general elections on 4th March 2013, and foreign exchange inflows through diaspora remittances, balance of payments support by the International Monetary Fund (IMF) under the Extended Credit Facility (ECF) programme support negotiated in January 2011, purchases of equity by foreigners at the Nairobi Securities Exchange, and macroeconomic stability.

- **Monetary Policy Implementation**. Liquidity management as guided by the CBR coordinated short term interest rates consistent with the monetary policy stance. This in effect resulted in less volatility of the interbank rate and other short term interest rates.

- **The Monetary Programme Performance.** The Central Bank achieved the targets for the monetary programme set under the ECF, a programme the Government had developed in line with its medium term economic programme and through which it requested the IMF for balance of payments support. This performance continued to complement achievement of fiscal targets by the National Treasury, thereby facilitating timely drawing of balance of payment support under the ECF.

- **Official Reserves accumulation.** The Central Bank increased its stock of foreign exchange reserves from US$5,282million (equivalent to 4.26 months of import cover) in June 2012 to US$6,089 million (equivalent to 4.35 months). The reserves remained above the statutory minimum 4 months. The accumulation reflects a combination of sources including good economic performance, balance of payments support from the IMF and purchases from the interbank market.

- **Financial Sector Development and Financial Inclusion.**

  The Central Bank continued to play a proactive role in financial sector development through:

  - Encouraging different products that are cost effective, serve different market segments and lower barriers of entry and thus increases market access
  - Strengthening regulatory capacity and capabilities to provide adequate oversight
  - Supporting development of traditional and alternative financial infrastructures
  - Developing partnership with key market players
  - Promoting competition and diversity.

  To deliver the above listed measure, the Central Bank pushed and encouraged the market to adopt innovative delivery channels beyond the traditional brick and mortar models including mobile phone financial services (MFS), deposit taking microfinance institutions (MFIs), technology led agency banking model and Islamic financial services (including Sharia compliant Islamic banking)

  The use of agency banking model by banks continued to enhance financial access. The Central Bank licensed three banks during the year, raising the total number of banks using the agency banking model to 13 by June 2013. As a result the number of agents increased by 7,582 or 62.8 percent to 19,649 agents. Since the launch of the agency banking model in 2010, the contracted agents have facilitated over 58.6 million transactions worth Ksh 310.5 billion.

Deposit taking microfinance institutions increased by 6 during the year to June 2013 bringing the total number of institutions to 9. The number of accounts increased to 1.9 million from 1.6 million in June 2012. The DTM recorded impressive growth in deposits and loans (at 60.2 percent and 25.7 percent, respectively). The Central Bank also licensed 2 foreign banks (Central Bank of India and Bank of Kigali) to open representative offices in Kenya, raising the number of banks with representative office to seven.

Towards promoting financial stability, in November 2012 the Central Bank issued revised Prudential and Risk Management Guidelines applicable to commercial banks and other institutions licensed pursuant to the Banking Act. These replaced the Prudential Guidelines issued in 2006 and Risk Management Guidelines issued in 2005. The review of the guidelines was informed by the need to up-date the banking sector regulatory framework in light of significant changes in the local, regional and global banking sector operating environment.

The Central Bank continued in 2012 to streamline its consolidated supervision efforts in the light of the continued cross border expansion by Kenyan banks as well as continued convergence of financial service providers in Kenya. Of significant note was the holding of an inaugural Supervisory College in October 2012 for a Kenyan regional banking group. The College convened by CBK brought together representatives from the Central Banks of Kenya, Tanzania, Rwanda, Burundi, Uganda and South Sudan to co-ordinate the supervision of the regional banking group that has operations in the six countries.

Furthermore, the Central Bank was involved in initiatives by the Financial Stability Board (FSB) aimed at improving global frameworks for a stable global financial system. This was through the FSB Regional Consultative Group (RCG) for Sub Saharan African. The Central Bank was the inaugural Co-Chair of the Regional Consultative Group with the Reserve Bank of South Africa. It hosted the third meeting of the FSB RCG for Sub-Saharan Africa in Nairobi in February 2013. The meeting discussed the FSB's work plan and policy priorities, major financial regulatory reforms and global macro-economic trends and their potential impact on financial stability in Sub-Saharan Africa. The meeting was attended by representatives from the FSB Secretariat, Angola, Botswana, Ghana, Kenya, Mauritius, Namibia, Nigeria, South Africa, Tanzania and Senegal.

The Central Bank continued to play a key role within the Alliance for Financial Inclusion (AFI) in 2012. AFI is a global network of financial policymakers from developing and emerging countries working together to increase access to appropriate financial services for the poor. The Central Bank served as the inaugural Chair of the Network's Steering Committee from September 2009 to September 2012. The Central Bank of the Republic of the Philipines took over as Chair in September 2012. During the Central Bank tenure as AFI Chair, its' membership grew from 35 members in 2009 to over 90 members in 2012. In February 2013, the Central Bank was elected as the inaugural Chair of the African Mobile Financial Services Policy Initiative AMPI). AMPI is a framework through which African Alliance for Financial Inclusion

(AFI) members will seek to determine effective solutions to advancing mobile financial services across the African continent.

The Central Bank commenced operationalization of the National Payment System Act 2011 by drafting and sharing the National Payment System Regulations with stakeholders and the public for comments. These regulations aim to entrench prudent conduct of businesses among payment service providers.

The milestones arising out of these successes for the banking sector comprise the following:

- Deposit accounts have increased by 26.8 percent, from 14.9 million accounts in June 2002 to 18.9 million accounts in June 2013
- Loans and advances accounts have increased by 80.9 percent, from 2.1 million accounts in June 2012 to 3.8 million accounts in June 2013
- Bank branches domestically increased by 8.9 percent , from 1,197 branches in June 2012 to 1,303 branches in June 2013
- Kenyan bank branches outside the country increased by 26.4 percent, from 223 branches in June 2012 to 282 branches in June 2013.

The above results show that Kenyan banks have continued to grow during the year to June 2013.

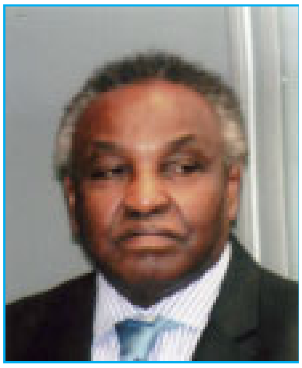
Challenges

- **Managing inflationary expectations**. Supply side shocks loom high; driven by food prices (reacting to drought that may hit the economy) and energy prices. These usually drive inflationary expectations.

- **The Current Account Deficit** continued to grow and the foreign direct investments estimates do not show whether they are significant in financing the balance of payments deficit.

- **Short term Capital Flows** at times drive the exchange rate and relative prices beyond the capability of monetary policy and therefore could pose a challenge to macroeconomic stability.

BOARD OF DIRECTORS



DR. MBUI WAGACHA
Ag. Chairman

PROF. NJUGUNA NDUNG'U (CBS)
Governor
Central Bank of Kenya

MR. JOSEPH M. KINYUA (CBS)
Permanent Secretary, Ministry of Finance

MS. VIVIENNE A.Y. APOPO
Member

MS. FLORENCE K. MUINDI
Member

DR. WILLIAM OTIENDE OGARA
Member

MR. JOHN G. MSAFARI
Member

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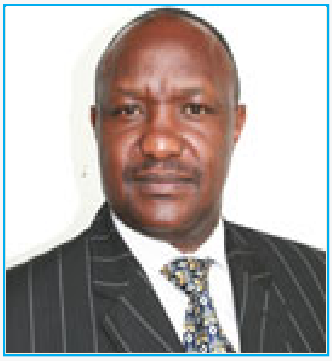


MR. WILLIAM NYAGAKA
Director, Internal Audit

MR. JAMES T. LOPOYETUM
Director, Currency Operations and Branch Administration

MEMBERS OF THE MONETARY POLICY COMMITTEE

Prof. Njuguna Ndung'u (CBS)
Governor, Chairman

Dr. Haron Sirima (OGW)
Deputy Governor, Vice-Chairman

Mr. Joseph K. Kinyua (CBS)
PS, Treasury
Treasury Representative

Mrs. Sheila S.M.R. M'Mbijjewe
Member

Mr. Charles Koori
Member

Prof. Francis Mwega
Member

Prof. Terry C. I. Ryan
Member

Mrs. Farida Abdul
Member

Mr. John Birech
Member

1. WORLD ECONOMY

The global economy continues to expand at a slow pace. Global growth is expected to remain at 3.1 percent, the same level as in 2012. This is driven largely by weaker domestic demand and reflects slower growth in several key emerging market economies as well as a more protracted recession in the Euro area. In 2014, global recovery is expected to improve to 3.8 percent, with persistent diversity in growth prospects across regions.

Across the advanced economies, growth is expected to remain constant at 1.2 percent in 2013, and improve to 2.1 percent in 2014. Europe is expected to remain in recession with growth declining to 0.6 percent in 2013 (same as in 2012) but expected to improve to 0.9 percent in 2014. U.S. growth is expected to slow down to 1.7 percent in 2013 from 2.2 percent in 2012 but recover to 2.7 percent in 2014.

Growth in the emerging and developing economies is projected to increase in 2013 to 5.0 percent from 4.9 percent in 2012 and accelerate to 5.4 percent in 2014. The stagnation in 2013 is backed by new risks of slowing credit and possibly tighter financial conditions if the anticipated unwinding of monetary policy stimulus in the United States leads to sustained capital flow reversals (Table 1.1).

TABLE 1.1: ACTUAL, AND PROJECTED OUTPUT GROWTH OF SELECTED COUNTRIES/REGIONS 2011 - 2014

Country/Region	2011	2012	2013	2014
World	3.9	3.1	3.1	3.8
Advanced economies	1.7	1.2	1.2	2.1
USA	1.8	2.2	1.7	2.7
Euro area	1.5	-0.6	-0.6	0.9
UK	1.0	0.3	0.9	1.5
Emerging and developing economies	6.2	4.9	5.0	5.4
Developing Asia	7.8	6.5	6.9	7.0
China	9.3	7.8	7.8	7.7
India	6.3	3.2	5.6	6.3
Latin America and the Caribbean	4.6	3.3	3.3	3.4
Brazil	2.7	0.9	2.5	3.2
Sub-Saharan Africa	5.4	4.9	5.1	5.9
Middle East and North Africa	4.0	4.5	3.0	3.7
South Africa	3.5	2.5	2.0	2.9

Source: IMF, Update World Economic Outlook Database (2013)

The sub-Saharan Africa (SSA) economies are projected to grow at a faster pace than other emerging and developing economies supported by robust domestic demand in both the resource rich and low income countries. The SSA output growth is estimated at 5.1 per cent in 2013 and 5.9 per cent in 2014, up from 4.9 per cent in 2012. However, growth in the Middle East and North Africa is expected to decline to 3.0 percent in 2013 from 4.5 percent in 2012 largely due to political instability in the region.

Capital Flows

Net capital flows to developing countries declined by 8.6 percent to US$ 1,107 billion in 2011 compared to US$ 1,211 billion in 2010. The decline was driven primarily by the substantial drop in portfolio equity flows, which recorded a net outflow of US$ 2.2 billion in 2011 compared to net inflows of US$ 120 billion in 2010. In addition, net debt flows from official creditors also contributed to the decline in net capital flows by registering US$ 46.8 billion decline. In contrast Foreign Direct Investment (FDI) to developing countries continued with its upward trend, rising by 10.6 percent or (US$ 62 billion) to a record high level of US$ 644.4 billion in 2011.

TABLE 1.2: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES BY CATEGORY (US$ Billion)

	2007	2008	2009	2010	2011
Net Capital Flows	**1180.2**	**812.6**	**701.7**	**1211.1**	**1106.8**
of Which					
1. Net Equity Inflows	692.3	583.3	542.1	702.9	642.2
Net FDI inflows	559.4	636.9	427.9	582.7	644.4
Net portfolio Equity Inflo	132.9	-53.6	114.2	120.2	-2.2
2. Net Debt Flows	487.9	229.3	159.7	508.3	464.6
Official Creditors	1.6	30.4	81.0	73.2	30.0
Private Creditors	486.3	198.8	78.7	435.1	434.6

Source: International Debt Tables (2013)

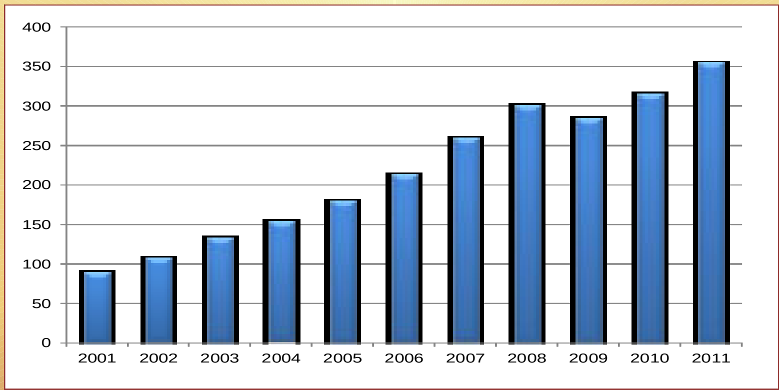
Among the developing countries, the 10 largest recipients of foreign direct investment absorbed over 70 percent of net foreign direct investment in developing countries in 2011. In sub Saharan Africa, foreign direct investment inflows increased by 55 percent to US$ 41 billion in 2011. The increase was attributed to the relatively positive outlook for the region and continued rise in commodity prices. The inflows were mainly invested in oil and mineral extraction industries and the services sector (banking, retail and telecommunications). Net inflows of foreign direct investment to countries in Latin America and the

Caribbean also reached record levels in 2011, increasing by 26 percent to US$ 158 billion, and driven by expanding consumer markets, higher growth rates and natural resource endowments. Foreign direct investment inflows to South Asia rose by 18 percent to US$ 36 billion. The increase was mainly driven by mergers and acquisition in the extractive industries in India. However, the East Asia and the Pacific region which account for the largest share of net inflows of FDI to developing countries saw a slight decline of 5 percent in the foreign direct inflows. This was largely due to a 10 percent drop in inflows to China. The drop was mainly in the manufacturing sector, which was under pressure due to rising wage and production costs. Foreign direct investment inflows to Middle East and North Africa also declined by 3.1 percent, attributed to political instabilities in the region.

Remittances to Developing Countries

Remittance flows proved to be resilient during the global financial crisis and had become an important source of foreign exchange earning in most of the developing countries. The inflows to developing countries continued on an upward trend, increasing by 12.5 percent in 2011 to US$ 355 billion from US$ 316 billion in 2010.

CHART 1A: WORKERS REMITTANCES TO DEVELOPING COUNTRIES (US$ billion)



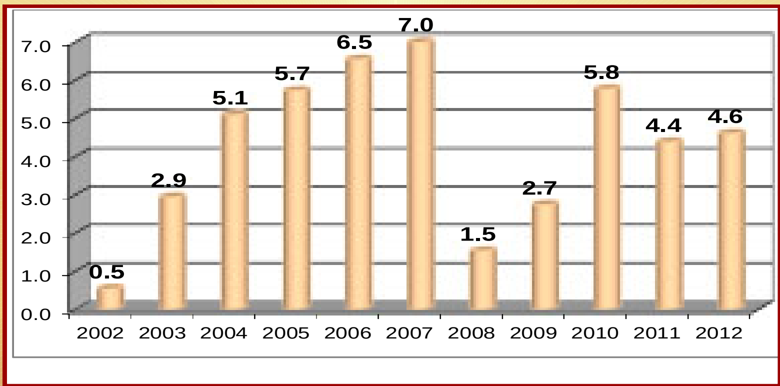
Source: International Debt Tables, 2013

The economy grew by 4.6 percent in 2012 compared with increases of 4.4 percent in 2011 and 5.8 percent in 2010 (Chart 2A). In value terms real output amounted to Ksh 1.61 trillion compared to Ksh 1.54 trillion in 2011. Of the total output produced in 2012, Agriculture and Forestry contributed 20.9 percent while Transport and Communication, Wholesale and Retail Trade and Manufacturing contributed 12.3 percent, 11 percent and 9.5 percent, respectively. In the first quarter of 2013, the economy is estimated to have expanded by 5.2 percent compared to 4.0 percent in the first quarter of 2012. The improved weather conditions experienced in the first quarter of 2013 boosted the performance in the agricultural sector.

2. REAL SECTOR

Total production, in 2012 grew by 4.6 percent and amounted to Ksh 1.61 trillion compared to 4.4 percent growth in 2011 (Table 2.1 and Chart 2A). The resilience of economic performance is attributed to improved weather conditions, which supported the agricultural sector in the second half of 2012. Real output at constant prices amounted to Ksh 1.61 trillion compared to Ksh 1.54 trillion in 2011. Of the total volume produced in 2012, Agriculture and Forestry contributed 20.9 percent while Transport and Communication, Wholesale and Retail Trade and Manufacturing contributed 12.3 percent, 11 percent and 9.5 percent, respectively. In the first quarter of 2013, the economy performed well, registering real growth of 5.2 percent compared to 4.0 percent in a similar quarter in 2012. The performance in the first quarter of 2013 was largely driven by the agricultural sector with significant growth in tea and horticultural output. However, performance of the Manufacturing, Hotels and Restaurants and Financial Intermediation sectors were suppressed by politically induced anxiety with respect to the economy prior to the March 2013 elections.

CHART 2A: REAL GDP GROWTH RATES, 2002 - 2012 (%)



Sources: Economic Survey

TABLE 2.1: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES

MAIN SECTORS	Share in 2012 Nominal GDP (%)	Share in 2012 Real GDP (%)	2006	2007	2008	2009	2010	2011	2012*
Agriculture and Forestry	***25.94***	***20.86***	312,926	320,423	307,354	299,431	318,586	323,415	335,785
Fishing	***0.47***	***0.38***	6,249	6,181	5,363	5,564	5,713	5,891	6,093
Mining and Quarrying	***0.69***	***0.47***	5,554	6,272	6,453	6,163	6,763	7,244	7,545
Manufacturing	***9.21***	***9.49***	122,953	130,673	135,291	137,060	143,263	148,198	152,735
Electricity and Water Supply	***1.37***	***2.22***	27,288	29,769	31,341	30,397	33,292	32,430	35,773
Construction	***4.12***	***3.50***	37,649	40,405	43,735	49,270	51,492	53,728	56,314
Wholesale and Retail Trade, Repairs	***10.18***	***10.99***	118,361	131,754	138,044	143,460	154,942	166,186	176,874
Hotels and Restaurants	***1.64***	***1.32***	17,894	20,814	13,298	18,993	19,796	20,775	21,322
Transport and Communication	***9.33***	***12.31***	136,306	156,845	161,615	171,994	182,181	190,654	198,234
Financial Intermediation	***5.16***	***4.31***	47,170	50,306	51,659	55,375	60,379	65,095	69,349
Real estate, Renting and Business Services	***4.25***	***5.19***	68,446	70,860	73,503	75,674	78,089	80,888	83,583
Public Administration and Defence	***5.41***	***3.08***	45,974	45,031	45,317	46,031	47,085	48,271	49,584
Education	***5.48***	***5.91***	73,188	76,257	80,771	82,952	86,651	90,836	95,102
Health and Social Work	***2.38***	***2.11***	28,075	28,983	30,035	31,352	31,786	32,892	34,008
Other Community, Social and Personal Services	***3.16***	***3.59***	47,814	49,420	50,829	52,156	53,507	55,952	57,753
Private Households with Employed Persons	***0.44***	***0.29***	4,091	4,173	4,256	4,342	4,428	4,517	4,607
less: Financial Services Indirectly Measured	***(0.81)***	***(0.73)***	(11,835)	(12,174)	(10,484)	(11,945)	(11,260)	(11,843)	(11,729)
All Industries at Basic Prices	***88.42***	***85.27***	1,088,103	1,155,991	1,168,382	1,198,270	1,266,694	1,315,126	1,372,932
Taxes less Subsidies on Products	***11.58***	***14.73***	161,367	180,855	188,882	196,117	208,607	224,785	237,153
Real GDP at market prices	***100.00***	***100.00***	1,249,470	1,336,846	1,357,263	1,394,387	1,475,302	1,539,912	1,610,084
GDP Deflator (2001 =100)			130	137	155	170	173	198	214

Growth Rates (Percent)

	Share in 2012 Nominal GDP (%)	Share in Real GDP in 2012 (%)	2006	2007	2008	2009	2010	2011	2012*
Agriculture and Forestry	25.94	20.86	4.4	2.4	-4.1	-2.6	6.4	1.5	3.8
Fishing	0.47	0.38	8.7	-1.1	-13.2	3.7	2.7	3.1	3.4
Mining and Quarrying	0.69	0.47	4.1	12.9	2.9	-4.5	9.7	7.1	4.2
Manufacturing	9.21	9.49	6.3	6.3	3.5	1.3	4.5	3.4	3.1
Electricity and Water Supply	1.37	2.22	-2.2	9.1	5.3	-3.0	9.5	(2.6)	10.3
Construction	4.12	3.50	6.2	7.3	8.2	12.7	4.5	4.3	4.8
Wholesale and Retail Trade, Repairs	10.18	10.99	11.7	11.3	4.8	3.9	8.0	7.3	6.4
Hotels and Restaurants	1.64	1.32	14.9	16.3	-36.1	42.8	4.2	4.9	2.6
Transport and Communication	9.33	12.31	11.5	15.1	3.0	6.4	5.9	4.7	4.0
Financial Intermediation	5.16	4.31	7.5	6.6	2.7	7.2	9.0	7.8	6.5
Real estate, Renting and Business Services	4.25	5.19	3.9	3.5	3.7	3.0	3.2	3.6	3.3
Public Administration and Defence	5.41	3.08	-1.0	-2.1	0.6	1.6	2.3	2.5	2.7
Education	5.48	5.91	0.4	4.2	5.9	2.7	4.5	4.8	4.7
Health and Social Work	2.38	2.11	3.0	3.2	3.6	4.4	1.4	3.5	3.4
Other Community, Social and Personal Services	3.16	3.59	4.2	3.4	2.9	2.6	2.6	4.6	3.2
Private Households with Employed Persons	0.44	0.29	2.0	2.0	2.0	2.0	2.0	2.0	2.0
less: Financial Services Indirectly Measured	-0.81	-0.73	5.1	2.9	-13.9	13.9	-5.7	5.2	(1.0)
All Industries at Basic Prices	88.42	85.27	5.8	6.2	1.1	2.6	5.7	3.8	4.4
Taxes less Subsidies on Products	11.58	14.73	12.0	12.1	4.4	3.8	6.4	7.8	5.5
Real GDP at market prices	100.00	100.00	6.5	7.0	1.5	2.7	5.8	4.4	4.6

* Provisional

Sources: Economic Survey 2010

AGRICULTURE

Real output growth for agriculture and forestry increased by 3.8 percent in 2012 from 1.5 percent growth in 2011. The recovery is attributed to favourable weather conditions in the second half of 2012. The performance continued improving through the first quarter of 2013 recording 8.3 percent growth in output compared to a growth of 2.1 percent in the first quarter of 2012. The sector's contribution to real GDP stabilized at 20.9 percent in 2012, compared to 21 percent in 2011.

TABLE 2.2: OUTPUT GROWTH IN KEY CROPS

	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13
Tea						
Production (Tonnes)	328,213	327,712	377,927	364,456	357,625	437,009
Annual Growth, %	*-12.5%*	*-0.2%*	*15.3%*	*-3.6%*	*-1.9%*	*22.2%*
Coffee						
Sales (Tonnes)	39,842	53,701	34,651	30,574	44,035	43,530
Annual Growth, %	*-21.7%*	*34.8%*	*-35.5%*	*-11.8%*	*44.0%*	*-1.1%*
Horticulture						
Exports (Tonnes)	283,780	244,717	248,664	258,388	234,764	285,592
Annual Growth, %	*29.7%*	*-13.8%*	*1.6%*	*3.9%*	*-9.1%*	*21.7%*
Sugar Cane						
Deliveries (Tonnes)	3,796,562	5,392,907	5,429,438	6,039,241	5,376,060	5,334,700
Annual Growth, %	*-23.4%*	*42.0%*	*0.7%*	*11.2%*	*-11.0%*	*-0.8%*
Milk						
Intake (Million Litres)	397	391	495	504	506	548
Annual Growth, %	*-1.2%*	*-1.6%*	*26.6%*	*1.8%*	*0.5%*	*8.2%*

Source: Kenya National Bureau of Statistics

Available high frequency indicators in the July-June 2012/13 period show mixed trends. Production of tea improved by 22.2 percent in July-June 2012/13 compared with a decline of 1.9 percent in the period July-June 2011/12. The amount of raw milk delivered for processing increased by 8.6 percent compared to 0.5 percent growth, while growth in exports of fresh horticultural products recovered to 21.7 percent from a 9.1 percent decline over the same period of 2011/12 (Table 2.2).

MANUFACTURING

The growth in the manufacturing sector production stabilized slightly above 3 percent growth in 2012 compared to 2011, and accounted for 9.5 percent of the overall GDP in 2012. The sector grew by 4.3 percent in the first quarter of 2013 compared with 1.4 percent in the first quarter of 2012 (Table 2.3). Available data indicate the sector's performance largely improved in July-June 2012/13 relative to July-June 2011/12. Growth in the production of processed sugar and soft drinks accelerated, while production of galvanised sheets, cement and assembly of motor vehicles decelerated (Table 2.3).

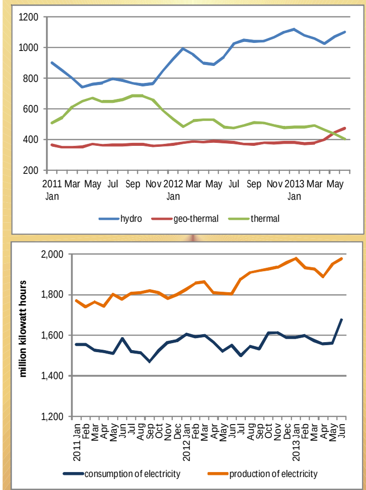
TABLE 2.3: PRODUCTION OF SELECTED MANUFACTURED GOODS

	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13
Processed Sugar						
Production (Tonnes)	530,129	536,893	507,217	572,800	459,276	471,348
Annual Growth, %	*11.6%*	*1.3%*	*-5.5%*	*12.9%*	*-19.8%*	*2.6%*
Soft Drinks						
Production ('000 Litres)	319,850	368,957	363,501	368,134	366,370	393,333
Annual Growth, %	*11.8%*	*15.4%*	*-1.5%*	*1.3%*	*-0.5%*	*7.4%*
Galvanised Sheets						
Production (Tonnes)	191,939	183,769	196,193	237,370	254,680	260,493
Annual Growth, %	*7.1%*	*-4.3%*	*6.8%*	*21.0%*	*7.3%*	*2.3%*
Cement						
Production (Tonnes)	2,633,494	3,123,473	3,485,639	4,120,493	4,582,710	4,703,225
Annual Growth, %	*11.1%*	*18.6%*	*11.6%*	*18.2%*	*11.2%*	*2.6%*
Assembled Vehicles						
Production (Units)	6,535	5,249	5,286	5,600	6,445	5,946
Annual Growth, %	*9.9%*	*-19.7%*	*0.7%*	*5.9%*	*15.1%*	*-7.7%*

Source: Kenya National Bureau of Statistics

ENERGY SECTOR DEVELOPMENTS

CHART 2B: PERCENTAGE SHARE OF ELECTRICITY SOURCES



Source: Kenya Power & Lighting Co.

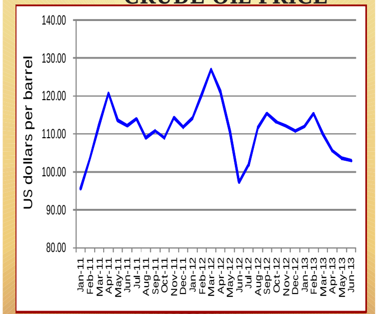
Total production of electricity increased more rapidly at 6.8 percent growth in July-June 2012/13 from 4.0 percent in July-June 2011/12 (Table 2.4). The recovery is attributed to improved weather conditions which supported hydro-electricity generation (Chart 2B). Production of hydro-electricity increased by 22.6 percent to 4,298 million kilowatt hours in the July-June 2012/13 while production of geo-thermal electricity increased by 6.3 percent to 1,599 million kilowatt hours in July-June 2012/13 (Chart 2B). Thermal electricity production however declined by 17.4 percent to 1,882 million kilowatt hours in July-June 2012/13 from 2,277 million kilowatt hours in July-June 2011/12. Electricity consumption improved marginally to 2.9 percent growth from 2.3 percent increase in the previous year.

TABLE 2.4: PERFORMANCE OF ENERGY SUB-SECTORS

	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13
Electricity Generation						
Output (Million KWH)	6,067	5,544	5,557	7,006	7,287	7,779
Annual Growth, %	*-0.5%*	*-8.6%*	*0.2%*	*26.1%*	*4.0%*	*6.8%*
Of which:						
Hydro-power Generation (Million KWH)	3,488	2,849	2,155	3,427	3,505	4,298
Annual Growth, %	*5.7%*	*-18.3%*	*-24.4%*	*59.0%*	*2.3%*	*22.6%*
Geo-Thermal Generation (Million KWH)	1,021	1,179	1,524	1,454	1,504	1,599
Annual Growth, %	*0.6%*	*15.5%*	*29.3%*	*-4.6%*	*3.5%*	*6.3%*
Thermal (Million KWH)	1,558	1,516	1,877	2,125	2,277	1,882
Annual Growth, %	*-12.6%*	*-2.7%*	*23.8%*	*13.2%*	*7.2%*	*-17.4%*
Consumption of Electricity (Million KWH)	5,243	5,328	5,602	6,056	6,192	6,371
Annual Growth, %	*5.6%*	*1.6%*	*5.1%*	*8.1%*	*2.3%*	*2.9%*

Sources: Kenya National Bureau of Statistics

CHART 2C: SAUDI ARABIAN CRUDE OIL PRICE



Source: Ministry of Energy

International crude oil prices remained high through the first three quarters of fiscal year 2012/13 (Chart 2C). The price of Murban crude oil imported to Kenya increased from US$ 97.35 per barrel in June 2011 to US$ 115.4 per barrel in February 2012 but declined to US$ 103.0 per barrel in June 2013.

BUILDING AND CONSTRUCTION

Cement consumption, a key indicator of building and construction performance, improved in July-June 2012/13 compared with the previous year. Consumption of cement increased from 3,858,402 metric tonnes in July-June 2011/12 to 4,007,226 metric tonnes in July-June 2012/13. The value of building plans approved by Nairobi City Council also increased significantly from Kshs 191,801 million in July-June 2011/12 to Kshs 211,037 million in July-June 2012/13.

TRANSPORT AND COMMUNICATION

Performance in the transport sector deteriorated in July-June 2012/13 compared with the performance recorded in July-June 2011/12 (Table 2.5). The number of passengers (both incoming and outgoing) recorded at the Jomo Kenyatta International Airport, Nairobi declined by 2.7 percent (compared with an increase of 22.5 percent in the previous year). The volume of fuel put through the Kenya Pipeline recorded an increase of 11.5 percent (compared with 9.3 percent growth in the previous year).

TABLE 2.5: PERFORMANCE OF TRANSPORT SUB-SECTORS

Activity	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13
Passengers through JKIA						
Total passenger flows	2,866,801	2,866,915	2,681,851	3,585,897	4,416,420	4,330,048
Number of incoming passengers	1,415,364	1,424,993	1,335,443	1,811,770	2,219,345	2,156,283
Growth %	-6.23%	0.68%	-6.28%	35.67%	22.50%	-2.84%
Number of outgoing passengers	1,451,437	1,441,922	1,346,408	1,774,127	2,197,075	2,173,765
Growth %	-3.32%	-0.66%	-6.62%	31.77%	23.84%	-1.06%
Throughput by Kenya Pipeline						
Output ('000 litres Equivalent)	3,873,855	4,058,727	4,317,439	4,149,757	4,536,099	5,055,838
Output Growth %	*-2.25%*	*4.77%*	*6.30%*	*-3.88%*	*9.31%*	*11.46%*

Sources: Kenya Airports Authority, Kenya Pipeline and Kenya National Bureau of Statistics

TOURISM

CHART 2D: TOURIST ARRIVALS

Source: Kenya Tourist Board

The number of tourists arriving in Kenya in July-June 2012/13 declined by 8.9 percent compared with 10.3 percent growth in the previous year. Arrivals at the Jomo Kenyatta International Airport (JKIA), Nairobi declined by 8.1 percent and arrivals through the Moi International Airport (MIAM) Mombasa declined by 13.0 percent (Table 2.6 and Chart 2D). The fall in tourist arrivals was reflected in reduced number of visitors from Europe (by 15.5 percent) in the July-June 2012/13 period compared with growth of 4.6 percent in the previous year. The decline in tourist arrivals is attributed to the uncertainty regarding the March 4, 2013 general elections coupled with recession in Europe.

TABLE 2.6: TOURIST ARRIVALS BY POINT OF ENTRY

	FY 2007/08	FY 2008/09	FY 2009/10	FY 2010/11	FY 2011/12	FY 2012/13
Cruise ships	3,531	15,518	287	586	270	-
Growth %	*-39.63%*	*339.48%*	*-91.87%*	*104.18%*	*-53.92%*	*0.00%*
JKIA	667,640	691,244	819,843	913,789	1,070,776	983,715
Growth %	*-8.70%*	*3.54%*	*22.80%*	*11.46%*	*17.18%*	*-8.13%*
MIAM	179,285	156,991	201,611	247,032	209,842	182,651
Growth %	*-34.54%*	*-12.43%*	*12.45%*	*22.53%*	*-15.05%*	*-12.96%*
Total	850,456	863,753	1,021,741	1,161,407	1,280,888	1,166,366
Growth %	*-19.40%*	*1.56%*	*20.14%*	*13.67%*	*10.29%*	*-8.94%*

FY - Fiscal year
Source: Kenya Tourist Board

USE OF AVAILABLE RESOURCES

Total resources available to the economy measured as gross national disposable income decreased from 107.6 percent of GDP in 2011 to 106.5 percent of GDP in 2012 (Table 2.7). The share of resources allocated to consumption increased to 94.6 percent of GDP in 2012 compared with 93.5 percent of GDP in 2011. The increase in total consumption reflected the increase in share of Government to 17.2 percent of GDP from 16.4 percent of GDP in 2011. The share of private consumption increased from 77.1 percent of GDP in 2011 to 77.3 percent of GDP in 2012. The share of gross domestic investment in GDP declined from 20.5 percent in 2011 to 20.1 percent in 2012. Gross national savings as a percent of GDP also declined from 14.1 in 2011 to 11.9 in 2012. The Savings-Investment gap therefore widened from 6.4 percent of GDP in 2011 to 8.2 percent of GDP in 2012.

In the external sector, the share of exports of goods and services in GDP declined from 28.5 percent in 2011 to 27.3 percent in 2012, while the share of imports of goods and services decreased from 45.1 percent to 44.5 percent in the period under review. The current account deficit as a percent of GDP therefore widened from 8.9 percent in 2011 to 10.7 percent in 2012.

TABLE 2.7: USE OF RESOURCES (KSH MILLION)

	2007	2008	2009	2010	2011	2012*
Gross national disposable income	1,966,957	2,265,727	2,541,383	2,726,429	3,280,827	3,663,409
Net current transfers (TR(F))	143,152	161,265	177,853	184,393	237,227	237,712
Gross national income	1,823,805	2,104,462	2,363,530	2,542,036	3,043,600	3,425,697
Net factor income payments (Y(f))	-9,706	-3,127	-3,454 -	11,697 -	5,267 -	14,418
Gross domestic product (at market prices)	1,833,511	2,107,589	2,366,984	2,553,733	3,048,867	3,440,115
Total Consumption (C)	1,711,521	1,930,913	2,233,429	2,422,622	2,850,415	3,252,953
Government consumption - C(g)	327,918	347,262	383,847	439,667	498,881	592,388
Private consumption - C(p)	1,383,603	1,583,651	1,849,582	1,982,955	2,351,534	2,660,565
Gross domestic investment (I)	348,850	405,477	471,476	504,523	625,483	691,052
Gross fixed capital formation	355,090	409,597	465,111	518,538	609,255	701,398
Increase/Decrease in stocks	-6,240	-4,120	6,365	-14,015	16,228	-10,346
Exports of goods and nfs (X)	490,987	581,806	571,305	709,209	870,168	939,116
Imports of goods and nfs (M)	-691,220	-879,821	-886,480	-1,021,873	-1,374,101	-1,530,664
Discrepancy	-26,627	69,214	-22,745	-60,474	76,901	87,658
GDP deflator (2001=100)	137.15	155.28	169.75	173.10	197.99	213.66
Real GDP	1,336,846	1,357,263	1,394,387	1,475,302	1,539,912	1,610,084
Real GDP growth (annual in %)	6.99%	1.53%	2.74%	5.80%	4.38%	4.56%
Gross National savings	255,436	334,814	307,954	303,807	430,412	410,456
Gross Domestic Savings	112,284	173,549	130,101	119,414	193,185	172,744
Total National Balance(S-I)	-93,414	-70,663	-163,522	-200,716	-195,071	-280,596
CAB (X-M+Y(f)+TR(f))	-66,787	-139,877	-140,776	-139,968	-271,973	-368,254
Discrepancy	-26,627	69,214	-22,746	-60,748	76,902	87,658
CAB + DISCREPANCY	-93,414	-70,663	-163,522	-200,716	-195,071	-280,596
Kenya - National Accounts in shares of GDP						
Gross national disposable income	107.28%	107.50%	107.37%	106.76%	107.61%	106.49%
Net current transfers (TR(F))	7.81%	7.65%	7.51%	7.22%	7.78%	6.91%
Gross national income	99.47%	99.85%	99.85%	99.54%	99.83%	99.58%
Net factor income payments (Y(f))	-0.53%	-0.15%	-0.15%	-0.46%	-0.17%	-0.42%
Gross domestic product (GDP)						
Gross Domestic Product (expend)						
Total Consumption (C)	93.35%	91.62%	94.36%	94.87%	93.49%	94.56%
Government consumption - C(g)	17.88%	16.48%	16.22%	17.22%	16.36%	17.22%
Private consumption - C(p)	75.46%	75.14%	78.14%	77.65%	77.13%	77.34%
Gross domestic investment (I)	19.03%	19.24%	19.92%	19.76%	20.52%	20.09%
Gross fixed capital formation	19.37%	19.43%	19.65%	20.31%	19.98%	20.39%
Increase/Decrease in stocks	-0.34%	-0.20%	0.27%	-0.55%	0.53%	-0.30%
Exports of goods and services (X)	26.78%	27.61%	24.14%	27.77%	28.54%	27.30%
Imports of Goods and services (M)	-37.70%	-41.75%	-37.45%	-40.01%	-45.07%	-44.49%
Gross National savings	13.93%	15.89%	13.01%	11.90%	14.12%	11.93%
Gross Domestic Savings	6.12%	8.23%	5.50%	4.68%	6.34%	5.02%
Total National Balance(S-I)	-5.1%	-3.4%	-6.9%	-7.9%	-6.4%	-8.2%
Trade Balance (TB=X-M)	-10.9%	-14.1%	-13.3%	-12.2%	-16.5%	-17.2%
CAB (X-M+Y(f)+TR(f))	-3.6%	-6.6%	-5.9%	-5.5%	-8.9%	-10.7%
CAB + DISCREPANCY	-5.1%	-3.4%	-6.9%	-7.9%	-6.4%	-8.2%

Source: Economic Survey, various issues, Kenya National Bureau of Statistics

3. INFLATION

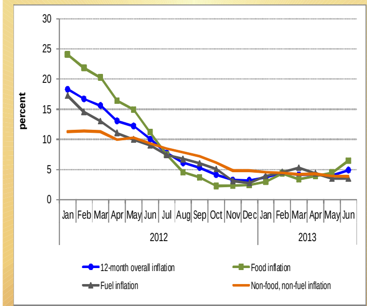
Inflation was brought under control in the twelve months to June 2013. The Kenya consumer price index (CPI) rose by 4.9 percent from 133.1 in June 2012 to 139.6 in June 2013 (Table 3.1). This represented a deceleration in inflation from 10 percent in June 2012 on account of favourable weather which boosted food supply and increased hydro-electricity power generation and decline in international price of crude oil which reduced cost of energy; prudent monetary policy and resilient inflows of foreign exchange, both of which supported stability of the Kenya shilling exchange rate, and the peaceful general elections in March 2013 which reinforced political stability thereby strengthening investor confidence also contributed to the slowdown in inflation. The decline in overall 12-month inflation in the year to June 2013 was reflected across all the categories of the CPI basket. Reflecting the deceleration in the 12 month overall inflation, the annual average inflation eased to 4.6 percent by June 2013 from 16.0 percent in June 2012. Both measures of inflation were contained within the allowable range of ±250 basis points from the 5 percent medium term target set by the National Treasury.

TABLE 3.1: CPI, 12-MONTH AND ANNUAL AVERAGE INFLATION (%)

	2012							2013					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Kenya CPI, Feb 2009=100	133.1	131.9	131.5	131.9	132.5	133.3	134.3	135.6	136.6	138.0	139.3	139.5	139.6
12-month overall inflation, percent	15.97	15.27	14.33	13.29	12.04	10.67	9.38	8.20	7.24	6.33	5.61	4.96	4.56
Annual average inflation, percent	10.05	7.74	6.09	5.32	4.14	3.25	3.20	3.67	4.45	4.11	4.14	4.05	4.91

Sources: Kenya National Bureau of Statistics and Central Bank of Kenya

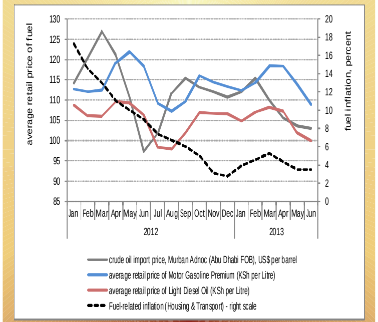
CHART 3A: FUEL INFLATION, NON-FOOD AND NON-FUEL INFLATION



Source:Kenya National Bureau of Statistics and Central Bank of Kenya

Fuel inflation declined to 3.5 percent in June 2013 compared with 9.0 percent in June 2012. The decline is reflected in 12-month change in the 'Transport' index which declined to 2.5 percent in June 2013 compared with 7.6 percent in June 2012, while the 12-month change in the 'Housing, Water, Electricity, Gas and other Fuels' index declined to 4.0 percent in June 2013 compared with 9.7 percent in June 2012. The decline in domestic fuel inflation reflected a decline in international oil prices. The international price of Murban crude oil declined from US$ 115.4/barrel in September 2012 to US$103.0/barrel in June 2013 as shown in Chart 3B. Consequently, the average domestic retail price of motor gasoline premium declined from Ksh 118.4 per litre in June 2012 to Ksh 108.9 per litre in June 2013, while the average domestic price of light diesel declined

CHART 3B:TRENDS IN FUEL PRICES AND FUEL RELATED INFLATION

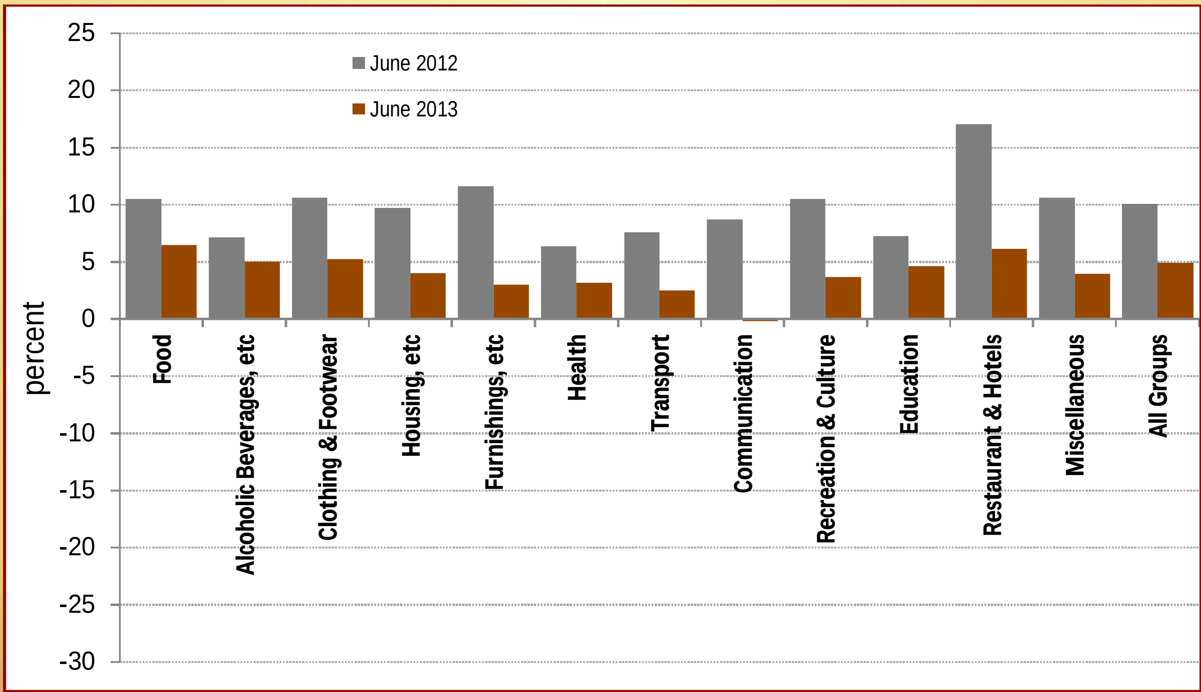


Source:Kenya National Bureau of Statistics

from Ksh 106.3 per litre in June 2012 to Ksh 100.0 per litre in June 2013.

Non-food, non-fuel inflation declined from 9.3 percent in June 2012 to 3.9 percent in June 2013 as shown in Chart 3A. This was reflected in the decline across all the other baskets of consumption goods. The 12-month inflation in 'Restaurants and Hotels', 'Clothing and Footwear', 'Alcoholic Beverages, Tobacco and Narcotics', 'Education', 'Miscellaneous Goods and Services', 'Recreation and Culture', 'Health', 'Furnishings, Household Equipment and Routine Household Maintenance' and 'Communication' consumption baskets declined from 17.0 percent, 10.6 percent, 7.2 percent, 7.3 percent, 10.6 percent, 10.5 percent; 6.4 percent; 11.6 percent and 8.7 percent, respectively, in June 2012 to 6.1 percent, 5.3 percent, 5.0 percent, 4.7 percent, 3.9 percent, 3.7 percent; 3.2 percent; 3.0 percent and -0.2 percent, respectively, in June 2013 (Chart 3C).

CHART 3C: 12-MONTH INFLATION RATES FOR GOODS AND SERVICES - JUNE 2013



Source: Kenya National Bureau of Statistics

In the period under review, inflation was higher in the urban centres outside of Nairobi (Table 3.2). Inflationary pressures within Nairobi were largely due to rising prices of education, transport and food, while inflation outside Nairobi was largely attributed to food prices.

The inflationary pressures experienced during the twelve months to June 2012 (due to supply side factors) eased in the comparable period in 2013. The average contribution of inflation in the 'Food and Non-Alcoholic Beverages' category to overall 12-month inflation declined from 50.5 percent to 29.0 percent over the period, while the average contribution of inflation in the 'Transport' category to overall inflation also declined from 10.5 percent to 6.4 percent during the period under review (Table 3.3).

TABLE 3.2: 12-MONTH INFLATION ACROSS INCOME GROUPS (NAIROBI) BY LOCATION JUNE 2013

	Nairobi			Total	Rest of
	lower income	middle income	upper income	Nairobi	Kenya
Food & Non-Alcoholic Beverages	5.5	6.5	3.4	5.6	7.1
Alcoholic Beverages, Tobacco & Narcotics	1.7	1.4	4.7	1.7	7.1
Clothing & Footwear	4.8	2.5	4.1	4.3	5.9
Housing, Water, Electricity, Gas & other Fuels	3.2	0.6	1.9	2.6	5.0
Furnishings, Household Equipment & Routine Household Maintenance	1.7	1.4	1.6	1.6	3.9
Health	5.0	5.2	1.7	4.9	2.1
Transport	8.6	-1.7	-1.1	5.8	0.0
Communication	-1.2	0.0	-1.2	-0.9	0.3
Recreation & Culture	2.3	3.7	4.6	2.8	4.3
Education	8.2	7.3	12.0	8.1	2.3
Restaurant & Hotels	5.0	4.8	0.2	4.8	7.1
Miscellaneous Goods & Services	3.9	3.9	3.2	3.9	4.0
All Groups	4.8	2.8	1.7	4.2	5.4

Source: Kenya National Bureau of Statistics & Central Bank of Kenya

TABLE 3.3: ESTIMATED CONTRIBUTIONS TO OVERALL 12-MONTH INFLATION, PERCENT

	FY 2011/12	FY 2012/13
Food & Non-Alcoholic Beverages	50.5	29.0
Transport	10.5	6.4
Housing, Water, Electricity, Gas & other Fuels	15.4	20.6
Restaurants & Hotels	5.5	8.9
Clothing & Footwear	4.8	10.2
Furnishings, Household Equipment & Routine Household Maintenance	4.5	7.3
Health	1.4	2.7
Miscellaneous Goods & Services	2.9	5.4
Recreation & Culture	1.5	2.7
Education	1.1	3.7
Alcoholic Beverages, Tobacco & Narcotics	1.7	2.4
Communication	0.3	0.7

Source: Kenya National Bureau of Statistics & Central Bank of Kenya

Inflation Outlook

Effects of improved supply side conditions are expected to carry over into the year to June 2014 and sustain low inflation. The continued stability in the Kenya shilling exchange rate will also help to sustain domestic inflation at low levels although there could be some short term pressures due to increased volatility in international oil prices as well as the upward revision of Value Added Tax on consumer items. Overall the Central Bank will pursue prudent monetary policy in the management of domestic inflation.

4. MONEY AND CREDIT DEVELOPMENTS

Monetary Policy in Fiscal Year 2012/13

The Central Bank monetary policy focused on achieving and maintaining stability in the general level of prices in the economy. In this regard, monetary policy aimed to achieve the inflation target of 5 percent set by the National Treasury for the fiscal year 2012/13. The real GDP growth was projected at 5.3 percent in the fiscal year 2012/13. Accordingly, the Central Bank set out the optimal path for both reserve money and money supply expansion consistent with the Government inflation target and the expected economic growth. Money supply, M3, and reserve money were targeted to grow by 15.8 percent and 9.8 percent, respectively (Table 4.1).

TABLE 4.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2012/13 MONETARY PROGRAMME

	Jun'12	Sep'12	Dec'12	Mar'13	Jun'13
Broad money supply (M3) (Ksh billion)	1,595.0	1,667.8	1,739.8	1,786.5	1,846.1
Reserve money (Ksh billion)	259.3	252.0	288.6	280.5	282.6
NFA of CBK (Ksh billion)	340.5	343.9	354.4	328.4	338.1
Memo:					
Annual change in reserve money	17.6	6.7	13.2	8.8	9.8
Annual change in broad money (M3)	15.5	12.4	14.9	17.8	15.8
Real GDP growth	4.8		5.1		5.3
GDP Deflator	13.4		11.6		9.1

Source: Central Bank of Kenya

The Central Bank applied its Central Bank Rate (CBR) to signal the monetary policy stance. The movement in the CBR guides money market participants on the direction of short term interest rates. The Central Bank operationalises the monetary policy stance through open market operations, the Central Bank Standing Facility (Central Bank Overnight Discount Window) and the sales and purchases of foreign exchange. The CBR remained the reference rate for pricing monetary policy operations during the fiscal year 2012/13. Whenever the Central Bank injected liquidity in the market through acquiring repo securities from banks, the CBR was the lowest acceptable rate. Similarly, whenever the Bank wished to withdraw liquidity through sale of Repo securities to banks, the CBR was the highest rate that it paid on any bid accepted. Those banks accessing liquidity at the Central Bank's Overnight Window were charged the CBR plus a penalty, set at 600 basis points.

During the fiscal year 2012/13, the Bank's Monetary Policy Committee adopted a gradual easing of monetary policy following the decline in inflation and stability of the exchange rate in the previous year. The frequency of MPC meetings was also reviewed from monthly to bi-monthly. In July 2012, the MPC reduced the CBR by 150 basis points from 18 percent to 16.5 percent and further by 350 basis points to 13.0 percent in September 2012. Given that the monetary policy measures continued to deliver the desired results, this provided policy space to encourage the private sector to fulfill its growth augmenting role. Consequently, the MPC reduced the CBR again by 200 basis points to 11.0 percent in November, 2012 and by a further 150 basis points to 9.50 percent in January, 2013. The MPC retained the CBR at 9.50 percent in March, 2013 in order to allow the implications of its previous decisions to work through the economy. The reduction in the CBR during the period contributed to a non-inflationary growth in credit to the private sector from 7.1 percent in October 2012 to 11.5 percent in February 2013.

In May 2013, the MPC reduced the CBR further by 150 basis points to 8.5 percent to consolidate gains from monetary policy measures implemented and to provide policy space for private sector to support the programmed economic recovery. The MPC noted that the monetary policy measures adopted continued to support low and stable inflation as well as exchange rate stability. Both measures of inflation were largely within the Government medium-term target (± 250 basis points deviation from 5 percent). The month-on-month overall inflation decreased to 4.91 percent in June 2013 from 10.05 percent in June 2012, and the non-food non-fuel inflation to 3.86 percent from 9.31 percent over the same period. The improvement was reflected across most categories of the CPI basket and was further attributed to adequate food supply supported by favourable weather and declining, though high prices of crude oil.

The Kenya Shilling exchange rate was largely stable against major world currencies following increased short term capital inflows and remittances, reduced inflationary expectations, disbursements under the IMF Extended Credit Facility (ECF) programme support and Central Bank interventions in the foreign exchange market. The Shilling however depreciated marginally against the US dollar in June 2013 to trade at an average of Ksh 85.49 per US dollar compared to an average of Ksh 84.79 per US dollar in June 2012. The depreciation of the shilling was associated with the strengthening of the US dollar in

the international markets, payment of dividends abroad towards end June 2013 and slowdown in inflows from tea exports.
The MPC also underscored that persistent strain in the Euro Zone, the balance of payments pressures attributed to the high current account deficit estimated at 11.4 percent of GDP in the year to June 2013, and volatile world oil prices remained a threat to the macroeconomic outlook. However, the latest growth projections for Kenya's main trading partners in the region remain strong, endorsing a stable outlook for the exchange rate with expectations for increased foreign exchange inflows from the region. The expected normal weather will continue to support a low and stable short term outlook for food inflation. A large share of manufactured goods and infrastructure related goods in the current account deficit somewhat fizzles down its negative impact given that the capacity so created provides space for enhanced economic growth through the private sector in the medium term.

The monetary programme implemented by the Bank was consistent with targets outlined in the Extended Credit Facility (ECF) where the Net International Reserves (NIR) and Net Domestic Assets (NDA) were the quantitative performance measures. As at June 2013, following favourable performance of the Government's economic programme under the ECF Arrangement, the IMF Executive Board has successfully completed five reviews and approved total disbursements of SDR 416.6 million (about US$ 628.2 million). During the fifth review in April 2013, the IMF Executive Board appreciated the good progress made in the Government's structural reform efforts in the areas of public financial management and tax reform, and financial sector reforms. As shown in Table 4.2 the Central Bank observed all quarterly targets on net international reserves (NIR) and net domestic assets (NDA) through June 2013.

TABLE 4.2: PERFORMANCE UNDER THE EXTENDED CREDIT FACILITY (ECF) PROGRAMME

	NDA Ksh Billion)			NIR (US$ Million)		
	1. Target*	2. Actual (avg)	3. Deviation (=2-1)	4. Target *	5. Actual (avg)	6. Deviation (= 5-4)
Indicative Targets (ITs)						
Sep-12	-45.0	-98.0	-53.0	4,115.0	4,429.3	314.3
Mar-13	-40.0	-46.6	-6.6	4,150.0	4,238.5	88.5
Performance Criteria (PC) Targets						
Jun-12	-55.0	-84.6	-29.6	4,070.0	4,144.3	74.3
Dec-12	-50.0	-80.7	-30.7	4,460.0	4,529.7	69.7
Jun-13	-35.0	-114.3	-79.3	4,250.0	4,919.1	669.1

*The target is a ceiling for the NDA and floor for the NIR

Source: Central Bank of Kenya

The sixth and final review of the ECF programme is scheduled for September 2013. The successful conclusion of the review will lead to disbursement of SDR 71.921million (or USD 109.0 million) by October 15, 2013, resulting in a total disbursement of SDR 488.52 million (or USD 740.2 million) under the programme. The completion of the ECF supported Economic Programme demonstrates Kenya's commitment to sound economic policies. The economic and structural reforms undertaken during the programme period have laid a strong foundation for higher economic growth.

Monetary Policy Implementation

To implement monetary policy, the Bank relied on open market operations (OMO) mainly repurchase agreement securities (REPOs), term auction deposits (TAD)and foreign operations in the interbank to stabilize domestic liquidity and the interbank interest rate. To address the threat posed by excess liquidity in the market, the Bank enhanced mop up operations, especially in April 2013 through June 2013. Consequently, stock of repos and term auction deposits held by commercial banks rose from Ksh 11.7 billion on February 13, 2013 to Ksh 82.9 billion on June 7, 2013, and thereafter decreased to Ksh 42.2 billion by June 28, 2013. The excess liquidity was occasioned by net redemptions of government securities. In the period, the Bank cautiously purchased foreign exchange from the interbank market to build foreign exchange reserves and observed the statutory limit of reserve level equivalent to a minimum of 4 months import cover.

Money Supply

Growth in broad money supply, M3, decreased to 14.2 percent in the year to June 2013 from 15.5 percent in the year to June 2012, and was below the target of 15.8 percent growth for the year to June 2013. The slowdown in the growth of broad money supply was reflected in the Net Foreign Assets (NFA) and Net domestic Assets (NDA) of the banking system (Table 4.3 and 4.4).

TABLE 4.3: PERFORMANCE OF MONETARY AGGREGATES JUNE 2012 - JUNE 2013 (PERCENT)

	RM		M3		Private Sector Credit	
	Act.	Targ.	Act.	Targ.	Act.	Targ.
2012						
Jun	16.7	14.2	15.5	18.7	16.1	16.8
Jul	15.6	12.1	14.2	14.6	13.5	14.9
Aug	8.4	7.9	14.0	14.4	11.9	16.0
Sep	9.7	6.7	12.6	12.4	7.7	14.8
Oct	6.7	10.9	12.5	11.6	7.1	11.4
Nov	14.0	10.3	16.8	15.1	9.1	13.2
Dec	15.1	13.2	14.1	14.9	10.4	15.4
2013						
Jan	12.2	17.3	14.9	16.8	12.0	17.0
Feb	23.9	23.3	16.1	18.1	11.5	13.7
Mar	11.5	8.8	15.7	17.8	11.2	13.7
Apr	9.5	14.6	17.3	17.6	10.4	14.1
May	18.9	18.1	16.7	17.0	9.5	14.3
Jun	11.7	9.8	14.2	15.8	12.7	15.7

Source: Central Bank of Kenya

Annual growth of the NDA of the banking system decelerated to 14.7 percent in the year to June 2013 from 15.8 percent over a similar period in 2012 due to contraction in private sector credit growth. Growth in NFA of the banking system decreased to 12.3 percent in the twelve months to June 2013 from 14.1 percent in a corresponding period in 2012, reflecting increased deposits and loans from non-residents in the books of commercial banks. Meanwhile, NFA of the Central Bank increased by 21.7 percent from Ksh 330.5 billion in June 2012 to Ksh 402.2 billion in June 2013 due to foreign exchange reserve accumulation to meet the statutory requirement of 4.0 months of import (Table 4.4).

TABLE 4.4: MONEY SUPPLY AND ITS SOURCES (KSH BILLION)

	Jun 2011 Act	Jun 2012 Act	Jun 2013 Act	Absolute Change 2011/12	Absolute Change 2012/13	Annual % Change 2011/12	Annual % Change 2012/13
1.0 Liabilities							
Money Supply							
Money supply, M2 1/	1,183.9	1,339.1	1,547.6	155.2	208.6	13.1	15.6
Money supply, M3 2/	1,380.7	1,594.7	1,820.6	213.9	226.0	15.5	14.2
Overall Liquidity, L 3/	1,709.2	1,970.1	2,277.4	260.9	307.3	15.3	15.6
2.0 Assets (2.1+2.2) 4/	1,380.7	1,594.7	1,820.6	213.9	226.0	15.5	14.2
2.1 Net foreign assets 5 /	281.9	321.8	361.2	39.8	39.4	14.1	12.3
Central Bank	282.8	330.5	402.1	47.7	71.7	16.9	21.7
Banking Institutions	-0.8	-8.7	-40.9	-7.9	-32.2	944.0	369.9
2.2 Net domestic assets (2.21+2.22)	1,098.8	1,272.9	1,459.4	174.1	186.5	15.8	14.7
2.21 Domestic Credit (2.210+2.211)	1,344.2	1,552.4	1,783.0	208.1	230.6	15.5	14.9
2.210 Government (net)	277.8	297.9	379.5	20.1	81.6	7.2	27.4
2.211 Private sector and other public sector	1,066.4	1,254.4	1,403.4	188.0	149.0	17.6	11.9
2.22 Other assets net	-245.4	-279.5	-323.5	-34.1	-44.1	13.9	15.8
Memorandum Item:							
Reserve Money 6/	220.4	257.3	287.4	36.8	30.2	16.7	11.7

\1 *Broad money, M2, comprises M1 and call, 7-days, savings & time deposits as well as certificates of deposits held by the private sector & parastatals with NBFIs. M2 excludes deposits of both the central & local Government with NBFIs, and all cross deposits of both commercial banks and NBFIs.*

\2 *Broad money, M3, comprises M2 plus foreign currency deposits held by residents with banking institutions.*

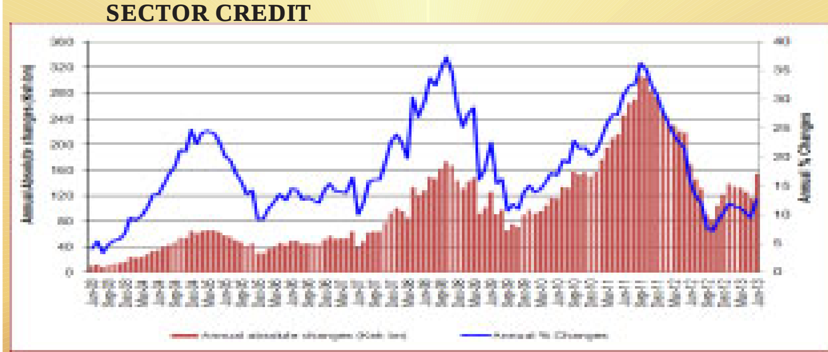
\3 *Overall liquidity L, comprises M3 plus non-bank holdings of government securities.*

Source: Central Bank of Kenya

Domestic Credit

Domestic credit grew by Ksh 230.6 billion (14.9 percent) in the year to June 2013 compared with an increase of Ksh 208.1 billion (15.5 percent) in a similar period in 2012. Net credit to Government increased by Ksh 81.6 billion (27.4 percent) in the year to June 2013 from Ksh 20.1 billion (7.2 percent) in the corresponding period in 2012. Credit extended to the private sector increased by Ksh 154.0 billion (12.7 percent) in the year to June 2013 compared with a growth of Ksh 168.6 billion (16.1 percent) in the year to June 2012 and the corresponding target of 15.7 percent for the year to June 2013 (Table 4.5 and Chart 4A). The slowdown in private sector credit growth partly reflects lagged-effects of monetary policy tightening and, more recently, uncertainty in the run up to general elections held in March 2013. The banking system lending was largely absorbed by the private sector which accounted for 76.7 percent of total lending in June 2013 compared with the net credit to the government which accounted for 21.3 percent.

CHART 4A: ANNUAL PERCENTAGE CHANGES IN PRIVATE SECTOR CREDIT



Source: Central Bank of Kenya

The expansion of private sector credit was largely attributed to private households and service activities. The major recipients of the additional credit in order of magnitude, included the following: private households - 28.7 percent (Ksh 44.2 billion); business services - 23.9 percent (Ksh 36.8 billion); real estate sector - 16.8 percent (Ksh 25.9 billion); trade - 13.8 percent (Ksh 21.2 billion); consumer durables - 6.6 percent (Ksh 10.2 billion); manufacturing - 5.7 percent (Ksh 8.7 billion); building and construction - 4.3 percent (Ksh 6.6 billion) and finance and insurance - 1.9 percent (Ksh 2.9 billion) (Table 4.5).

TABLE 4.5: CREDIT TO PRIVATE AND OTHER PUBLIC SECTORS (KSH BN)

	2012 June		2013 June		Annual Change		Share of private sector credit expansion (%)
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)	
1. Credit to other public sector	**41.2**	**3.3**	**36.2**	**2.6**	**-5.0**	**-12.1**	
Local government	1.3	0.1	-3.0	-0.2	-4.3	-320.0	
Parastatals	39.8	3.2	39.2	2.8	-0.7	-1.7	
2. Credit to private sector	**1213.2**	**96.7**	**1367.2**	**97.4**	**154.0**	**12.7**	**100.0**
Agriculture	54.3	4.3	55.3	3.9	1.0	1.9	0.7
Manufacturing	159.2	12.7	167.9	12.0	8.7	5.5	5.7
Trade	206.7	16.5	227.9	16.2	21.2	10.3	13.8
Building and construction	59.3	4.7	65.9	4.7	6.6	11.1	4.3
Transport & communications	83.3	6.6	77.2	5.5	-6.0	-7.2	-3.9
Finance & insurance	26.7	2.1	29.6	2.1	2.9	11.0	1.9
Real estate	150.7	12.0	176.6	12.6	25.9	17.2	16.8
Mining and quarrying	25.9	2.1	21.8	1.6	-4.2	-16.0	-2.7
Private households	163.3	13.0	207.4	14.8	44.2	27.1	28.7
Consumer durables	75.3	6.0	85.4	6.1	10.2	13.5	6.6
Business services	80.8	6.4	117.6	8.4	36.8	45.6	23.9
Other activities	127.9	10.2	134.5	9.6	6.6	5.2	4.3
3. TOTAL (1+2) *	**1254.4**	**100.0**	**1403.4**	**100.0**	**149.0**	**11.9**	

* Absolute and percentage changes may not necessarily add-up due to rounding

Source: Central Bank of Kenya

Reserve Money

Reserve money, which comprises currency in circulation and commercial bank deposits at the Central Bank, increased by Ksh 30.2 billion (11.7 percent) to Ksh 287.4 billion in June 2013 from Ksh 257.3 billion in June 2012. As shown in Table 4.6, the increase in reserve money reflected Ksh 21.0 billion (16.6 percent) growth in currency outside banks and Ksh 9.1 billion (7.0 percent) in bank reserves. At Ksh 287.4 billion in June 2013, reserve money was Ksh 4.85 billion above target.

The source of reserve money growth in the twelve months to June 2013 were increases in the net foreign assets (NFA) of the Central Bank. NFA of the Central Bank rose by Ksh 71.7 billion (21.7 percent) to Ksh 402.1 billion in the year to June 2013 reflecting build-up of official foreign exchange reserves.

The NDA of the Central Bank of Kenya declined by Ksh 41.5 billion (56.7 percent) to Ksh -114.7 billion in the year to June 2013, from Ksh -73.2 billion in the previous year. This was reflected in the reduction of net claims on commercial banks and Government on account of open market sales for liquidity management and build-up of government deposits, respectively. Commercial banks' stock of repo securities and term auction deposits increased from Ksh 35.4 billion in June 2012 to Ksh 41.7 billion in June 2013, while net government borrowing from the Central Bank decreased by Ksh 31.5 billion to a net deposit of Ksh 20.9 billion in June 2013 compared to Ksh 10.7 billion net borrowing in June 2012. Other domestic assets of the Central Bank decreased by Ksh 5.4 billion to Ksh -56.0 billion in June 2013 from Ksh -50.6 billion in June 2012 (Table 4.6).

TABLE 4.6: RESERVE MONEY AND ITS SOURCES (KSH BN)

	2011	2012	2013	Absolute Change		%age Change (%)		2013	
	June	June	June	2011/12	2012/13	2011/12	2012/13	June Target	Deviation
1. Net Foreign Assets	282.8	330.5	402.1	47.7	71.7	16.9	21.7	338.1	64.1
2. Net Domestic Assets	-62.3	-73.2	-114.7	-10.9	-41.5	17.5	56.7	-55.5	-59.2
2.1 Government Borrowing (net)	-7.1	10.7	-20.9	17.8	-31.5	-250.0	-295.9	1.5	-22.4
2.2 Advances & Discounts	19.9	-35.4	-41.7	-55.3	-6.3	-278.1	17.7	-3.3	-38.3
2.3 Other Domestic Assets (net)	-80.0	-50.6	-56.0	29.4	-5.4	-36.7	10.7	-53.7	-2.3
3. Reserve Money	220.4	257.3	287.4	36.8	30.2	16.7	11.7	282.6	4.9
3.1 Currency outside banks	119.0	126.9	148.0	8.0	21.0	6.7	16.6	147.3	0.6
3.2 Bank reserves	101.5	130.3	139.5	28.9	9.1	28.4	7.0	135.2	4.2

Source: Central Bank of Kenya

Outlook

Over the next twelve months to June 2014, the Bank will target 13.3 percent expansion in broad money supply, M3, and 10.2 percent increase in reserve money (Table 4.7). The liquidity supply in the Monetary Programme will support the projected economic growth of 6.0 percent by June 2014. Inflation as measured by the GDP deflator is projected to decline from 7.4 percent in June 2013 to 6.8 percent in June 2014 owing to reduced food and oil prices. In tandem, credit to private sector is projected at 14.1 percent in the year to June 2014 compared with 12.7 percent in a similar period in 2013, in line with the growth in nominal GDP. The Bank will continue to use open market operations to implement monetary policy.

TABLE 4.7: MONETARY PROGRAMME FOR 2013/14

	Jun-13	Jun-14
	Est	Proj.
Ksh Billion		
Reserve Money	287.4	311.3
Net Foreign assets	402.1	400.2
Money Supply (M3)	1,638.6	2,091.5
Annual Growth Rates		
Money Suppy (M3)	14.2	13.3
Reserve Money	11.7	10.2
Credit to Private Sector	12.7	14.1
Real GDP	5.2	6.0
GDP deflator	7.4	6.8
Months of import cover	4.5	4.0

Source: Central Bank of Kenya

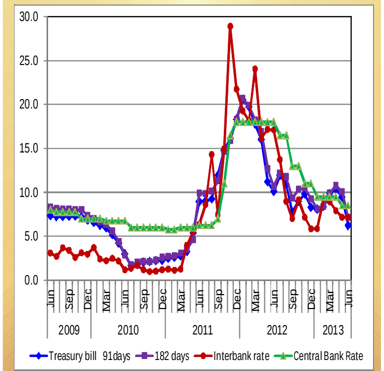
5. INTEREST RATES

Central Bank Rate (CBR)

During the FY 2012/13 the Monetary Policy Committee eased the monetary policy stance through gradual reduction in the Central Bank Rate (CBR) (from 18.0 percent in June 2012 to 8.5 percent in tandem with the easing of inflationary pressure in June 2012 and in order to realign interest rates in the economy and to provide policy space for private sector to support the programmed economic recovery. Chart 5A and 5B, and Table 5.1 show the movement in interest rates during the period.

Short-Term Rates

CHART 5A: SHORT TERM INTEREST RATES



Source: Central Bank of Kenya

The movements in the short-term interest rates generally tracked the CBR as expected (Table 5.1 and Chart 5A). With the easing of the CBR, the average interbank rate decreased from 17.09 percent in June 2012 to 7.14 percent in June 2013, while the repo rate decreased from 17.59 percent to 7.93 percent over the same period. The easing of the average interbank rate reflects improved market liquidity supported by net redemptions of Government securities.

The 91-day Treasury bill rate fell from 10.09 percent in June 2012 to 6.21 percent in June 2013, and the 182-day Treasury bill rate also dropped from 10.67 percent to 7.12 percent over the same period under review. A reduction in government securities offered for sale in the auctions during the quarter to June 2013 contributed to the fall in short term interest rates.

Lending Rates

Average commercial banks' lending rate declined from 20.30 percent in June 2012 to 16.97 percent in June 2013. The decrease in the overall lending rate was reflected in all loan categories (overdraft, 1-5 years and over 5 years loans) for the corporate, business and personal loans. The decrease was most pronounced in the lending rate for the 1-5 years loans category in the business loans, which decreased by 494.3 basis points from 22.97 percent in June 2012 to 18.03 percent in June 2013.

TABLE 5.1: INTEREST RATES (%)

	2012							2013					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91-day	10.09	11.95	10.93	7.77	8.98	9.80	8.30	8.08	8.38	9.88	10.38	9.46	6.21
Treasury bill 182-day	10.67	12.21	11.77	9.36	10.33	10.47	9.25	8.09	8.40	9.89	10.75	10.04	7.12
Average Lending Rate	20.30	20.15	20.13	19.73	19.04	18.74	18.15	18.13	17.84	17.73	17.87	17.45	16.97
Overdraft	20.36	19.96	20.31	19.80	19.13	19.01	17.79	17.97	17.68	17.54	17.71	17.60	16.92
Interbank rate	17.09	13.71	8.97	7.02	9.14	7.14	5.84	5.86	9.25	8.93	7.90	7.16	7.14
Average Deposit rate	7.88	8.25	7.85	7.40	6.86	6.69	6.80	6.51	6.29	6.54	6.39	6.53	6.65
3 - months deposits	12.12	12.58	12.12	10.55	9.58	9.34	9.19	8.78	8.38	8.58	8.58	8.96	8.77
Savings	1.46	1.66	1.58	1.55	1.60	1.75	1.60	1.65	1.61	1.42	1.45	1.53	1.73
Spread	12.41	11.90	12.28	12.33	12.18	12.05	11.34	11.62	11.55	11.19	11.48	10.91	10.32

Source: Central Bank of Kenya

Deposit Rates

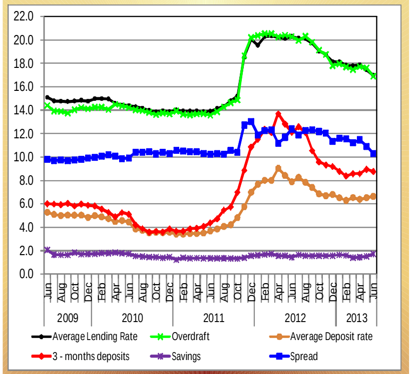
Average commercial banks' deposit rate dropped from 7.88 percent in June 2012 to 6.65 percent in June 2013. The fall in the overall deposit rate was reflected in the 0-3 months and 'over 3 months' deposits rates which decreased by 335 basis points and 62 basis points from 12.12 percent and 10.07 percent in June 2012 to 8.77 percent and 9.45 percent in June 2013, respectively. Over a similar period, the interest rate on demand deposits rose from 1.63 percent in June 2012 to 1.86 percent in June 2013, and the savings deposits rate also rose from 1.46 percent to 1.73 percent. The increase in the deposit rate was due to increased competition for deposits among commercial banks.

The decrease in the overall lending rate in the year to June 2013 was much higher than the fall in average deposits rate. Consequently, the interest rate spread narrowed from 12.41 percent in June 2012 to 10.32 in June 2013.

Interest Rates Outlook

In the medium term, interest rates are expected to remain relatively stable, consistent with expected stability in most of the macroeconomic fundamentals. The Central Bank will support interest rates stability by continued implementation of prudent monetary policy. However, in order to stimulate savings and investments, deposit rates must increase and lending rates must decline in line with return on investments and improvement in

CHART 5B: COMMERCIAL BANKS' AVERAGE INTEREST RATES



Source: Central Bank of Kenya

efficiency of the money market. Lower interest rate spreads will signal increasing efficiency in the financial market.

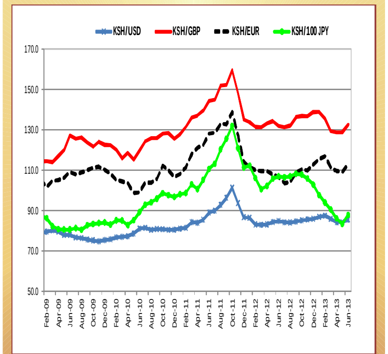
6. EXCHANGE RATES

The Kenya shilling exchange rate remained stable against the major world currencies but strengthened sharply against the Japanese Yen in the 2012/13 fiscal year (Chart 6A and Table 6.1). Exchange rate stability was supported by improved liquidity management in the interbank market, resilient foreign exchange inflows through Diaspora remittances, increased purchases of equity by foreigners at the Nairobi Securities Exchange (NSE) and improved macroeconomic stability that resulted in confidence in the economy.

Against major international currencies, the Kenya shilling exchange rate weakened marginally by 0.83 percent, 0.35 percent and 5.92 percent against the US Dollar, the Sterling Pound and the Euro, respectively to trade at an average of Ksh 85.5 per US Dollar, Ksh 132.4 per Sterling Pound and Ksh 112.8 per Euro in June 2013. The Shilling strengthened by 18 percent against the Japanese Yen to trade at an average of Ksh 87.8 per 100 Japanese Yen in 2013.

Against the regional currencies, the shilling depicted mixed performance, weakening against the major currencies in the East African Community Region and strengthening significantly against the South African Rand. The weakening of the South African Rand was mainly attributed to the Eurozone crisis combined with reduced foreign exchange inflows from exports of minerals due to prolonged labour unrests by miners (Table 6.1 and Chart 6A).

CHART 6A: KENYA SHILLING EXCHANGE RATES



Source: Central Bank of Kenya

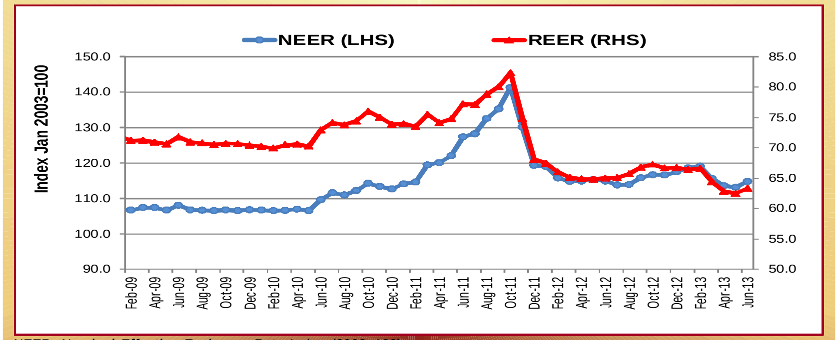
TABLE 6.1: KENYA SHILLING EXCHANGE RATES

	2010			2011			2012			2013		
	Jan	June	Dec	Jan	June	Dec	Jan	June	Dec	Jan	June	% change June 12-June 13
KSH/USD	75.8	81.0	80.6	81.0	89.0	86.7	86.3	84.8	86.0	86.3	85.5	0.83
KSH/GBP	122.5	119.6	125.7	127.7	144.4	135.1	133.9	132.0	139.0	133.9	132.4	0.35
KSH/EUR	108.3	99.0	106.5	108.2	128.1	114.1	111.4	106.5	113.6	111.4	112.8	5.92
KSH/100 JPY	83.1	89.2	96.8	98.1	110.6	111.3	112.2	106.9	99.9	112.2	87.8	-17.90
KSH/ZAR	10.2	10.6	11.8	11.7	13.1	10.6	10.8	10.1	10.1	10.8	8.5	-15.88
USH/KSH*	25.5	27.9	28.6	28.8	27.6	28.2	27.9	29.3	31.3	27.9	30.3	3.53
TZS/KSH*	17.7	18.0	18.2	18.4	17.8	18.7	18.4	18.7	18.4	18.4	19.1	2.40
RWF/KSH*				7.3	6.7	7.0	7.0	7.1	7.2	7.0	7.6	6.26
BRF/KSH*				15.1	13.8	15.1	15.2	16.5	17.9	15.2	18.2	10.50

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

CHART 6B: KENYA SHILLING REER AND NEER



NEER: Nominal Effective Exchange Rate Index (2003=100)
REER: Real Effective Exchange Rate Index (2003=100)

Source: Central Bank of Kenya

International Trade Competitiveness

The Nominal Effective Exchange Rate (NEER), appreciated by 0.10 percent to an indexed level of 114.81 in June 2013 compared to an index of 114.93 in June 2012. The stability of the NEER was largely supported by stability in the bilateral exchange rates during the period. The Real Effective Exchange Rate (REER), which measures Kenya's competitiveness compared with its main trading partners appreciated by 2.62 percent from 65.02 percent in June 2012 to 63.32 percent in June 2013. The marginal appreciation of the REER was mainly due to a higher domestic inflation relative to foreign inflation.

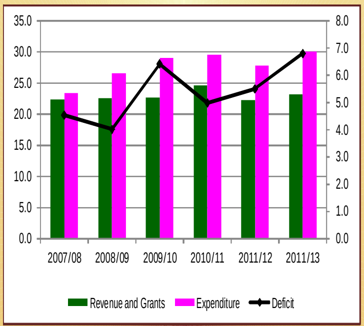
Outlook for the Kenya Shilling

The exchange rate is expected to remain stable in the remainder of the fiscal year 2013/14 in spite of the continued pressure from the current account of the balance of payments. The monetary policy measures in place project easing of imports of machinery and equipment while sustained rise in foreign exchange inflows through foreign direct investment and diaspora remittances are expected to support exchange rate stability in 2013. The World Bank forecasts Economic growth in Kenya to reach 6 percent in 2014. This growth is attributed to aggregate demand fuelled by strong consumption and investment growth. However, the main risks to the exchange rate remain the uncertainty over the full resolution of the euro-zone problems and balance of payments pressures attributed to the high current account deficit in addition to inflationary risk associated with monetary easing to stimulate growth.

7. GOVERNMENT BUDGETARY OPERATIONS

Government budgetary operations in the fiscal year 2012/13 resulted in a budget deficit of Ksh 249.6 billion or 6.8 percent of GDP on commitment basis, compared with Ksh 181.5 billion or 5.5 percent of GDP in a similar period in the fiscal year 2011/12. The deficit, however, remained within the revised target of Ksh 324.2 billion or 8.9 percent of GDP for the 2012/13 fiscal year (Table 7.1 and Chart 7A). Government revenue and expenditure increased more rapidly during fiscal year 2012/13 but remained within respective targets. The Government financed 73.8 percent of its budget deficit through domestic borrowing compared with 57.6 percent in the 2011/12 fiscal year.

CHART 7A: GOVERNMENT BUDGET PERFORMANCE



Sources: Central Bank of Kenya and National Treasury

TABLE 7.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS Ksh (Billion)

	June 2011		June 2012		June 2013	
	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT						
Securitised debt	**753.0**	**98.5**	**848.8**	**98.8**	**1040.8**	**99.1**
Treasury Bills	157.4	**20.6**	161.8	**18.8**	296.6	**28.2**
Of which Repo Treasury bills	30.8	**4.0**	29.8	**3.5**	28.9	**2.8**
Treasury Bonds	595.7	**77.9**	687.0	**80.0**	744.2	**70.8**
Government Stocks	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**
Non Securitised debt	**11.2**	**1.5**	**10.0**	**1.2**	**9.8**	**0.9**
Overdraft/Advances	9.8	**1.3**	7.3	**1.1**	7.0	**0.7**
others	1.4	**0.2**	2.8	**0.1**	2.8	**0.3**
TOTAL DOMESTIC DEBT	**764.2**	**100.0**	858.8	**100.0**	**1050.6**	**100.0**
(as a % of GDP)*	**27.7**		**26.1**		28.7	
(as a % of Total Debt)	51.2		52.9		55.5	
EXTERNAL DEBT**						
Bilateral	257.0	35.3	246.2	31.8	257.6	30.5
Multilateral	445.3	61.2	452.9	59.8	511.8	60.7
Comm. Banks	0.0	0.0	50.5	6.5	58.9	7.0
Export Credit	25.0	3.4	14.8	1.9	15.2	1.8
TOTAL EXTERNAL DEBT	**727.3**	**100.0**	764.5	**100.0**	**843.6**	**100.0**
(as a % of GDP)*	26.3		23.2		23.0	
(as a % of Total Debt)	48.8		47.1		44.5	
TOTAL PUBLIC DEBT	**1,491.5**		**1,623.4**		**1,894.1**	
(as a % of GDP)*	54.0		49.3		51.7	

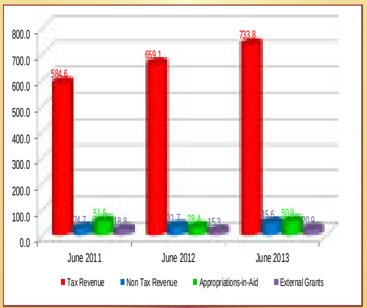
* Estimates
** Provisional

Sources: National Treasury and Central Bank of Kenya

Government Revenue

Government receipts (tax revenue and grants) amounted to Ksh 851.2 billion in the fiscal year 2012/13 compared with Ksh 734.4 billion in a similar period in the fiscal year 2011/12 (Chart 7B). This represented an overall increase of Ksh 116.8 billion (or 3.2 percent of GDP), which was largely attributed to ordinary tax revenue during the period. However, total government receipts underperformed in the main components of total revenue and grants. Tax revenue collections in the fiscal year 2012/13 was Ksh 733.8 billion, or 11.3 percent above Ksh 659.1 billion collected in a similar period of fiscal year 2011/12.

CHART 7B: COMPOSITION OF REVENUE



Sources: Central Bank of Kenya and National Treasury

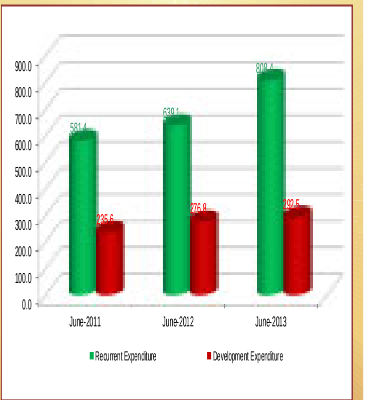
Except for the non-tax revenue, all the other revenue sources performed below their respective targets for the fiscal year. The shortfall was attributed to underperformance in the economy as a result of the events leading to the March 2013 general election and delays in the enactment of the VAT bill. As a share of GDP, total revenue and grants increased from 22.3 percent in fiscal year 2011/12 to 23.2 percent in fiscal year 2012/13.

Expenditure and Net Lending

Government expenditure and net lending increased by 20.2 percent, from Ksh 915.9 billion in the fiscal year 2011/12 to Ksh 1,100.8 billion in the fiscal year 2012/13. Recurrent expenditure increased by Ksh 169.3 billion (to Ksh 808.4 billion) and accounted for 91.5 percent of the increase in government expenditure and net lending, while development expenditure increased by Ksh 15.6 billion in fiscal year 2012/13 (Chart 7C).

Despite the increases during the year, recurrent and development expenditure remained below their respective programmed targets of Ksh 819.7 billion and Ksh 458.5 billion. Development expenditure was Ksh 166.0 billion or 36.2 percent below target, following slower absorption rates, especially with respect to the externally financed projects. The percentage of development expenditure in total expenditure, however, decreased from 30.2 percent in the fiscal year 2011/12 to 26.6 percent in the fiscal year 2012/13, while that of recurrent expenditure to total expenditure rose from 69.8 percent to 73.4 percent, during the same period. These trends reflect the increased costs associated with the implementation of the devolved government as well as higher salaries awarded to the civil servants.

CHART 7C: GOVERNMENT EXPENDITURE



Sources: Central Bank of Kenya and National Treasury

Financing

Budgetary operations of the Government resulted in a financing requirement of Ksh 255.5 billion in the fiscal year 2012/13 compared with Ksh 173.0 billion in the same period of the 2011/12 fiscal year. The funds were allocated to finance the budget deficit of Ksh 230.2 billion, retire domestic debt by Ksh11 billion and build up government deposits by Ksh 14.3 billion. The Government accessed Ksh 195.1 billion through additional domestic borrowing and Ksh 60.5 billion through net external borrowing (Table 7.2.)

TABLE 7.2: GOVERNMENT OVERALL BORROWING REQUIREMENTS AND ITS SOURCES, JULY-JUNE (KSH BN)

I. FINANCING REQUIREMENTS	2009/10	2010/11	2011/12	2012/13
1. Budget deficit	163.7	117.8	172.6	230.2
2. External debt reduction	-	-	-	-
3. Domestic debt reduction	-	10.8	-	11.0
3.1 Central Bank (incl. items in transit)	-	10.8	-	11.0
3.2 Commercial banks (net of deposits)	-	-	-	-
3.3 Non-bank sources	-	-	-	-
4. Increase in GoK deposits at CBK	-	5.2	0.4	14.3
5. Adjustment to cash basis		3.0	-	-
TOTAL	163.7	136.8	173.0	255.5
II. FINANCING SOURCES	**2009/10**	**2010/11**	**2011/12**	**2012/13**
1. Budget surplus	-	-	-	-
2. External debt increase	11.9	29.1	99.4	60.5
3. Increase in domestic debt	131.1	107.7	73.6	195.1
3.1 Central Bank	9.8	-	7.7	
3.2 Commercial banks	91.6	24.4	25.4	112.4
3.3 Non-bank sources	29.7	83.3	40.6	82.7
4. Reduction in GoK deposits at CBK	20.7	-	-	-
5. Privatisation proceeds (Net of Restructuring Co	-	-	-	-
TOTAL	163.7	136.8	173.0	255.5

Source: National Treasury and Central Bank of Kenya

8. PUBLIC DEBT

Kenya's public and publicly guaranteed debt increased by Ksh 270.7 billion to reach Ksh 1,894.1 billion at the end of the fiscal year 2012/13, from Ksh 1,623.4 billion recorded at the end of fiscal year 2011/12 (Table 8.1). The increase was largely in domestic debt, which grew by Ksh 191.8 billion (accounting for 70.8 percent share) following increased domestic borrowing, necessitated by lower than targeted revenue performance and increased demand for financing for the devolved Government. External debt grew by Ksh 79.1 billion, during the fiscal year 2012/13. Following these developments, the share of domestic debt in total debt increased from 52.9 percent to 55.5 percent, while that of external debt declined from 47.1 percent to 44.5 percent, during the year under review. Similarly, as a percentage of GDP, domestic debt stock increased from 26.1 percent in June 2012 to 28.7 percent at the end of June, 2013. The overall public debt share in GDP increased from 49.3 percent in June 2012 to 51.7 percent in June 2013, driven by increased domestic debt to finance the budget deficit resulting from increased expenditure associated with the implementation of the new constitution and increased salaries for the civil servants amid a slowdown in economic performance.

TABLE 8.1: PUBLIC DEBT (KSH BN)

	June 2011		June 2012		June 2013	
	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT						
Securitised debt	**753.0**	**98.5**	**848.8**	**98.8**	**1040.8**	**99.1**
Treasury Bills	157.4	**20.6**	161.8	**18.8**	296.6	**28.2**
Of which Repo Treasury bills	30.8	**4.0**	29.8	**3.5**	28.9	**2.8**
Treasury Bonds	595.7	**77.9**	687.0	**80.0**	744.2	**70.8**
Government Stocks	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**
Non Securitised debt	**11.2**	**1.5**	**10.0**	**1.2**	**9.8**	**0.9**
Overdraft/Advances	9.8	**1.3**	7.3	**1.1**	7.0	**0.7**
others	1.4	**0.2**	2.8	**0.1**	2.8	**0.3**
TOTAL DOMESTIC DEBT	**764.2**	**100.0**	858.8	**100.0**	**1050.6**	**100.0**
(as a % of GDP	**27.7**		**26.1**		28.7	
(as a % of Total Debt	51.2		52.9		55.5	
EXTERNAL DEBT**						
Bilateral	257.0	35.3	246.2	31.8	257.6	30.5
Multilateral	445.3	61.2	452.9	59.8	511.8	60.7
Comm. Banks	0.0	0.0	50.5	6.5	58.9	7.0
Export Credit	25.0	3.4	14.8	1.9	15.2	1.8
TOTAL EXTERNAL DEBT	**727.3**	**100.0**	764.5	**100.0**	**843.6**	**100.0**
(as a % of GDP	26.3		23.2		23.0	
(as a % of Total Debt	48.8		47.1		44.5	
TOTAL PUBLIC DEBT	**1,491.5**		**1,623.4**		**1,894.1**	
(as a % of GDP)	54.0		49.3		51.7	

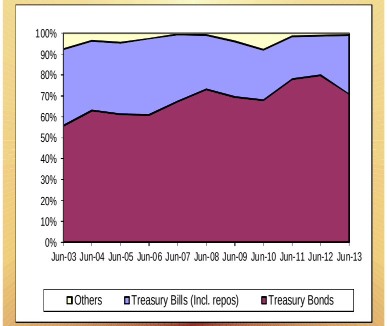
** Provisional

Sources: Central Bank of Kenya and National Treasury

Public Domestic Debt

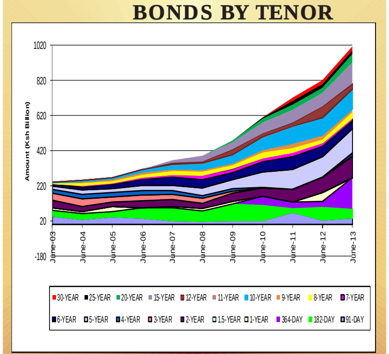
Total domestic debt increased by 191.8 billion during the fiscal year 2012/13 from Ksh 858.8 billion in June 2012 to Ksh 1,050.6 billion in June 2013, largely as a result of increased securitized debt. Total Government securities (including repos), held at the end of June 2013 amounted to Ksh 1,040.8 billion compared with Ksh 848.8 billion held at the end of June 2012.

CHART 8A:COMPOSITION OF GOVERNMENT DOMESTIC DEBT



Sources: Central Bank of Kenya and National Treasury

CHART 8B: OUTSTANDING TREASURY BILLS & BONDS BY TENOR



Sources: Central Bank of Kenya

Treasury bonds alone accounted for 71.5 percent of the outstanding securitized domestic debt. Meanwhile, holdings of Treasury bills excluding repos and Treasury bonds increased by Ksh 135.7 billion and Ksh 57.2 billion, respectively, during the fiscal year 2012/13. Consequently, the proportion of domestic debt held in Treasury bonds declined from 80.0 percent in June 2012 to 70.8 percent in June 2013 following increased Treasury bill issues during the second half of the fiscal year (Chart 8A).

Following this development the average maturity of domestic debt (by the period to maturity) declined from 5 years and 4 months in June 2012 to 5 years and 2 months in June 2013. As shown in Chart 8B, the 364 day Treasury bill registered the largest increase, equivalent to Ksh 146.8 billion, while the 15 year and the 2 year Treasury bonds increased by Ksh 44.3 billion and Ksh 35.6 billion, respectively, during the year.

The trends in the holdings of Treasury bills and bonds by creditor categories are shown in Tables 8.2 and 8.3. Treasury bills holdings by commercial banks increased from 46.7 percent in June 2012 to 61.9 percent in June 2013. Commercial bank holdings of Treasury bonds declined from 48.6 percent to 45.8 percent during the period.

TABLE 8.2: OUTSTANDING STOCK OF TREASURY BILLS BY HOLDER (KSH BN)

Holders	Jun-11		Jun-12		Jun-13	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	119.4	75.9	105.5	65.2	212.3	71.8
Central Bank*	31.7	20.1	30.0	18.5	28.9	9.7
Comm. Banks	87.7	55.8	75.5	46.7	183.5	61.9
NBFIs	0.0	0.0	0.0	0.0	0.0	0.0
Insurance Companies	4.7	3.0	7.2	4.5	14.9	5.0
Parastatals	3.2	2.1	1.2	0.7	5.6	1.9
of which NSSF	0.0	0.0	0.0	0.0	0.0	0.0
Building Societies	0.0	0.0	0.0	0.0	0.0	0.0
Others	30.9	19.6	47.9	29.6	63.7	21.5
Total	157.3	100.0	161.8	100.0	161.8	100.0

Source: Central Bank of Kenya

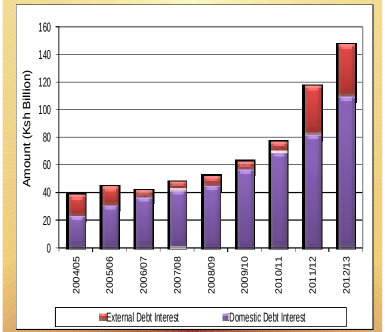
TABLE 8.3: OUTSTANDING STOCK OF TREASURY BONDS BY HOLDER (KSH BN)

Holders	Jun-11		Jun-12		Jun-13	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	290.9	48.8	338.9	49.3	341.2	45.9
Central Bank	0.0	0.0	3.3	0.5	0.0	0.0
Comm. Banks	288.4	48.4	334.1	48.6	341.0	45.8
NBFIs	2.5	0.4	1.5	0.2	0.2	0.0
Insurance Companies	74.7	12.5	74.7	10.9	93.7	12.6
Parastatals	23.7	4.0	21.6	3.1	42.7	5.7
of which NSSF	22.5	3.8	24.5	3.6	22.7	3.1
Building Societies	0.3	0.0	0.6	0.1	0.6	0.1
Others	206.1	34.6	251.1	36.6	266.0	35.7
Total	595.7	100.0	687.0	100.0	744.2	100.0

Source: Central Bank of Kenya

Debt Service

CHART 8C: INTEREST PAYMENTS ON PUBLIC DEBT



Sources: Central Bank of Kenya

Cumulative Government expenditure on interest and other charges on domestic debt increased from Ksh 82.3 billion in the fiscal year 2011/12 to Ksh 110.2 billion in the fiscal year 2012/13 (Chart 8C). At the same time, interest accumulated on external debt increased by Ksh 2.3 billion from Ksh 34.7 billion to Ksh 37.0 billion, during the same period.

Public and Publicly Guaranteed External Debt

Kenya's external debt increased by 10.3 percent, from Ksh 764.5 billion (US$ 9.1 billion) in June 2012 to Ksh 843.6 billion (US$ 9.8 billion) in June 2013, as a result of increased bilateral debt stock, largely attributed to disbursements from China, meant for financing infrastructural projects and disbursements from France. Multilateral debt stock increased on account of disbursements from the International Development Association (IDA) and Africa Development Bank (ADB). The bulk of external debt was owed to multilateral creditors, with IDA accounting for 38.3 percent of the total external debt. Debt owed to Japan declined from Ksh 107.4 billion in June 2012 to Ksh 86.8 billion in June, 2013 while debt owed to China increased by Ksh 23.8 billion over the same period. Other changes in the external debt position during the period were attributed to debt service and exchange rate revaluations.

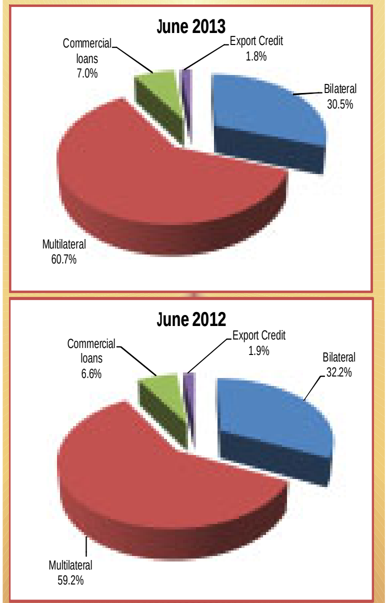
TABLE 8.4: DISTRIBUTION OF EXTERNAL PUBLIC DEBT

	Jun-11	%	Jun-12	%	Jun-13	%
Bilateral	257.0	35.3	246.2	32.2	257.6	30.5
Multilateral	445.3	61.2	452.9	59.2	511.8	60.7
Commercial loans	0.0	0.0	50.5	6.6	58.9	7.0
Export Credit	25.0	3.4	14.8	1.9	15.2	1.8
Total	**727.3**	**100.0**	**764.5**	**100.0**	**843.6**	**100.0**

Sources: Central Bank of Kenya and National Treasury

Kenya's official creditors, the multilateral and bilateral lenders, accounted for 91.2 percent of total external debt in June 2013. The proportion of multilateral and commercial debt holdings in total debt increased from 59.2 and 6.6 percent in June 2012 to 60.7 and 7.0 percent, respectively, in June 2013, while bilateral debt and that extended through supplier's credits declined from 32.2 and 1.9 percent in June 2012 to 30.5 and 1.8 percent in June 2013, respectively (Chart 8D and Table 8.4).

CHART 8D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2013



Sources: Central Bank of Kenya and National Treasury

External Debt Service

External debt service for the period July 2012 – June 2013 amounted to Ksh 37.0 billion, comprising Ksh 25.6 billion in principal repayments, and Ksh 11.4 billion in interest payments.

Performance for the FY 2012/13

In the fiscal year 2012/13, external debt amounted to Ksh 843.6 billion, which was Ksh 57.2 billion less than the revised estimate of Ksh 900.8 billion, while gross and net domestic debt surpassed the revised targets of Ksh 996.0 billion (26.4 percent of GDP) and Ksh 844.1 billion (22.4 percent of GDP), to stand at Ksh 1,050.6 billion (28.7 percent of GDP) and Ksh 889.1 billion (24.3 percent of GDP), respectively.

Debt Sustainability

Kenya has lowered it public debt from 77.4 percent of GDP in June 2000 to 51.7 percent in June 2013 without a debt relief programme. The reduction has largely been in the external debt component (by nearly 50 percent over the period) as the domestic debt component share of GDP has remained relatively stable. The reduction of the external debt component is attributed to prudent fiscal management and modest fiscal deficits. The external debt component is highly concession and held by multilateral and bilateral creditors (IDA, AfDB, Japan and China).

According to a debt sustainability analysis (DSA) conducted by the National Treasury jointly with the IMF in April 2013, the Kenya's debt burden in relation to thresholds for a comparator 'medium performer' country would decline substantially over the next ten years. Hence there is space for the uptake of more debt. The analysis incorporates as a key assumption contracting the US $ I billion sovereign debt in 2013. The findings of the DSA include:

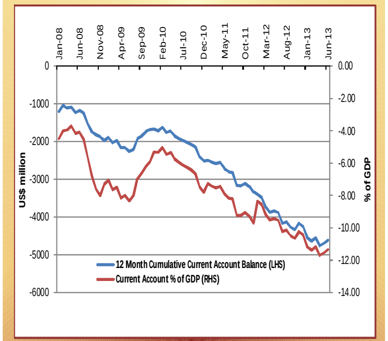
- Present value of debt to GDP ratio projected to decline from 40 percent (spot on target) in 2013 to 36 percent by 2023
- The present value of debt to revenue ratio projected to decline from 156 percent (below the target of 250 percent)in 2013 to 144 percent by 2023
- The debt service to revenue ratio projected to decline from 22 percent (below the target 30 percent) in 2013 to 22 percent in 2023

Furthermore the rollover risks in domestic debt component is low given the large component of longer term treasury bonds (accounting for 70 percent of domestic debt) as opposed to the previous arrangement where the short dated treasury bills dominated. The refinancing risk has been minimized with the lengthening of the maturity profile of government securities to 5 years and 2 months as at June 2013.

9. BALANCE OF PAYMENTS

Kenya's overall balance of payments surplus declined to US$ 597 million in the fiscal year 2012/13 from US$ 841 million in the fiscal year 2011/12. The reduction reflected a smaller build up in the capital and financial account surplus relative to the widening in the current account deficit. The deficit in the current account widened from US$ 3,881 million (or 9.54 percent of GDP) in the fiscal year 2011/12 to US$ 4,621 million (or 11.35 percent of GDP) in the fiscal year 2012/13 (Chart 9A and Table 9.1).

CHART 9A: TRENDS IN THE CURRENT ACCOUNT BALANCE



Sources: Central Bank of Kenya

TABLE 9.1: BALANCE OF PAYMENTS (US $ M)

ITEM	Year to June 2012*	Year to June 2013**	Absolute Change	Percentage Change
1. OVERALL BALANCE	841	597	-244	-29.0
2. CURRENT ACCOUNT	-3881	-4621	-740	19.1
2.1 Goods	-10000	-10578	-577	5.8
Exports (fob)	5958	6150	192	3.2
Coffee	263	218	-45	-17.3
Tea	1138	1291	153	13.4
Horticulture	648	732	84	13.0
Oil products	85	71	-14	-16.7
Manufactured Goods	744	685	-60	-8.0
Raw Materials	428	361	-67	-15.6
Chemicals and Related Products (n.e.s)	584	500	-84	-14.3
Miscelleneous Man. Articles	546	570	24	4.3
Re-exports	365	491	126	34.5
Other	1157	1233	75	6.5
Imports (cif)	15959	16728	769	4.8
Oil	4192	3954	-238	-5.7
Chemicals	1979	2148	170	8.6
Manufactured Goods	2315	2414	99	4.3
Machinery & Transport Equipment	4049	4867	818	20.2
Other	3424	3344	-79	-2.3
2.2 Services	6119	5957	-163	-2.7
Non-factor services (net)	3225	3398	173	5.4
of which tourism	974	915	-59	-6.1
Income (net)	-121	-153	-32	26.9
of which official interest	-102	-133	-31	30.8
Current Transfers	3015	2712	-303	-10.1
Private (net)	2815	2614	-201	-7.1
Public (net)	200	98	-102	-51.1
3. CAPITAL & FINANCIAL ACCOUNT	4722	5218	496	10.5
3.1 Capital Tranfers (net)	235	243	8	3.3
3.2 Financial Account	4487	4975	488	10.9
Official, medium & long-term	1128	683	-444	-39.4
Inflows	1414	990	-424	-30.0
Outflows	-287	-307	-21	7.2
Private, medium & long-term (net)	39	316	278	718.0
Commercial Banks (net)	94	375	281	298.8
Other private medium & long-term (net)	-55	-59	-3	6.0
Short-term (net) incl. errors & omissions	3320	3975	655	19.7
memo:				
Gross Reserves	7030	7900	870	
Official	5283	6089	806	
imports cover**	4	4		
imports cover***	4	4		
Commercial Banks	1747	1811	64	

* Provisional
** Based on current year's imports of goods and non-factor services
*** Based on 36 months average of imports of goods and non-factor services

Source: Central Bank of Kenya

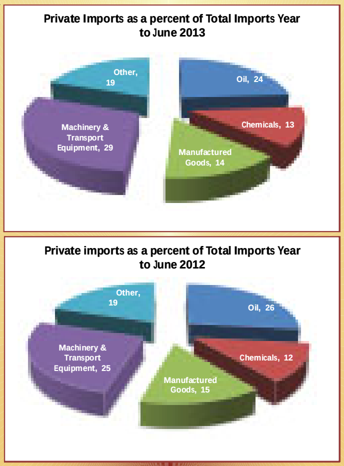
Goods Account

Kenya's trade deficit deteriorated by US$ 577 million, from US$ 10,000 million in the fiscal year 2011/12 to US$ 10,578 million in the fiscal year 2012/13. The 5.8 percent deterioration in the trade account was attributed to a faster growth in merchandise imports (4.8 percent) in the fiscal year 2012/13 compared to a slower growth in merchandise exports (3.2 percent) Table 9.1.

Imports

Growth in merchandise imports was largely driven by increased importation of machinery and transport equipment, which increased by 20 percent from US$ 4,049 million in the fiscal year 2011/12 to US$ 4,867 million in the fiscal year 2012/13. As a result the share of machinery and transport equipment in the total import bill increased from 25 percent to 29 percent over the same period. The share of oil import bill on the other hand declined from 26 percent to 23.6 percent of total imports largely due to reduced importation of crude oil and declining international oil prices. Other categories of imports reflected marginal growth, with importation of chemicals and manufactured goods increasing by 6.6 percent and 4.3 percent, respectively (Chart 9B).

CHART 9B: COMPOSITION OF KENYA'S IMPORTS

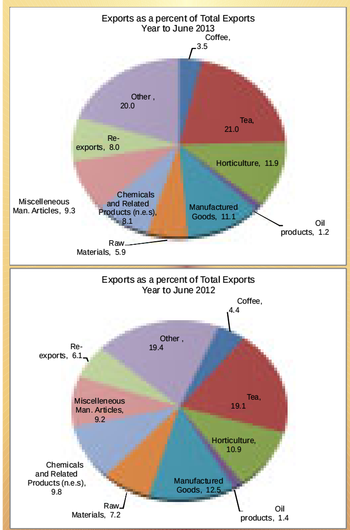


Source: Central Bank of Kenya

Exports

The value of goods exported increased by 3.2 percent from US$ 5,958 million in the fiscal year 2011/12 to US$ 6,150 million in the fiscal year 2012/13. The improvement in export performance arose from exports of tea, horticulture, miscellaneous manufactured articles, re-exports and other non-categorized exports whose value increased by 13.4 percent, 13.0 percent, 4.3 percent, 34.5 percent and 6.5 percent, respectively in fiscal year 2012/13. Increased value of tea and horticulture exports largely reflected increased export quantities, due to good weather. However, the value of coffee exports declined by US$ 45 million to US$ 218 million as a result of a decline in world coffee prices. Other categories of exports which declined included exports of oil products, manufactured goods, chemicals and raw materials which went down by 16.7 percent, 8.0 percent, 14.3 percent and 15.6 percent, respectively (Chart 9C).

CHART 9C: COMPOSITION OF KENYA'S EXPORTS



Source: Central Bank of Kenya

Services

The services account comprises of non-factor services, income and current transfers. The surplus in the services account decreased by US$ 163 million or 2.7 percent to US$ 5,957 million in the fiscal year 2012/13 from US$ 6,119 million in the fiscal year 2011/12. The reduction was largely in net public and private current transfers, which declined by US$ 303 million or 10 percent. The deficit in the income account also worsened by US$ 32 million or 26.9 percent in the year to June 2013, reflecting increased interest payments on official foreign debt by the public sector.

However, net non-factor service increased by US$ 173 million or 5.4 percent in the fiscal year 2012/13 reflecting higher receipts from transportation services and other government services. In addition, remittance inflows under current transfers increased by US$ 118 million or 11 percent, to US$ 1,199 million in the fiscal year 2012/13 from US$ 1,081 million in the fiscal year 2011/12. Remittance transfers have remained resilient despite global economic weakness (Table 9.2).

TABLE 9.2: REMITTANCES TO KENYA ('000 US $)

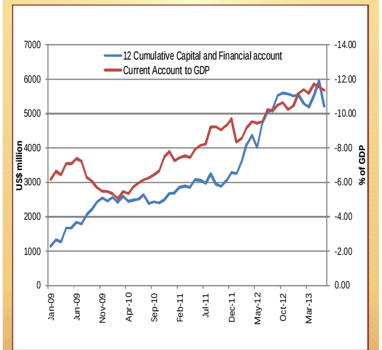
Month/Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
January	25,154	28,564	31,506	40,930	53,925	39,535	45,117	64,139	89,755	102,969
February	27,676	26,056	30,283	39,533	50,382	53,353	46,423	60,759	103,970	102,372
March	29,944	31,219	36,354	48,562	59,344	55,361	52,309	71,557	106,399	103,393
April	27,773	29,216	35,369	38,251	67,872	48,117	52,679	70,071	95,625	104,993
May	26,931	32,358	42,427	41,163	48,538	49,180	51,172	68,124	100,995	110,150
June	30,047	34,360	35,667	48,643	49,490	46,347	52,541	71,888	99,488	99,809
July	33,187	29,133	41,065	53,350	44,137	50,372	50,652	72,797	92,736	
August	28,894	31,759	30,587	58,803	43,388	55,947	51,993	79,563	94,819	
September	28,894	31,616	28,841	60,575	48,953	53,347	58,557	84,854	92,519	
October	25,223	33,037	29,633	46,848	61,113	53,037	58,503	81,311	91,627	
November	25,473	34,282	31,403	55,564	43,970	48,231	56,380	80,802	97,504	
December	29,130	40,557	34,459	41,421	40,129	56,329	65,617	85,244	105,656	
Annual Total	**338,326**	**382,153**	**407,593**	**573,643**	**611,242**	**609,156**	**641,943**	**891,109**	**1,171,095**	**623,686**

Source: Central Bank of Kenya

Capital and Financial Flows

The surplus in the capital and financial account improved to US$ 5,218 million (or 12.82 percent of GDP) in the fiscal year 2012/13 from US$ 4,722 million (or 11.60 percent of GDP) in the fiscal year 2011/12 (Chart 9D). The surplus was largely in the financial account which increased by US$ 488 million or 10.5 percent, largely, attributable to short term flows and a drawdown on commercial banks deposits held abroad. The

CHART 9D: TREND IN THE CAPITAL FINANCIAL ACCOUNT



Source: Central Bank of Kenya

capital account, also improved by 7.8 percent, to US$ 243 million in the fiscal year 2012/13.

Net private medium and long-term financial inflows increased by US$ 278 million to US$ 316 million in the fiscal year 2012/13 largely due to a drawdown of commercial bank deposits abroad of US$ 281 million. Over the same period, short term flows (including portfolio flows) increased by US$ 220 million or 10 percent to US$ 2,402 million from US$ 2,182 million in the year to June 2012. However, the official medium and long-term financial flows dropped from US$ 1,128 million in the fiscal year 2011/12 to US$ 683 million in the fiscal year 2012/13. The 2011/12 official medium and long-term financial flows included the US$ 600 million syndicated loan contracted by the government by June 2012.

Direction of Trade

Table 9.3 shows that the share of Kenya's exports to Africa dropped to 46.9 percent in the fiscal year 2012/13 from 48.9 percent in the fiscal year 2011/12. This decline reflected in Kenya's exports to the EAC and COMESA regions, by 1.7 percent and 6.9 percent, respectively. The value of exports to Uganda, Tanzania, Egypt, Sudan and Somalia declined by 2.7 percent, 2.8 percent, 12.7 percent, 59.5 percent and 9.8 percent respectively. The share of exports to the European Union (EU) also declined from 21 percent to 20 percent. Over the same period, exports to the Middle East increased with the main destination being Pakistan, United Arab Emirates and Afghanistan.

TABLE 9.3: KENYA'S EXPORTS: MAIN DESTINATION COUNTRIES (US$ M)

Destination Country	Exports (US$ millions)			Share of Exports (%)		
	Fiscal Years			Fiscal Years		
	2010/11	2011/12	2012/13	2010/11	2011/12	2012/13
Uganda	808	814	792	14.7	13.8	13.0
Tanzania	442	521	506	8.0	8.8	8.3
Egypt	226	269	235	4.1	4.5	3.9
Sudan	257	167	68	4.7	2.8	1.1
Somalia	152	233	211	2.8	4.0	3.5
DRC	175	209	227	3.2	3.5	3.7
Rwanda	142	166	184	2.6	2.8	3.0
Others	399	509	639	7.3	8.6	10.5
Total Africa	**2,600**	**2,888**	**2,860**	**47.3**	**48.9**	**46.9**
United Kingdom	507	487	478	9.2	8.2	7.8
Netherlands	362	361	373	6.6	6.1	6.1
USA	309	298	331	5.6	5.0	5.4
Pakistan	231	249	286	4.2	4.2	4.7
United Arab Emirates	225	248	364	4.1	4.2	6.0
Germany	90	104	105	1.6	1.8	1.7
India	101	105	99	1.8	1.8	1.6
Afghanistan	146	135	173	2.7	2.3	2.8
Others	928	1,034	1,029	16.9	17.5	16.9
Total Exports	**5,499**	**5,908**	**6,098**	**100**	**100**	**100**

Source: Central Bank of Kenya

In the fiscal year 2012/13, Kenya sourced most of its imports from India (15.8 percent), China (12 percent), the UAE (10.4 percent) and Japan (5.3 percent). Imports from Africa accounted for 10 percent of total imports and declined by 5.4 percent to US$ 1,635 million in the fiscal year 2012/13. The decline was reflected in reduced imports from the COMESA region (by US$ 22 million) and other African countries including South Africa (US$ 44 million) and Tanzania (US$ 8 million). Imports from the EU region accounted for 14.8 percent of total imports having increased by US$ 128 million to US$ 2,411 million in the fiscal year 2012/13.

TABLE 9.4: KENYA'S IMPORTS: MAIN SOURCE COUNTRIES (US$ M)

Source Country	Imports (US$ millions) Fiscal Years			Share of Imports (%) Fiscal Years		
	2010/11	2011/12	2012/13	2010/11	2011/12	2012/13
South Africa	797	768	724	5.9	4.9	4.4
Egypt	233	273	335	1.7	1.7	2.1
Others	549	687	575	4.1	4.4	3.5
Total Africa	**1,579**	**1,728**	**1,635**	**11.7**	**11.0**	**10.0**
India	1,581	1,802	2,576	11.7	11.5	15.8
United Arab Emirates	1,780	2,142	1,688	13.2	13.6	10.4
China	1,651	1,811	1,935	12.2	11.5	11.9
Japan	697	697	860	5.2	4.4	5.3
USA	483	671	730	3.6	4.3	4.5
United Kingdom	622	508	571	4.6	3.2	3.5
Singapore	551	110	231	4.1	0.7	1.4
Germany	353	431	457	2.6	2.7	2.8
Saudi Arabia	350	888	557	2.6	5.6	3.4
Indonesia	389	669	530	2.9	4.3	3.3
Netherlands	244	216	226	1.8	1.4	1.4
France	241	260	284	1.8	1.7	1.7
Bahrain	81	227	449	0.6	1.4	2.8
Italy	137	196	245	1.0	1.2	1.5
Others	2,760	3,370	3,327	20.4	21.4	20.4
Total Imports	**13,499**	**15,727**	**16,299**	**100**	**100**	**100**

Source: Central Bank of Kenya

Kenya's Trade Structure

Kenya's total trade with the European countries declined by 3.9 percent to Ksh 375 billion in 2012 compared to Ksh 390 billion in 2011. The decline was mainly in exports to the EU. Consequently, the proportion of Kenya's total trade to the EU countries declined to 19.8 percent in 2012 from 21.4 percent in 2011 (Table 9.5).

As a share of total trade, trade between Kenya and Africa declined to 20.7 percent in 2012 from 21.9 percent in 2011. Trade with COMESA countries (excluding Uganda, Rwanda and Burundi) declined by 8.8 percent to Ksh. 316 billion in 2012 while trade with EAC countries increased marginally from Ksh. 164 billion in 2011 to Ksh. 166 billion in 2012. However, within the EAC region, trade with Uganda declined by 4.1 percent or Ksh 3.5 billion to Ksh 82.8 billion.

The Asian region remained the dominant trading partner accounting for 50.8 percent of total trade. Within this region, trade between Kenya and the Far East countries (including China, India, Indonesia, Japan, Pakistan among others) increased by 10 percent from Ksh 581 billion in 2011 to Ksh 636 billion in 2012. However, trade with the Middle East countries declined by 3 percent to Ksh 326 billion mainly due to substantial reduction of imports from the United Arabs Emirates.

TABLE 9.5: KENYA'S TRADE STRUCTURE

	Total Trade in Billions of Kenya Shillings				Proportion (%)			
	2009	2010	2011	2012*	2009	2010	2011	2012
Europe	272.2	313.3	390.3	375.0	24.0	23.1	21.4	19.8
Western Europe	242.3	287.1	353.1	340.0	21.4	21.2	19.3	18.0
European Union	229.0	264.6	308.8	312.9	20.2	19.5	16.9	16.5
Others	13.4	17.5	44.3	27.1	1.2	1.3	2.4	1.4
Eastern Europe	29.9	26.2	37.2	35.0	2.6	1.9	2.0	1.8
America	83.8	80.0	106.9	148.0	7.4	5.9	5.8	7.8
U.S.A	67.5	61.8	70.3	92.4	6.0	4.6	3.8	4.9
Others	16.3	10.0	28.0	55.7	1.4	0.7	1.5	2.9
Africa	267.4	303.7	399.5	391.3	23.6	22.4	21.9	20.7
E.A.Community	103.0	121.7	164.1	166.0	9.1	9.0	9.0	8.8
Tanzania	37.9	43.8	57.4	60.4	3.3	3.2	3.1	3.2
Uganda	50.7	61.3	86.3	82.8	4.5	4.5	4.7	4.4
Comesa[a]	72.7	176.8	236.8	216.0	6.4	13.0	13.0	11.4
Other Countries	91.7	83.1	105.2	115.0	8.1	6.1	5.8	6.1
Asia	501.4	649.5	916.5	962.0	44.2	47.9	50.2	50.8
Middle East	168.2	199.3	335.9	326.2	14.8	14.7	18.4	17.2
Far East	333.2	450.3	580.6	635.8	29.4	33.2	31.8	33.6
Australia & Oceanic	5.3	4.7	4.0	10.0	0.5	0.3	0.2	0.5
All other Countries N.E.S	3.0	5.7	9.5	6.1	0.3	0.4	0.5	0.3
Grand Total	**1133.0**	**1357.0**	**1826.7**	**1892.4**	**100.0**	**100.0**	**100.0**	**100.0**

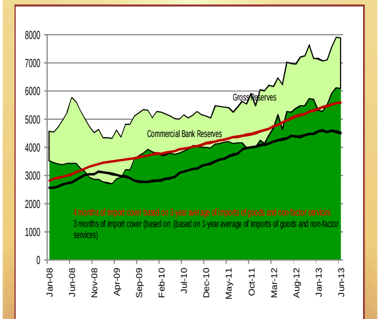
*Provisional

[a] Excluding member countries Uganda, Rwanda & Burundi

Source: Economic Survey, 2008

Foreign Exchange Reserves

CHART 9E: FOREIGN EXCHANGE RESERVES



Source: Central Bank of Kenya

The banking system's total foreign exchange holdings increased by 12.4 percent from US$ 7,030 million in June 2012 to US$ 7,900 million in June 2013. Official reserves held by the Central Bank constituted the bulk of gross reserves and increased by 15.3 percent to US$ 6,089 million or 4.4 months of import cover in June 2013 (a level above the statutory minimum requirement of 4 months imports cover). The accumulation of official reserves during the period consisted of IMF disbursements under the Extended Credit Facility programme financing and purchase from the Foreign Exchange market. Foreign Exchange Reserves held by Commercial Banks increased marginally by US$ 64 million or 3.6 percent to US$ 1,811 million in June 2013.

10. BANKING SECTOR DEVELOPMENTS

Overview

During the period ended June 30, 2013, the Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company, 9 deposit taking microfinance institutions, 7 representative offices of foreign banks, 107 foreign exchange bureaus and 2 credit reference bureaus.

The Banking Sector recorded enhanced performance with the size of assets standing at Ksh 2.5 trillion, loans and advances amounting to Ksh 1.5 trillion, while the deposit base stood at Ksh 1.9 trillion and profit before tax of Ksh 61.5 billion as at June 30, 2013. During the same period, the number of bank customer deposit and loan accounts stood at 18.9 million and 3.8 million, respectively.

Structure of the Balance Sheet

The banking sector balance sheet size increased by 15 percent from Ksh 2.2 trillion in June 2012 to Ksh 2.5 trillion in June 2013 (Table 10). The major components of the balance sheet on the asset side were loans and advances, government securities and placements, which accounted for 55.7 percent, 22.4 percent and 6.2 percent of total assets respectively, while customer deposits were the main component on the liabilities side accounting for 73.9 percent of the total liabilities.

TABLE 10.1: BALANCE SHEET (KSH MILLION)

	13-Jun	12-Jun	% Change
Cash	43,779	39,669	10%
Balances at CBK	124,815	122,183	2%
Placements	156,718	160,073	-2%
Govt. Securities	562,992	428,733	31%
Other Investments	55,847	46,727	20%
Loans & Advances (Net)	1,400,052	1,242,367	13%
Other Assets	169,302	155,253	9%
Total Assets	**2,513,505**	**2,195,005**	**15%**
Deposits	1,857,342	1,667,760	11%
Other Liabilities	261,775	212,130	23%
Capital & Reserves	394,388	315,115	25%
Total Liabilities and Shareholders' Funds	**2,513,505**	**2,195,005**	**15%**

Source: Central Bank of Kenya

Loans and Advances

The banking sector gross loans and advances increased from Ksh 1.29 trillion in June 2012 to Ksh 1.45 trillion in June 2013 translating to a growth of 12.9 percent. The growth was registered in 9 sectors out of 11 sectors as indicated in Table 10.2 below.

TABLE 10.2: SECTORAL DISTRIBUTION OF LOANS (KSH BN)

Sectors	13-Jun	12-Jun	% Change
Personal/Household	376.9	326.8	15.3%
Trade	300.4	257.1	16.9%
Manufacturing	193.1	174.8	10.5%
Real Estate	194.9	168.6	15.7%
Transport and Communication	99.4	102.8	-3.3%
Agriculture	67	64.7	3.6%
Financial Services	53.2	51.7	2.9%
Building and Construction	71.7	51.9	38.2%
Energy and Water	49.6	42.3	17.3%
Tourism, Restaurant and Hotels	34.4	32.6	5.5%
Mining and Quarrying	14.3	16.1	-11.2%
Gross/Total	**1454.9**	**1,289.30**	**12.9%**

Source: Central Bank of Kenya

Deposit Liabilities

Customer deposits were the main source of funding for the banking sector assets, accounting for 73.9 percent of total liabilities and shareholders' funds. The deposit base increased by 11.8 percent from Ksh 1.7 trillion in June 2012 to Ksh 1.9 trillion in June 2013 mainly attributed to branch expansion, remittances and receipts from exports.

Capital and Reserves

The banking sector registered improved capital levels in June 2013 with total capital which comprises core and supplementary capital, growing by 23.7 percent from Ksh 294.3 billion in June 2012 to Ksh 364.0 billion in June 2013. The shareholders' funds increased by 25.2 percent from Ksh 315.1 billion in June 2012 to Ksh 394.4 billion in June 2013. The ratios of total and core capital to total risk-weighted assets, therefore increased from 20.3 percent and 17.7 percent to 23.3 percent and 20.2 percent, respectively.

Non–Performing Loans

The stock of gross non-performing loans (NPLs) increased by 34.4 percent from Ksh 57.5 billion in June 2012 to Ksh 77.3 billion in June 2013. Similarly, the ratio of gross NPLs to gross loans deteriorated from 4.5 percent in June 2012 to 5.3 percent in June 2013.

The increase in NPLs is attributed to high interest rates and reduced economic activities during the period towards and after the March 2013 general elections. During the period under review, 9 sectors out of 11 sectors registered increase in NPLs as shown in Table 10.3.

TABLE 10.3: SECTORAL DISTRIBUTION OF NPLs (KSH BN)

Sectors	Jun-13	Jun-12	% Change
Personal/Household	21.9	19.7	11.2%
Trade	20	12.3	62.6%
Manufacturing	4.9	5.0	-2.0%
Real Estate	10.8	6.5	66.2%
Transport and Communication	6.1	3.7	64.9%
Agriculture	5	4.1	22.0%
Financial Services	1.5	1.4	7.1%
Building and Construction	4.2	2.3	82.6%
Energy and Water	1.1	0.3	266.7%
Tourism, Restaurant and Hotels	1.7	2.1	-19.0%
Mining and Quarrying	0.1	0.1	0.0%
Gross/Total	**77.3**	**57.5**	**34.4%**

Source: Central Bank of Kenya

Profitability

The banking sector registered Ksh 61.5 billion pre-tax profits during the period ending June 30, 2013, which was an increase of 15.6 percent from Ksh 53.2 billion as at June 2012 as shown in Table 10.4. Total income stood at Ksh 177.3 billion, a marginal growth of 0.5 percent compared with Ksh 176.4 billion registered at the end of June 2012. However, total expenses decreased by 6.0 percent from Ksh 123.3 billion in June 2012 to Ksh 115.9 billion in June 2013, partly contributing to improvement in pre-tax profit.

Interest on advances at Ksh 102.6 billion constituted 58 percent of total income. On the other hand, interest on deposits, staff costs and other expenses were the key components of expenses, accounting for 31 percent, 29 percent and 24 percent, respectively.

TABLE 10.4: BANKING INDUSTRY PROFITS (KSH BILLION)

Item	Jun-13	Jun-12	% change
Total income	177.3	176.4	0.5%
Expenses before provisions	121.4	128	-5.2%
Profit before provisions	67.0	57.9	15.7%
Provisions for bad debts	5.5	4.7	17.0%
Profit before tax	61.5	53.2	15.6%

Source: Central Bank of Kenya

Credit Reference Bureaus

The Credit Information Sharing (CIS) mechanism has continued to register increased usage by the banks since its launch in July 2010. The number of credit reports requested by banks stood at 2,907,375 in June 2013 an increase of 63.9 percent compared with 1,774,185 reports in June 2012.

Banks have now incorporated credit reference reports in their credit risk appraisal processes. It is expected that borrowers with good track record would be able to negotiate for competitive credit terms including accessing credit based on their credit record without a requirement for collateral.

Agency Banking

The use of the agency banking model by banks has continued to improve access to banking services since its launch in 2010. As at June 30, 2013, CBK had authorized 13 commercial banks to offer banking services through third parties (agents). Since 2010, a total of 19,649 agents had been contracted facilitating over 58.6 million transactions valued at Ksh 310.5 billion. As at June 2012, 10 banks had contracted 12,067 active agents facilitating over 20.4 million transactions valued at Ksh 104.4.1 billion.

Deposit Taking Microfinance Institutions

The number of Deposit Taking Microfinance Institutions (DTMs) in operation increased from 6 in June 2012 to 9 in June 2013. As at June 30, 2013, DTMs had gross loans worth Ksh 22.5 billion compared to Ksh 17.9 billion registered in June 2012 thus translating to a growth of 25.7 percent. The deposits base stood at Ksh 19.7 billion representing a growth of 60.2 percent from Ksh 12.3 billion in June 2012. The number of DTMs deposit accounts stood at 1.9 million in June 2013 compared to 1.6 million deposit accounts at end of June 2012.

Representative Offices

In February 2013, the Central Bank granted authority to the Central Bank of India (CBI) and the Bank of Kigali to open Representative Offices in Kenya. There are now 7 foreign banks that operate Representative Offices in Kenya.

Under the Banking Act, a Representative Office of a foreign bank in Kenya is not permitted to engage in banking business as defined in the Act but can only engage in marketing and liaison roles in connection with the activities of its parent bank and affiliates.

Banking Sector 2013 Outlook

The banking sector is expected to sustain the growth momentum on the backdrop of a stable macro-economic environment, domestic and regional expansion by banks and increased economic activities through the devolved system of government.

12. NATIONAL PAYMENTS SYSTEM

MODES OF PAYMENTS

There are two main modes of payments, namely non-cash and cash instruments.

1 NON-CASH INSTRUMENTS

1.1 KENYA ELECTRONIC PAYMENT AND SETTLEMENT SYSTEM (KEPSS)

KEPSS moved a volume of 1,757,482 transactions worth Ksh 20,686 billion in the year to June 30, 2013, compared to 1,402,886 transactions worth Ksh 20,887 billion in the same period last year. The growth represents a 24.9 percent increase in volume and 1.0 percent decrease in value compared to the year to June 30, 2012. The average amount moved per transaction decreased from Ksh 14.98 million to Ksh 11.81 million, reflecting a decrease of 21.2 percent signifying an increased use of the system by the public for low value payments. The number of transactions moved per day, however, increased by 25.5 percent to 7,006 transactions from 5,583 transactions in the year to June 30, 2013. This increase is attributed to increased awareness by the public of KEPSS as a safe and efficient mode of payment for both high value and time critical payments, the continuing effects of both value capping and G-Pay system. These factors have increased the daily flows through the KEPSS System. The proportion of direct payments through KEPSS decreased from 98.5 percent to 98.4 percent, while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS increased from 1.5 percent to1.6 percent in the same period (Tables 12.1 and 12.2).

TABLE 12.1: TRENDS IN TOTAL ANNUAL FLOWS

Year to June 30	Total value moved per year (Ksh m)	No. of Transactions	Average value per transaction (Ksh m)	Days worked	Per day Value (Ksh m)	Per day Transactions
2006	7,641,197	120,249	61.38	227	32,919	532
2007	7,929,003	155,131	51.38	249	32,038	627
2008	14,506,951	232,516	62.30	247	59,419	949
2009	15,441,446	277,445	55.67	248	62,139	1,121
2010	16,806,252	673,368	28.78	254	66,259	2,663
2011	18,792,538	1,048,206	17.81	252	74,758	4,163
2012	20,886,830	1,406,886	14.98	252	82,884	5,583
2013	20,686,221	1,757,482	11.81	252	84,417	7,006

Source: Central Bank of Kenya, Banking/National Payments Division

TABLE 12.2: DIRECT PAYMENT VS. NET SETTLEMENT INSTRUCTIONS (NSI)

Year to June 30	Total value moved (Ksh)	Settlement proportions Direct (Ksh m)	%	Indirect {NSI (Ksh m)}	%
2006	7,461,197	6,878,229	92.20	582,968	7.80
2007	7,929,003	7,234,837	91.20	694,166	8.80
2008	14,506,951	13,606,759	93.79	900,193	6.21
2009	15,441,446	14,549,876	94.23	891,570	5.77
2010	16,806,252	14,549,876	86.57	2,256,376	13.43
2011	18,792,538	16,360,759	87.06	2,431,779	12.94
2012	20,866,830	20,549,173	98.48	317,657	1.52
2013	20,686,221	20,355,986	98.40	330,235	1.60

Source: Central Bank of Kenya, Banking/National Payments Division

MT 102 (a single customer transfer message that credits multiple beneficiaries) and MT 103 (a single customer transfer message that credits one beneficiary) are messages processed by commercial banks through KEPSS on behalf of their customers.

Multiple third parties Message Type MT 102 increased by 8.4 percent from 151,814 messages in the year to June 30, 2012 to 164,545 messages in the year to June 30, 2013. In the same period, single third party Message Type MT 103 increased by 32.6 percent from 1,395,902 messages to 1,850,580 messages. Overall, total third party messages processed through KEPSS increased by 30.2 percent from 1,547,716 messages to 2,015,125 messages in the year to June 30, 2013 (Table 12.3). The increase in these messages reflects growing awareness of KEPSS among the public as a safe and efficient payment system for large value and time critical payment.

TABLE 12.3: THIRD PARTY TRANSACTIONS PROCESSED THROUGH KEPSS BY MESSAGE TYPE

Year to June 30	MT102	MT103	TOTAL
2006	6,192	24,978	31,170
2007	8,147	46,587	54,734
2008	9,132	75,674	84,806
2009	9,410	115,443	124,853
2010	73,704	561,768	635,472
2011	125,262	977,569	1,102,831
2012	151,814	1,395,902	1,547,716
2013	164,545	1,850,580	2,015,125

Source: Central Bank of Kenya, Banking/National Payments Division

1.2 THE AUTOMATED CLEARING HOUSE OPERATIONS

Automated Clearing House (ACH) largely operated smoothly during the year to June 30, 2013. The ACH throughput for the period under review was 27.82 million transactions with a value of Ksh2,607 billion for both Debit and Credit instruments compared to 27.63 million transactions valued at Ksh2,497 billion in the same period last year as indicated in Table 12.4. This represents an increase of 4.4 percent and a 0.7 percent in value and volume throughput, respectively. This outcome can be attributed to the reduced clearing cycle after implementation of cheque truncation and the trust the public has in the new clearing system.

Cheques dominated the ACH payment instruments accounting for 66.6 percent of total volume of transactions through the Clearing House. In the year to June 2013, the volume of cheques processed through the Automated Clearing House was 18.4 million cheques valued at Ksh 2,196 billion compared to 18.2 million cheques valued at Ksh 2,134 billion in similar period in 2012.

Electronic Funds Transfer (EFT) based payments increased by 13.2 percent during this period from Ksh 363 billion to Ksh 411 billion (Table 12.4).

TABLE 12.4: CLEARING HOUSE KSH TRANSACTIONS TO JUNE 30, 2013

Financial Year	Items	Values (Ksh bn)	Volumes ('000')
2006	Debit	2,642	14,513
	Credit	479	5,032
	Total	**3,121**	**19,545**
2007	Debit	3,063	16,859
	Credit	592	5,601
	Total	**3,655**	**22,460**
2008	Debit	3,616	18,670
	Credit	676	5,496
	Total	**4,293**	**24,166**
2009	Debit	3,901	18,549
	Credit	766	7,859
	Total	**4,667**	**26,408**
2010	Debit	1,954	15,732
	Credit	367	9,304
	Total	**2,321**	**25,036**
2011	Debit	1,939	16,713
	Credit	345	11,942
	Total	**2,284**	**28,655**
2012	Debit	2,134	18,222
	Credit	363	9,409
	Total	**2,497**	**27,631**
2013	Debit	2,196	18,436
	Credit	411	9,386
	Total	**2,607**	**27,821**

Source: Central Bank of Kenya, Banking/National Payments Division

The ACH continued to witness increased transactions activity in Domestic Foreign Currency Cheque Clearing (DFCCC) in the year to June 30, 2013 compared to the same period last year. The US dollar denominated Cheques processed through the clearing house increased from a volume of 393.9 to 402.4 thousand, while the EURO denominated Cheques processed through the clearing house increased from a volume of 11.0 to 11.2 thousand. This represents an increase of 2.1 percent and 2.1 percent respectively. However, the GBP denominated Cheques declined by 4.6 pecent from 57.05 thousand Cheques to 47.35 thousand Cheques in the same period. In terms of value moved, the US dollar recorded an increase of 6.2 percent while the EURO and GBP recorded a decrease of 17.0 and 8.9 percent, respectively (Table 12.5). The US dollar remained the preferred currency in the domestic foreign currency cheque clearing followed by the Euro and the Pound, respectively.

TABLE 12.5: DOMESTIC FOREIGN CURRENCY CHEQUE CLEARING TRANSACTIONS TO JUNE 30, 2013

Currency	USD		GBP		EURO	
As at June	Value (m)	Volume ('000')	Value (m)	Volume ('000')	Value (m)	Volume ('000')
2006	1,812.80	240.8	23.07	2.60	114.30	7.2
2007	2,124.75	272.4	23.86	2.60	108.13	7.5
2008	2,457.48	278.0	35.82	2.68	99.06	7.9
2009	2,637.32	282.0	52.98	2.95	138.31	9.8
2010	1,500.33	302.4	17.57	2.57	75.75	10.0
2011	1,239.25	337.2	11.41	2.29	77.01	12.3
2012	1,475.46	393.9	6.43	1.97	57.02	11.0
2013	1,566.31	402.4	5.86	1.88	47.35	11.2
Growth (%)	6.16%	2.14%	-8.91%	-4.62%	-16.96%	2.10%

Source: Central Bank of Kenya, Banking Services Division

1.3 AUTOMATED TELLER MACHINES (ATMS) AND PLASTIC CARD USAGE

The number of Automated Teller Machines (ATMs) in the payment card industry increased by 6.4 percent from 2,292 ATMs in June 2012 to 2,439 ATMs in June 2013. This growth may be attributed to commercial banks' business expansion strategies.

The value of transactions effected through cards in the year to June 2013 increased by 6.4 percent and 79.1 percent from Ksh 673.34 billion to Ksh 716.44 billion and Ksh 762.23 billion to Ksh 1,365.43 billion for acquirers and issuers, respectively. Correspondingly, withdrawals increased by 95.7 percent and 41.7 percent from 148.8 million withdrawals to 291.22 million withdrawals and 219.98 million withdrawals to 311.83 million withdrawals for acquirers and issuers, respectively. The growing usage of cards signifies a growing shift from cash based payments to non-cash payments by the public (Table 12.6 A).

TABLE 12.6A: AUTOMATED TELLER MACHINES USAGE

	2006	2007	2008	2009	2010	2011	2012	2013
Number of ATM machines	737	1,078	1,510	1,827	1,943	2,183	2,291	2,439
Number of transactions (m)								
Acquirers	-	58.63	77.92	86.72	93.43	110.56	148.80	291.22
Issuers	-	42.08	54.70	77.42	83.80	115.70	219.98	311.83
Other	-	-	3.44	3.56	-	-	0.01	0.24
Value of transactions (bn)								
Acquirers	-	312.87	396.93	431.79	507.99	623.74	673.34	716.44
Issuers	-	136.44	258.33	417.04	439.22	555.17	762.23	1,365.43
Other	-	-	18.51	18.93	-	-	62.52	73.37

Source: NPS Cards Statistics

The total number of cards in use rose by 10.0 percent from 9.9 million cards in June 2012 to 10.9 million cards in June 2013, with debit cards recording a growth of 12.4 percent from 8.1 million cards in June 2012 to 9.1 million cards in June 2013 (Table 12.6B).

TABLE 12.6B: NUMBER OF CARDS IN CIRCULATION

	2006	2007	2008	2009	2010	2011	2012	2013
ATM cards	829,962	943,359	900,148	985,141	1,252,893	1,439,729	1,640,004	1,625,895
Debit cards	750,085	971,449	1,528,866	3,700,646	4,156,187	7,002,091	8,121,460	9,126,946
Credit cards	73,238	107,106	107,653	106,842	111,383	117,835	131,397	133,137
Charge cards	3,769	5,775	5,160	1,682	791	1,418	2,877	772
Total	1,657,054	2,027,689	2,541,827	4,794,311	5,521,254	8,561,073	9,895,738	10,886,750

Source: NPS Cards Statistics

1.4 MOBILE PHONE USAGE FOR FUNDS TRANSFER

Mobile phone money transfer service usage continued to increase among the Kenyan public as indicated by the growth in the number of transactions which increased by 26.6 percent from 507.9 million transactions in the year to June 30, 2012 to 643.01 million transactions in the year to June 30, 2013. The Central Bank continues to monitor the developments in this sector in line with the Government's policy of enhancing financial inclusion and deepening especially for rural/urban poor and the un-banked.

The customer base mobile phone money transfer service increased by 19.9 percent from 19.8 million customers to 23.75 million customers, while the number of agents increased by 68.3 percent from 61,313 to 103,165 in the same period with M-Pesa accounting for 70.3 percent, Airtel 9.5 percent and Yu 8.4 percent.

The value transferred through mobile money transfer services increased by 22.7 percent from Ksh 1,375.83 billion for the year to June 30, 2012 to Ksh 1,689.04 billion for the year to June 30, 2013 (Table 12.7).

TABLE 12.7: MOBILE PHONE MONEY TRANSFER

Year to	Jun-07	Jun-08	Jul-09	Jun-10	Jun-11	Jun-12	Jun-13
Amount transferred (Ksh billion)	1.49	61.07	318.44	597.31	919.22	1,375.83	1,689.04
Number of agents	527	3,011	10,735	31,902	46,588	61,313	103,165
Number of transactions (million)	0.48	21.77	125.12	251.25	364.06	507.90	643.01
Number of 'registered' customers/accounts (million)	0.18	3.04	7.39	10.44	17.99	19.80	23.75

Source: Service providers

2. CASH INSTRUMENT

Currency in circulation increased from Ksh 159.49 billion as at the end of June 2012 to Ksh183.04 billion as at end of June 2013 reflecting an increase of Ksh 23.55 billion or 14.8 percent from the previous year's issued currency as indicated in Table 12.8. In weighted terms, bank notes account for 97.0 percent, while coins account for 3.0 percent of currency in circulation.

TABLE 12.8: CURRENCY IN CIRCULATION (NOTES & COINS)

	Jun-07		Jun-08		Jun-09		Jun-10		Jun-11		Jun-12		Jun-13	
Item	Ksh bn.	%	Ksh bn.	%	Ksh bn.	%	Kshs bn.	%	Kshs bn.	%	Ksh bn.	%	Ksh bn.	%
Currency in circulation	89.94	100.00	99.89	100.00	108.25	100.00	125.17	100.00	147.76	100.00	159.49	100.00	183.04	100.00
Bank Notes	86.45	96.12	96.14	96.25	104.22	96.27	120.72	96.44	143.07	96.83	154.60	96.93	177.49	96.97
Coins	3.49	3.88	3.75	3.75	4.04	3.73	4.45	3.56	4.69	3.17	4.89	3.07	5.55	3.03

Source: Central Bank of Kenya, Currency Division

TABLE 12.9: CURRENCY IN CIRCULATION (PIECES)

	Bank notes					
	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013	% change
	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	
1000/=	78.69	90.22	108.99	119.66	138.58	15.81
500/=	20.86	25.33	29.87	29.77	34.23	14.98
200/=	31.74	38.21	43.67	41.38	42.74	3.28
100/=	61.80	70.71	75.39	81.47	92.38	13.39
50/=	44.39	55.28	62.24	65.60	73.72	12.37
20/=	10.10	10.05	10.04	10.01	9.99	-0.20
10/=	12.06	12.00	11.99	11.96	11.94	-0.15
5/=*	5.80	5.80	5.77	5.75	0.00	
	265.44	307.60	347.96	365.62	403.59	

	Coins					
	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013	% change
	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	
40/=	1.92	2.25	2.51	5.71	9.41	64.86
20/=	69.84	75.95	81.20	82.81	93.56	12.98
10/=	111.34	125.80	128.75	128.85	154.54	19.94
5/=	151.19	170.60	183.25	183.45	196.95	7.36
1/=	511.45	539.00	569.13	605.86	635.48	4.89
/50=	258.90	272.00	274.69	274.80	275.14	0.12
/10=	358.64	360.00	358.61	358.53	0.00	
/05=	305.12	300.00	305.10	305.06	0.00	
	1768.39	1,845.60	1,903.23	1,945.07	1,365.08	

*Demonetised December 31, 2011

Source: Central Bank of Kenya, Currency Division

Notes in circulation grew by 11.7 percent from 366 million pieces in the year to June 30, 2012 to 409 million pieces in the year to June 30, 2013. There was notable increase in the usage of Ksh 1,000,Ksh 500, Ksh 100 and Ksh 50notes that increased by 15.8 percent, 15.0 percent, 13.4 percent and 12.4 percent in the year to June 30, 2013, respectively, while the circulation of the Ksh 20 and Ksh 10 notes decreased by -0.2 percent and -0.1 percent, respectively. Coins in circulation grew by 6.5 percent in the same period with the Ksh 40 coin, Ksh 20 coin, Ksh 10 coin, Ksh 5 coin, Ksh 1 coin and Ksh 0.50 coin increasing by 64.9 percent, 13.0 percent, 19.9 percent, 7.4 percent, 4.9 percent and 0.1 percent, respectively. Public preference for bank notes explains the high proportion of currency in circulation being in Bank notes than coins.

2.1 CASH INFLOWS AND OUTFLOWS

Deposits by banks (i.e. Cash inflows) increased by 4.8 percent from Ksh 384.9 billion as at June 30, 2012 to Ksh 403.7 billion as at June 2013. Similarly, withdrawals (i.e. cash outflows) increased by 7.8 percent from Ksh 395.6 billion to Ksh 427.2 billion in the same period. This reflects a net currency outflow in the year to June 30, 2013 of Ksh 23.5 billion (Table 12.10).

TABLE 12.10: CURRENCY INFLOWS AND OUTFLOWS (KSHS M)

Inflow by banks	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Bank Notes	268,543	283,083	271,257	175,149	384,996	403,678
Coins	562	376	248	29	21	9
Total	**269,105**	**283,459**	**271,505**	**175,178**	**385,017**	**403,687**
Outflows by banks						
Bank Notes	278,236	291,161	287,754	194,935	395,599	426,495
Coins	831	657	658	147	204	726
Total	**279,066**	**291,818**	**288,412**	**195,082**	**395,803**	**427,221**
Net Outflows	**(9,961)**	**(8,359)**	**(16,907)**	**(19,904)**	**(10,786)**	**(23,534)**

Source: Central Bank of Kenya, Currency Division

2.2 DEVELOPMENT IN COUNTERFEITING PRACTICES

Counterfeit activity declined significantly as the number of counterfeit notes decreased by 57.5 percent from 353 counterfeit notes in the year to June 30, 2012 to 150 counterfeit notes in the year to June 30, 2013 (Table 12.11). The resultant impact in value terms was a decrease of 39.0 percent in the total value of counterfeit notes from Ksh 0.21 million in the previous year to Ksh 0.13 million in the year to June 30, 2013.

In terms of denomination, there were 118 pieces of Ksh 1,000 making up 78.67 percent, 10 pieces of Ksh 500 or 6.7 percent, 17 pieces of Ksh 200 or 11.3 percent, and 5 pieces of Ksh 100 or 3.3 percent of the counterfeit notes, respectively.

The reduction in number of counterfeits is attributed to increased public education, which is carried out by the Central Bank and enforcement of sorting guidelines issued to commercial banks. These initiatives have resulted in more vigilance in the industry and the public in general.

TABLE 12.11: COUNTERFEIT NOTES BY DENOMINATION

	Pieces						Proportion
	2007/2008	2008/2009	2009/2010	2010/2011	2010/2012	2010/2013	2012/2013
1000/=	653	1,376	485	259	165	118	78.67%
500/=	205	442	113	75	35	10	6.67%
200/=	172	411	297	204	123	17	11.33%
100/=	94	60	143	72	8	5	3.33%
50/=	4	7	4	29	4	0	0.00%
20/=	0	0	0	0	2	0	0.00%
10/=	0	0	0	0	0	0	0.00%
5/=	0	0	0	0	0	0	0.00%
Total	**1,128**	**2,296**	**1,042**	**639**	**353**	**150**	**100.00%**
	Amounts (KSH)						Proportion
	2006/2007	2007/2008	2009/2010	2009/2011	2009/2012	2009/2013	2010/2011
1000/=	653,000	1,376,000	485,000	259,000	165,000	118,000	92.99%
500/=	102,500	221,000	56,500	37,500	15,500	5,000	3.94%
200/=	34,400	82,200	59,400	40,800	24,600	34,000	2.68%
100/=	9,400	6,000	14,300	7,200	2,800	500	0.39%
50/=	200	350	200	1,450	200	0	0.00%
20/=	0	0	0	0	80	0	0.00%
10/=	0	0	0	0	0	0	0.00%
5/=	0	0	0	0	0	0	0.00%
Total	**799,500**	**1,685,550**	**615,400**	**345,950**	**208,180**	**126,900**	**100.00%**

Source: Central Bank of Kenya, Currency Department

3 CURRENT AND FUTURE DEVELOPMENTS

3.1 LEGAL FRAMEWORK

The National Payment System Act 2011 provides for the regulation and supervision of payment systems and payment service providers, and for connected purposes. In the period under review, the Bank commenced operationalization of the NPS Act 2011 by drafting the National Payment System Regulations and sharing with the stakeholders and the public for comments.

The National Payment System Regulations and guidelines are:

- Regulation for the Provision of Electronic Retail Transfers
- E-Money Regulation
- Regulation for the Designation of a Payment System
- Regulation for the Designation of a Payment Instrument
- Anti-Money Laundering Guidelines for the provision of Mobile Payments

These regulations are aimed at ensuring that Payment Service Providers conduct their businesses prudently and in accordance with the provisions of the NPS Act. The NPS Act provides for Central Bank power and authority to oversee all payments systems including those that the Bank does not operate.

3.2 CONNECTIVITY TO KEPSS

The system integration between Kenya Revenue Authority's Common Cash Receipting System (CCRS), the Central Bank back office T24 System and KEPSS was finalized and testing of functional operation is being undertaken. The integration will increase efficiency of KRA in receiving and managing tax revenues.

3.3 EAST AFRICAN CROSS BORDER PAYMENT SYSTEM

The East Africa Payment System functionalities have been integrated to the live environment of the EAC member states' respective Real Time Gross Settlement Systems and is currently undergoing the pilot run. This will provide a platform for efficient and safe settlement of intra-regional financial transactions across the EAC member countries.

3.4 CHEQUE TRUNCATION PROJECT

The Cheque Truncation System (CTS) implemented in August 2011 transformed the country's cheque clearing cycle to T + 2. This ensured a high turnover for cheque payments and contributed to a significant improvement of cash flow in the economy. CTS also improved the safety and efficiency of the clearing house by minimizing fraud through encryption of standard security features for all cheques and reducing handling costs for commercial banks. The Kenya Bankers Association in liaison with the Central Bank is exploring modalities of clearing cheques in a T + 1 cycle.

13. CURRENCY DEVELOPMENTS

The following is a summary of developments in Currency Management in the financial year 2012/13:

Currency in Circulation

Overall Currency in Circulation increased by Ksh 23.7 billion in the year as detailed below:

TABLE 13.1: CURRENCY IN CURCULATION

CENTRE	CIRCULATION JUNE 30TH 2012 (KES.)	CIRCULATION JUNE 30TH 2013 (KES.)
Nairobi	197,761,461,471.20	212,553,683,178.00
Mombasa	39,424,138,826.25	44,550,187,481.00
Kisumu	-2,972,157,860.00	4,249,302,170.00
Eldoret	-65,826,490,524.70	-66,685,537,122.00
Nyeri	539,321,000.00	2,014,856,000.00
Nakuru	-11,945,997,000.00	-20,124,026,000.00
Meru	2,506,161,000.00	6,682,051,000.00
Total	**159,486,436,912.75**	**183,240,516,707.00**

Source: Central Bank of Kenya, Currency Operations and Branch Administration Department

Currency Centres

The three Currency Centres in Nyeri, Nakuru and Meru account for a total of 14 percent of all Currency activities in the Country. The Centres serve a total of 185 commercial bank branches.

Combating Counterfeits

In an effort to ensure that counterfeiting is minimized, the Bank stepped up its public awareness campaigns on Security features of Banknotes. It scored up public education on currency and security features during the Nairobi international trade fair and the Mombasa, Kisumu, Eldoret, Nyeri, Nakuru and Meru Agricultural Shows. The Bank also collaborated with other large cash handling institutions through the Kenya School of Monetary Studies in ensuring that their employees are educated on security features of Banknotes

14. REGIONAL INTEGRATION DEVELOPMENTS

1.0 INTRODUCTION

The Central Bank participates in a number of regional integration initiatives and programmes, particularly those relating to monetary and financial integration. These initiatives include the implementation of monetary and financial cooperation programmes of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB). This chapter reviews the progress in the implementation of macroeconomic convergence and other financial and monetary developments in the EAC, COMESA and AACB in 2012/13.

2.0 THE EAC MONETARY COOPERATION PROGRAMME

2.1 Background

Pursuant to economic integration efforts, Articles 5, 82 to 85 of the EAC Treaty, provides that Partner States undertake to cooperate in monetary and fiscal matters in accordance with the approved macro-economic policies, harmonization programmes and convergence framework. Partner States Central Banks through the Monetary Affairs Committee of Governors (MAC) are mandated to steer aspects of the EAC treaty relating to monetary and financial cooperation. MAC is tasked with laying the foundation for a monetary union charaterised by a single currency and one central bank for the region among other related aspects in East Africa. The specific objectives of MAC include the following: Monetary Policy Harmonization; Macroeconomic Convergence; Capital Account Liberalization; Harmonization of Legal and Regulatory Framework of Banking Supervision; Development of the Payment System; Information Technology Infrastructure Development; and Financial Markets Integration, among others.

The Monetary Affairs Committee (MAC) of the East African Community (EAC) held its 16th ordinary meeting on 23rd May, 2013 in Kampala, Uganda. Key highlights of the meeting included: enhancing currency convertibility in the region, progress in the East African Payment Systems (EAPS) implementation, legal and regulatory frameworks harmonization particularly with regard to the banking and microfinance sub-sectors, information technology, and the building of requisite technical capacity to facilitate effective conduct of monetary policy and support for the East African Monetary Union.

The Governors noted the completion of the studies they had commissioned to inform the EAC Monetary Union negotiation process which had been forwarded to the High Level Task Force (HLTF) spearheading negotiation of the EAMU Protocol. In particular, the studies on "*Exchange Rate Arrangements in the Transition to the East African Monetary Union (EAMU)*" and "*Harmonization of Monetary Policy Frameworks in the EAC*", contributed to the drafting and negotiation of articles on transitional arrangements, exchange rate arrangements and monetary policy frameworks in the draft EAMU protocol. The MAC reported progress in the EAPS project aimed at interlinking all the Real Time Gross Settlement Systems in the region to enable cross border transactions to be processed in an efficient manner, which is essential for boosting intra-regional trade. Progress was also reported on various initiatives to enhance currency convertibility that would further facilitate intra-regional trade in the EAC. The importance of regional and international banks in the EAC economies and the associated risks required for effective systems of consolidated supervision, was noted. The Governors therefore agreed to consider the establishment of supervisory colleges for the region in order to enhance oversight on regulatory challenges emanating from the emergence of cross border banking.

PROGRESS OF THE EAC MONETARY UNION INTEGRATION

The Governors, under the Sectoral Coordination Committee of the Council on East African Monetary Union (SCEAMU) held the second and third meetings in Kigali (February 2013) Arusha (July 2013), respectively.

The Sectoral Coordination Committee of the Council on East African Monetary Union provided guidance to the HLTF on all outstanding matters in the East African Community Monetary Union (EAMU) Draft Protocol during the negotiation process. The Sectoral Coordination Committee also provided guidance on the road map of the EAMU. Subsequently, the Sectoral Council on East African Monetary Union finalized all outstanding matters on the draft protocol during the third meeting of the SCEAMU, in Kigali.

The EAMU draft protocol has been forwarded to a drafting team that will submit the protocol to the 15th meeting of the Sectoral Council on Legal and Judicial Affairs for legal input. The draft protocol will then be considered by the Council in a meeting scheduled for November, 2013 before signing by the Heads of State.

2.1 EAC Macroeconomic Convergence Criteria and Progress in 2011

Since May 2007, the Governors of EAC Partner States adopted a set of convergence criteria with the following timelines.

- **Stage 1 (Year 2007-2010)**
- **Stage II (2011-2014)**
- **Stage III (2015)**

The criteria were classified into primary and secondary criteria. The primary criteria are the preconditions for convergence, which need to be met while secondary criteria reinforce the primary criteria. The primary criteria include benchmarks on fiscal deficits, inflation and external reserves. The secondary criteria include areas of policy and real convergence.

Stage II (2011-2014)

The primary criteria are:

(a) Overall budget deficit to GDP ratio (excluding grants) not exceeding 5 percent; and overall budget deficit to GDP Ratio (including grants) not exceeding 2 percent;

(b) Annual average inflation rate of not more than 5 percent;

(c) External reserves of more than 6 months of imports of goods and non-factor services.

The Secondary Criteria are:

(a) Maintenance of market based interest rates;
(b) Achievement of sustainable growth rate of real GDP of not less than 7.0 percent.
(c) Sustained pursuit of debt sustainability;
(d) Domestic savings to GDP Ratio of at least 20 percent;
(e) Maintenance of sustainable level of current account deficit (excluding grants) as percent of GDP;

Growth in the EAC region has remained generally robust. In 2012, output growth for the region averaged 5.2 percent compared to 6.1 percent in 2011. Kenya and Tanzania recorded average growth rates of 4.7 percent and 6.9 percent in 2012, respectively compared to 4.4 percent and 6.4 percent in 2011. In 2012, Uganda, Rwanda and Burundi experienced decelerated growth averaging at 2.6 percent, 7.7 percent and 4.0 percent respectively compared to 6.7 percent, 8.6 percent and 4.2 percent in 2011. Going forward, growth for the region is projected to accelerate to 6.0 percent in 2013 and 6.4 percent in 2014. The factors that have supported growth include strong investment, favorable commodity prices and generally prudent macroeconomic management, among others.

Inflation in the region dropped from 13.2 percent in 2011 to 11.5 percent in 2012 and is expected to maintain the downward trend in 2013. The slowing pace of inflation is attributed to moderation of world food and fuel prices, prior tightening of monetary policies in high-inflation countries, and improved weather conditions. Disinflation was particularly marked in Burundi (from 14.9 percent to 11.8 percent), Kenya (14 percent to 9.4 percent) and Uganda (18.7 percent to 14.1 percent). However, Rwanda and Tanzania experienced some upward pressures in the 2011-2012 periods.

In 2012, the region recorded a widening current account deficit of 12.5 percent compared to 11.1 percent in 2011. The widening of current account deficits across much of EAC region is largely attributed to the sluggish external demand for exports. Exports have weakened significantly over the past year from 21.1 percent of GDP in 2011 to 19.8 percent of GDP in 2012, and are expected to slow down further to 19.1 percent of GDP in 2013. Fiscal deficits remain higher in most countries in the region largely attributed to reduced revenues and higher expenditures. Consequently, countries in the EAC region have witnessed higher public debt. Rebuilding policy buffers and containing inflation remains a priority in the EAC.

Kenya's performance with respect to each convergence criteria are provided in Table 14.1. Under the primary criteria, Kenya's annual average inflation dropped to an average of 4.6 percent in the financial year 2012/2013 compared to 16.0 percent in the financial year 2011/2012 fulfilling the EAC criteria of annual average inflation of not more than 5 percent. On the budget deficit, Kenya did not meet this criterion due to increases in expenditure levels and declining revenue collections. Performance of the official external reserves improved from 4.3 months of import cover to 4.4 months of import cover, however this was below the EAC target level of at least 6 months of external reserves. On the secondary criteria, Kenya met the criteria of maintaining positive real interest rates. In the year to June 2013, Kenya real interest rate was 0.3 percent compared to -0.2 percent in June 2012. The positive real interest rate was largely attributed to a declining inflation rate over this period. Performances of all the other secondary criteria were within the EAC targets.

TABLE 14.1: MACROECONOMIC PERFORMANCE AND CONVERGENCE UNDER THE EAC CRITERIA

Criteria	Target level Stage 2 and Date	2008	2009	Jun-10	Jun-11	Jun-12	Jun-13
Budget Deficit (Excl. Grants) / GDP*	Not exceeding 5% between 2011-2014	(5.2)	(5.7)	(7.9)	(5.2)	(6.1)	(7.4)
Budget Deficit (Incl. Grants) / GDP*	Not exceeding 2% between 2011-2014	3.9	4.9	(4.4)	(4.5)	(5.6)	(6.8)
Inflation rate– annual average	not > 5% per year between 2011-2014	16.2	9.4	5.4	6.9	16.0	4.6
Gross Foreign Exchange Reserves in Months of Imports of goods & non-factor services**	External Reserves of more than 6 months of imports of goods and non-factor services between 2011-2014	4.5	3.6	3.9	3.8	4.3	4.4
GDP Growth Rate At Factor Cost-constant prices***	Not less than 7% p.a. between 2011-2014	1.1	2.6	5.7	3.8	4.4	
Current Account Deficit (Excl. Grants) / GDP	Sustainable levels between 2011-2014	(7.3)	(5.3)	(6.0)	(8.2)	(9.5)	(11.4)
Gross National Savings/GDP***	at least 20% between 2011-2014	15.9	12.9	11.8	14.0	12.2	

* Fiscal year 2012/13 is provisional budget deficit as a percent of GDP on commitment basis: Source various Quarterly

** Based on average of 36 monhts import

*** at Basic Prices: Source 2012 Economic Surveys

The performance of individual EAC Partner States against the above criteria has been characterized with missed targets in most cases. This has led to the current efforts to revise the targets to reflect the economic realities of the EAC Partner States, taking into account that there are new entrants into the community. The new targets are still being negotiated by Partner States in order to form the bench marks to be enshrined in the EAMU protocol.

THE COMESA MONETARY COOPERATION PROGRAMME

Background

The mandate to establish a Monetary Union in the COMESA region is derived from Article 4 (4) of the COMESA Treaty signed in Kampala, Uganda on November 5, 1993, which states that the Member States shall "in the field of monetary affairs and finance, co-operate in monetary and financial matters and gradually establish convertibility of their currencies and a payments union as a basis for the eventual establishment of a monetary union". To be consistent with the Africa Monetary Cooperation Programme led by the Association of African Central Banks and to fast track achievement of a monetary union, the Seventh Meeting of the Ministers of Finance held in Lusaka, Zambia in November, 2004 adopted revised macroeconomic convergence criteria aimed at establishing a monetary union in COMESA by 2018. The revised convergence criteria, are categorized into primary (preconditions for convergence) and secondary (reinforcement conditions) criteria, to be implemented in three phases; (i) Stage 1 (2005-2010), Stage 2 (2011-15) and; Stage 3 (2016-18). The following are convergence criteria in the second stage.

Primary Criteria:

(a) Overall budget deficit/GDP ratio (excluding grants) of not more than 4 percent;
(b) Annual average inflation rate not exceeding 3 percent;
(c) Eliminate central bank financing of the budget.

(d) External reserves of equal to or more than 5 months of imports of goods and non-factor services;

Secondary Criteria

(a) Achievement and maintenance of stable real exchange rates;
(b) Achievement and maintenance of market based positive real interest rates;
(c) Achievement of a sustainable real GDP of not less than 7 percent;
(d) Pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to sustainable level;
(e) Total domestic revenue to GDP ratio of at least 20 percent.
(f) Maintenance of current account deficit (excluding grants) as a percentage of GDP to sustainable level;
(g) Achievement and maintenance of domestic investment rate of at least 20 percent;
(h) Gradual liberalisation of the Capital Account.

The key highlights during the year to June 2013 include hosting of the eighteenth Meeting of the COMESA Committee of Governors of Central Banks from 11th to 12th December, 2012 in Kigali, Rwanda to review progress on attainment of COMESA macroeconomic convergence, operations of the COMESA Monetary Institute (CMI) and the status of implementation of the Regional Payments and Settlement System. The COMESA Monetary Institute (CMI) hosted at the Kenya School of Monetary Studies (KSMS), Nairobi, Kenya became operational on 7th March 2011. The Host Agreement was finalized and endorsed by the Government of Kenya and COMESA Secretariat early in the year. The institute is currently in operation following the recruitment of the Director in 2012. Regional Payment and Settlement System (REPSS) went LIVE on 3rd October 2012 with the first transaction between Bramer Bank of Mauritius and Fina Bank of Rwanda, through their respective Central Banks. The system allows member countries to transfer funds more easily and promptly when channeling intra-COMESA import transactions. Nine central banks have already signed the REPSS Agreements and prefunded their accounts at the Bank of Mauritius. Governors also held the first COMESA Governors of

Central Bank symposium on "Financial Innovation and Inclusion: Challenges and Implications for Monetary Policy and Financial Stability" in Kampala, Uganda on 24th May 2013. The main objective of the symposium was to share experiences that will assist in designing strategies to enhance financial innovation and inclusion in member countries. Governors noted the importance of financial inclusion as an avenue for savings, credit and increasing the efficiency of monetary policy.

2.2 Kenya's Progress in the Implementation of COMESA Monetary Harmonization Programme

Kenya did not meet the primary convergence criteria for Stage 2 (Year 2011-15) of the COMESA Monetary Harmonization Programme.

- The overall budget deficit increased from 6.1 percent in the year to June 2012, to 7.4 percent in the Year to June 2013, surpassing the COMESA target of 4 percent.
- The overall annual average inflation rate declined from 16 percent in June 2012 to 4.6 percent in June 2013. The decline was largely attributed to reduction in food and energy prices over the period. However, Kenya did not meet the COMESA target of 3 percent.
- Kenya's official external reserves at 4.4 months of import cover in June 2013, was below the 5 months of import cover for the COMESA Monetary Harmonization Target.
- Kenya however, met several of the secondary criteria targets. Total domestic revenues to GDP were 23.1 percent in the year to June 2013, above the 20 percent or more COMESA target. The real interest rate was positive at 0.3 percent in the year to June 2013 compared to -0.2 percent in the year to June 2012. The real effective exchange rate remained relatively stable over the period. However, the ratio of public debt relative to GDP increased from 49.6 percent in the year to June 2012 to 51.7 percent in the year to June 2013 as a result of increased uptake of the domestic debt to finance the budget deficit.

TABLE 14.2: KENYA'S PROGRESS IN IMPLEMENTATION OF COMESA MONETARY CO-OPERATION PROGRAMME DURING STAGE 2 (YEAR 2011-2015)

Primary Criteria	Target for Stage 2 (2011-2015)	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
1. Overall budget deficit/GDP ratio (excluding grants)*	Not exceeding 4 percent	(5.2)	(5.7)	(7.9)	(5.2)	(6.1)	(7.4)
2. Inflation rate– annual average	Not exceeding 3 per cent	9.9	15.1	5.4	6.9	16.0	4.6
3. Central Bank financing of the budget deficit **	Eliminate	-	0.2	0.7	0.3	0.2	0.2
4. External reserves in months of imports of goods and non-factor services***	Equal to or more than 5 months of imports of goods and non-factor services	4.5	3.6	3.9	3.8	4.3	4.4
Secondary Criteria	Target Stage 2 (2011-2015)	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12	
1. Achievement of a sustainable real GDP ****	Not less than 7 percent	1.1	2.6	5.7	3.8	4.4	
2. Domestic fiscal receipts/GDP ratio*****	= or > 20 percent	22.0	22.0	21.9	21.9	23.1	23.1
3. Current account deficit (excluding grants) as percent of GDP	Sustainable level	(3.9)	(7.4)	(6.0)	(8.2)	(9.5)	(11.4)
4. Achievement and maintenance of domestic investment rate (%)	at least 20 percent	19.2	19.9	19.8	20.5	20.1	
5. Maintanance of positive real interest rates	Positive real interest rates	(0.7)	(0.4)	0.2	(0.7)	(0.2)	0.3
6. Maintenance of real exchange rate stability - REER Index	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	(11.3)	7.6	1.6	5.9	(15.8)	(2.6)

* Fiscal year 2012/13 is provisional budget deficit as a percent of GDP on commitment basis: Source various Quarterly
** Based on Government Audited revenues for the Fiscal year and Central Bank overdraft to GDP
*** Based on average of 36 months of import
**** at Basic Prices: Source 2012 Economic Surveys
***** Based on revenues (excluding grants) as a percent of GDP at current market prices for each fiscal year

***** Fiscal receipts= ordinary revenues (defined by the AMCP)

3.0 THE AFRICAN MONETARY COOPERATION PROGRAMME (AMCP)

3.1 Background

The AMCP was adopted during the 26th ordinary Assembly of the Association of African Central Bank (AACB) Governors held in Algiers on September 4, 2002. The programme involves the adoption of collective policy measures aimed at implementing a harmonized monetary system and a common management institution in Africa. It envisages the harmonization of the monetary cooperation programme of the various sub regional groupings as building blocks with the ultimate aim of evolving to a single monetary zone by the year 2021 with a common currency and a common central bank at the continental level. It has both primary and secondary convergence criteria under the AMCP which should be attained by at least 51 percent of the AACB Membership before the launch of the African Monetary Union by 2021.

Stage III Criteria (Year 2009 - 2012)

Observance of the following macroeconomic indicators by year 2012

Primary Criteria:

(a) Budget deficit/GDP ratio not exceeding 3 percent by 2012.
(b) Elimination of Central Bank credit to government.
(c) Inflation rate of less than 5 percent.
(d) External reserves/imports cover of equal or greater than 6 months.

Secondary Criteria:

(a) Domestic fiscal receipts/GDP - equal to or greater than 20 percent.
(b) Government capital investments/fiscal receipts – equal or greater than 20 per cent
(c) Positive real interest rates
(d) Maintenance of real exchange rate (REER) stability

Revenue collections were marginally above target with the share in GDP of 21.3 percent in the fiscal year 2012/13 compared to 21.1 percent recorded in fiscal year 2011/12. The share of wages in total domestic fiscal receipts increased to 34.9 percent in the fiscal year 2012/13 from 32.5 percent in fiscal year 2011/12. The increase can be attributed to a higher wage bill following agitation and subsequent award of higher salaries to the police and other public sector employees including the doctors. Over the same period, the share of domestic fiscal receipts allocated to finance the development budget declined to 23.8 percent from 27.3 percent. The real effective exchange rate remained stable during this period and marginally appreciated by 2.6 percent to 63.3 in June 2013 from 65 in June 2012.

3.2 Progress in Implementation of the AMCP

The year 2012 was the fourth year of the stage III of the AMCP implementation. However, due to the slowdown in the global economic activity, Africa's growth rate generally declined, but remained relatively strong with trends differing across the Sub-regions. For most countries, a number of targets under the primary criteria were not met as standards became tighter with the transition to stage III of the AMCP implementation. Only four of the forty-six countries (8.7 percent) that submitted their reports fulfilled the four primary criteria in 2012. Most of the secondary criteria of the AMCP were, however, observed.

The year 2013, according to the AMCP marks the beginning of stage IV of AMCP implementation (2013-2015). The stage introduces tougher requirements on inflation with a threshold of less than 3% against the 5% requirement in the third stage. Noting from the report of the implementation of stage III that most countries performed poorly due to adverse impact of the international economic environment, the Assembly of Governors of Central Banks during their 37th Ordinary meeting in Mauritius (August 2013) deferred proceeding to stage IV by two years during which criteria under stage III would still be valid.

The Governors observed the need for the establishment of the Community of African Banking Supervisors (CABS) to strengthen collaboration of banking supervision in Africa, especially following the aftermath of the 2008/09 global financial crisis. They insisted that there should be synergy and complementarity in the activities of the CABS and that of regional supervisory bodies.

Table 14.3 shows Kenya’s performance in the implementation of the AMCP. Kenya’s overall deficit to GDP ratio (excluding grants) rose to 7.4 percent in the fiscal year 2012/13 from 6.1 percent in fiscal year 2011/12. The budget deficit was within the programmed target of 8.9 percent, but above the AMCP target of 3 percent. The increase in overall budget deficit was mainly on account of the increased expenditure on wages and salaries, interest payments and implementation of the new constitution. In addition, real GDP growth remained sluggish, thereby resulting in reduced tax revenues.

The overall annual average inflation rate rose to 16.0 percent in June 2012 from 6.9 percent in June 2011. By June 2013 the annual inflation rate for Kenya was 4.6 percent which was within the AMCP target of 5 percent. The decline was largely attributed to increase in food supply resulting from favorable weather conditions, decline in fuel prices as well as the prudent management of liquidity in the money market. The share of credit to government to GDP remained at 0.2 percent in the fiscal year 2012/13 the same level attained during the fiscal year 2011/12. The Central Bank support for the Government was therefore minimal.

Kenya's external reserve position improved from 4.3 months of import cover as at June 2012 to 4.4 months of import cover as at June 2013. The increase is mainly attributed to the funds accessed by the Government through a dollar syndicated loan to bridge a shortfall in net domestic financing (June 2012), disbursement of funds by the International Monetary Fund under the extended credit facility (ECF-January 2011-January 2014) and purchase of reserves from the foreign exchange market.

With regard to secondary criteria, Kenya fulfilled almost all the targets under the AMCP. Domestic fiscal receipts to GDP at 23.1 percent were above the set target of 20 percent. Government Investment capital from fiscal receipts declined from 24.1 percent in the fiscal year 2011/2012 to 21.7 percent in the fiscal year 2012/2013. However, this was slightly above the AMCP target of 20 percent or more. Over the same period, Kenya maintained a positive real interest rate and the real effective exchange rate remained relatively stable.

TABLE 14.3: MACROECONOMIC PERFORMANCE AGAINST CONVERGENCE CRITERIA UNDER THE AMCP IN 2012 – AACB EASTERN AFRICA REGION

AMCP Targets for Stage III (2009 – 2013)							
Primary Criteria							
	Targets for Stage III (2009 – 2012)	2008	2009	Jun-10	Jun-11	Jun-12	Jun-13
Overall Budget deficit/GDP excluding grants*	not exceeding 3% by 2012	(5.2)	(5.7)	(7.9)	(5.2)	(6.1)	(7.4)
Inflation rate Annual Average	less than 5 percent per annum	16.2	9.4	5.4	6.9	16.0	4.6
Elimination of Central Bank Credit to Government		-	0.2	0.7	0.3	0.2	0.2
External reserves months of Imports cover** *	equal or greater than 6 months	4.5	3.6	3.9	3.8	4.3	4.4
Secondary Criteria							
	Targets for Stage III (2009 – 2012)	2008	2009	Jun-10	Jun-11	Jun-12	Jun-13
Domestic fiscal Receipts/GDP ratio	equal to or more than 20%	22.02	22.04	21.92	21.86	21.05	21.28
Salary mass/total domestic fiscal receipt ratio	Less than 35 percent	33.8	34.1	32.0	32.6	32.5	34.9
The sourcing of minimum of 20% Government investment capital from fiscal receipts	equal to or more than 20%	24.6	25.7	25.6	27.1	27.3	23.8
Current Account/GDP ratio	Sustainable level	(7.3)	(5.3)	(6.0)	(8.2)	(9.5)	(11.4)
Real effective exchange rate	Maintenance of real exchange rate stability	66.8	71.8	72.9	77.2	65.0	63.3

* Fiscal year 2012/13 is provisional budget deficit as a percent of GDP on commitment basis: Source various Quarterly Economic
** Based on Government Audited revenues for the Fiscal year and Central Bank overdraft to GDP
*** Based on average of 36 months of import
***** Based on revenues (excluding grants) as a percent of GDP at current market prices for each fiscal year

15. ECONOMIC OUTLOOK

The Kenyan economy is projected to grow by 6 percent in 2014, supported by improved supply side conditions which are expected to carry over to 2014, and sustain low inflation. The Central Bank will continue to pursue prudent monetary policy to manage domestic inflation and support interest rate stability. The exchange rate is expected to remain stable in the fiscal year 2013/14 in spite of the continued pressure from the Balance of Payments current account deficit. The banking sector is expected to sustain the growth momentum supported by the stable macroeconomic environment, domestic and regional expansion by banks and the increased economic activities occasioned by the devolved system of Government.

The main risks remain the uncertainty over the full resolution of the Euro Zone crisis and international oil prices that may continue to put pressure on the exchange rate and inflation.

APPENDIX

Appendix: Macroeconomic Indicators for Selected African Countries for the Period 2010-12

Country	2010	2011	2012
	Real GDP growth (%)		
Burundi	3.8	4.2	4.0
Ethiopia	8.0	7.5	7.0
Ghana	8.0	14.4	7.0
Kenya	***5.8***	***4.4***	***4.6***
Nigeria	8.0	7.4	6.3
Ruwanda	7.2	8.3	7.7
South Africa	3.1	3.5	2.5
Tanzania	7.0	6.4	6.9
Uganda	5.6	6.7	2.6
	Inflation rate (%) (end of period)		
Burundi	4.1	14.9	11.8
Ethiopia	14.6	35.9	12.9
Ghana	8.6	8.6	8.8
Kenya	***4.5***	***18.6***	***3.2***
Nigeria	11.7	10.3	12.0
Ruwanda	0.2	8.3	3.9
South Africa	3.5	6.1	5.6
Tanzania	5.6	19.8	12.1
Uganda	3.1	27.0	5.9
	General Government Debt as % of GDP		
Burundi	39.4	36.2	32.0
Ethiopia	27.6	25.9	21.6
Ghana	46.3	43.4	56.5
Kenya	***53.7***	***45.1***	***46.4***
Nigeria	15.5	17.2	17.8
Ruwanda	23.1	23.9	28.0
South Africa	35.9	39.6	42.3
Tanzania	37.7	40.0	41.4
Uganda	27.0	32.2	34.5
	Current Account Balance as % of GDP		
Burundi	-12.2	-13.7	-15.6
Ethiopia	-4.0	0.6	-5.8
Ghana	-8.6	-9.2	-12.6
Kenya	***-7.8***	***-9.7***	***-10.4***
Nigeria	5.9	3.6	6.6
Ruwanda	-5.9	-7.3	-10.9
South Africa	-2.8	-3.4	-6.3
Tanzania	-9.3	-13.6	-15.8
Uganda	-10.2	-11.5	-10.9
	Real Effective Exchange Rate (2005=100)		
Burundi	113.3	112.6	115.7
Ghana	97.6	92.8	86.8
Kenya	***84.9***	***88.3***	***76.8***
Nigeria	117.9	119.8	135.6
South Africa	101.2	99.1	93.7
Uganda	111.4	106.3	124.6
	Broad Money Supply, M2 as % of GDP		
Burundi	27.0	23.9	23.0
Ghana	29.5	30.9	
Kenya	***50.1***	***51.0***	***50.8***
Nigeria	32.5	33.6	36.1
South Africa	78.3	77.3	75.2
Tanzania	34.1	34.7	32.9
Uganda	26.9	26.5	24.3

Source: IMF, World Economic Outlook Database, July 2013 and Central Bank

REPUBLIC OF KENYA

KENYA NATIONAL AUDIT OFFICE

REPORT OF THE AUDITOR-GENERAL

ON

THE FINANCIAL STATEMENTS OF CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2013

REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE CENTRAL BANK OF KENYA AT 30 JUNE 2013

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CENTRAL BANK OF KENYA
BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2013

Board of Directors

Dr Mbui Wagacha		Interim Chairperson – Elected on 11 February 2013
Prof Njuguna Ndung'u		Governor
Dr Kamau Thugge	Principal Secretary, Treasury	Appointed on 7 June 2013
Mr Joseph K. Kinyua	Permanent Secretary, Treasury	Retired on 7 June 2013
Dr William O. Ogara		
Ms Vivienne Y. Apopo		
Ms Florence K. Muindi		
Mr John G. Msafari		

Senior Management

Prof Njuguna Ndung'u	Governor
Dr Haron Sirima	Deputy Governor
Mr Kennedy K. Abuga	Director – Governors' Office and Board Secretary
Mr Aggrey J.K. Bett	Director – Special Projects - Appointed 5 November 2012
Mr Fredrick Pere	Director – Bank Supervision Department
Prof Kinandu Muragu	Executive Director – Kenya School of Monetary Studies
Mr William Nyagaka	Director – Internal Audit Department
Mr Charles Koori	Director – Research Department
Mr Cassian J. Nyanjwa	Director – Department of Estates, Supplies and Transport
Mr James T. Lopoyetum	Director – Currency Operations and Branch Administration Department - Resigned 26 June 2013
Mr Paul K. Wanyagi	Ag .Director – Currency Operations and Branch Administration Department - Appointed 12 July 2013
Mr Gerald Nyaoma	Director – Financial Markets Department
Mr Peter K. Rotich	Director – Finance & IMS Department - Appointed 5 November 2012
Mr Mark Lesiit	Director – Banking & Risk Management Department
Ms Mary Waceke	Director – Human Resources and Administration Department - Appointed 3 June 2013

Registered office and principal place of business

Central Bank of Kenya Building
Haile Selassie Avenue
P.O. Box 60000
00200 Nairobi, Kenya
Tel.(+254) (02)2860000

Branches

Mombasa Branch
Central Bank of Kenya Building
Nkrumah Road
P.O.Box 86372
80100 Mombasa

Kisumu Branch
Central Bank of Kenya Building
Jomo Kenyatta Highway
P.O.Box 4
40100 Kisumu

Eldoret Branch
Kiptagich House
Uganda Road
P.O.Box 2710
30100 Eldoret

Currency centres

Nyeri Currency Centre
Kenya Commercial Bank Building
Kenyatta Street
P.O.Box 840
10100 Nyeri

Meru Currency Centre
Co-operative Bank Building
Njuri Ncheke Street
P.O.Box 2171
60200 Meru

Nakuru Currency Centre
Central Bank of Kenya Building
George Morara Street
P.O.Box 14094
20100 Nakuru

CENTRAL BANK OF KENYA
BANK INFORMATION - CONTINUED
FOR THE YEAR ENDED 30 JUNE 2013

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Off Thika Road
Mathare North Road
P.O.Box 65041
00618 Nairobi

Main Lawyers

Oraro and Co. Advocates
ACK Garden House
1st Ngong Avenue
P.O. Box 51236
00200 Nairobi

Auditor

PricewaterhouseCoopers
Certified Public Accountants
PwC Tower, Chiromo Road
P.O. Box 43963 – 00100 GPO
Nairobi

On behalf of:-
Auditor General
Anniversary Towers
P.O. Box 30084 – 00100 GPO
Nairobi

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE
FOR THE YEAR ENDED 30 JUNE 2013

1. Statement of Corporate Governance

The Central Bank of Kenya is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from Article 231 of the Constitution of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act provides that the Board of Directors shall be composed of a Chairperson, a Governor, The Principal Secretary to the National Treasury, who is a non-voting member and five Non-Executive Directors. Previously, all the Board members were appointed by the President. With effect from 2 May 2012 however, the Act was amended and now requires that the President appoints the Governor after the conduct of a competitive process and following the approval of Parliament. The proposed procedure for appointing the Chairperson, although not yet enacted, is intended to be similar to the appointment procedure applicable to the Governor. Other than the Principal Secretary to the Treasury who is ex-officio, all the non-executive Directors of the Board are appointed by the President of the Republic of Kenya. All the Board members are appointed for terms of four years each and are eligible for reappointment provided that no Board Member holds office for more than two terms.

There are five Non-Executive Directors namely Dr Mbui Wagacha, Mr John Gerin Msafari, Ms Vivienne Yeda Apopo and Ms Florence Kagendo Muindi who are all serving their first term and Dr William Otiende Ogara who is serving his second term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

The Board meets once every two months and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to maintain full and effective control over strategic, financial and operational issues. The Board is not involved in the conduct of day-to-day business as this is the responsibility given to the Governor by the Act. It, however, retains responsibility for determining the policy of the Bank.

The Members of the Board as at 30 June 2013 and their attendance of the 5 meetings held in the year were as follows:

No	Name	Position	Discipline	Date of appointment	Nationality	Meetings attended
1	Dr Mbui Wagacha	Interim Chairperson	Economist	14 March 2011	Kenyan	5
2	Prof Njuguna Ndungu	Governor, Member	Economist	14 March 2011	Kenyan	5
3	Dr William Otiende Ogara	Member	Professional Accountant	14 March 2011	Kenyan	5
4	Mr.John Gerin Msafari	Member	Business management	1 June 2011	Kenyan	5
5	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	14 March 2011	Kenyan	4
6	Ms Florence Kagendo Muindi	Member	Human Resource	1 June 2011	Kenyan	5
7	Principal Secretary/ National Treasury	Executive Officer	Economist	Permanent	Kenyan	2

The remuneration paid to the Directors for services rendered during the financial 2013/2012 is disclosed in Note 29 of the financial statements. The Non-Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for staff loans.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2013

1. Statement of Corporate Governance (continued)

1.1. Audit Committee

The members of the Audit Committee are Dr William Otiende Ogara (Chairman), Dr Mbui Wagacha, Mr John Gerin Msafari and Ms Vivienne Yeda Apopo. The members are all Non-Executive Directors having experience in Accounting, Auditing, Economics, Banking, Financial and Business Management and Legal matters. The Committee currently meets once every two months and as necessary. The Terms of Reference for the Audit Committee cover five major areas, namely, Internal Control, Financial Reporting, Risk management, Internal Audit and External Audit.

The Audit Committee's mandate under **Internal Control** covers evaluation of control culture; the adequacy of the internal control systems and compliance with International Financial Reporting Standards in preparation of financial statements; the overall effectiveness of the internal control and risk management frameworks; and review of the effectiveness of the system for monitoring compliance with laws and regulations.

The mandate relating to **Financial Reporting** requires the Audit Committee to review significant accounting and reporting issues and their impact on the financial reports and ensure current financial risk areas are being managed appropriately. The Committee also ensures the adequacy of the financial reporting process and reviews the Bank's monthly management accounts and annual financial statements before approval by the Board and release.

With regard to **External Audit**, the Audit Committee reviews the external auditors' proposed audit scope, approach and audit deliverables; and review draft accounts before submission to the External Auditors for audit.

The Committee's mandate on **Internal Audit** covers review of the activities and resources of the Internal Audit function; effectiveness, standing and independence of internal audit function within the Bank; review of the internal audit plan; and follow up of implementation of internal auditors' findings and recommendations. The Audit Committee reports to the Board of Directors standing and independence of internal audit function within the Bank; review of the internal audit plan; and follow up of implementation of internal auditors' findings and recommendations. The Audit Committee reports to the Board of Directors on approach and audit deliverables; and review draft accounts before submission to the External Auditors for audit.

The Members of the Audit Committee as at 30 June 2013 and their attendance of the 15 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Dr William Otiende Ogara	Chairman	Professional Accountant	Kenyan	15
2	Mr John Gerin Msafari	Member	Business management	Kenyan	15
3	Ms Florence Muindi	Member	Human resource	Kenyan	8
4	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	Kenyan	7
5	Dr Mbui Wagacha	Member	Economist	Kenyan	5

1.3 Monetary Policy Committee (MPC)

Section 4D of the CBK (Amendment) Act 2008 establishes the Monetary Policy Committee. The committee is responsible for formulating monetary policy and is required to meet at least once in two months. Members of the committee are appointed by the Minister for Finance for an initial period of three years each and may be reappointed for another final term of three years.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2013

1. 1 Statement of Corporate Governance (continued)

1.3 Monetary Policy Committee (MPC) (continued)

The Members of the MPC as at 30 June 2013 and their attendance of the 6 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Prof Njuguna Ndungu	Chairman	Economist	Kenyan	6
2	Dr Haron Sirima	Vice Chairman	Economist	Kenyan	6
3	Principal Secretary/ National Treasury	Member	Economist	Kenyan	6
4	Prof Francis Mwega	Member	Economist	Kenyan	6
5	Prof Terry C. Ryan	Member	Economist	Kenyan	6
6	Mrs Sheila Mbijjewe	Member	Finance	Kenyan	6
7	Mrs Farida Abdul	Member	Economist	Kenyan	6
8	Mr Charles Koori	Internal-Member	Economist	Kenyan	6
9	Mr John K. Birech	Internal-Member	Economist	Kenyan	6

1.4 Human Resources Committee

The Committee meets once every two months and when need arises to review human resource policies and make suitable recommendations to the Board. The Governor and the Deputy Governor attend the meetings as and when necessary.

The Members of the Human Resources as at 30 June 2013 and their attendance of the 8 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Florence K. Muindi	Chairperson	Human Resource	Kenyan	8
2	Dr William Otiende Ogara	Member	Finance	Kenyan	8
3	Mr John Gerin Msafari	Member	Business management	Kenyan	8
4	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	Kenyan	2

1.5 Financial Stability and Investment Committee

The Committee meets regularly and as and when need arises to review financial stability issues and foreign reserves management and investments policies and make suitable recommendations to the Board.
Members of this Committee who served during the year are as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Vivienne Yeda Apopo	Chairperson	Lawyer and banker	Kenyan	5
2	Dr William Otiende Ogara	Member	Finance	Kenyan	5
3	Dr Mbui Wagacha	Member	Economist	Kenyan	5

1.6 Management Structure

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on page 76. The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

There are several other Management Committees, which advise the Governor on specific issues in order to enable him to discharge his responsibilities as the Chief Executive Officer of the Bank.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2013

1. Statement of Corporate Governance (continued)

1.3 Code of Ethics

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests, which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct apply to the entire Bank's staff under the staff rules and regulations.

1.4 Internal Controls

The Management of the Bank has put in place a series of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2005. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

1.5 Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of Bank policies and procedures. There is a budget and a procurement plan that is prepared and approved by the Board before commencement of the financial year. The Board of Directors receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.

1.10 Internal Audit and Risk Management

The internal audit function is performed by Internal Audit Department. Risk Management Unit is a separate function under Banking Department and is responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit Department and Risk Management are availed to the Audit Committee of the Board.

1.11 Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explains current monetary policy and also provides the expected monetary policy stance. In addition, the Bank issues policy briefs to the Treasury on both the monetary and fiscal policies. On an annual basis, the Financial Statements are published in the Kenya Gazette and are also placed in the Bank's website.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2013

2. Financial Performance

The Bank's financial performance is affected by monetary policy undertaken, money supply, interest rates and exchange rate. The Bank's financial performance is presented on page 87 of these financial statements.

During the financial year ended 30 June 2013, the Bank's net interest income after impairment charge was Shs 1,912 million (2012: Shs 7,422 million). The decline is due to monetary policy undertaken in the year due to mop-up of excess liquidity in the economy. The reduction was further compounded by the low interest rates recorded on the foreign denominated deposits and investments.

The Bank's unrealized foreign exchange gains were Shs 5,623 million (loss 2012: Shs 27,993 million) due to favourable movements in major foreign exchange rates.

Trading income mainly generated from sale of foreign currency reduced to Shs 1,699 million (2012: Shs 2,902 million). The decrease in trading income is due to favourable movements in major foreign exchange rates.

Administrative expenses decreased to Shs 9,325 million (2012: Shs 12,058 million) as a result of the one off provision of Shs 4,686 million recorded in 2012. The one off provision posted in 2012 was offset by increases in staff expenses at Shs 3,483 million (2012: Shs 2,908 million) as the Bank introduced a defined contribution retirement benefit scheme. Currency costs increased to Shs 2,396 million (2012: Shs 1,216 million) as the Bank makes investments in the new generation currency to comply with Constitutional requirements. Administrative expenses were further reduced by actuarial gain of Shs 600 million (loss 2012: Shs 69 million) from revaluation of the Retirement Benefit Asset.

The Bank revalues its leasehold land and buildings every three years. The last valuation was in 2012 which resulted in gains of Shs 7,498 million.

The outcome of the Bank's operations was a net surplus of Shs 3,652 million (deficit 2012: Shs 18,356 million) that has been added to the general reserve fund.

The financial position for the year is set out on page 12. The Bank's assets increased to Shs 590,389 million (2012: Shs 509,498 million) fostered by favorable exchange rates compared to the previous year. Excess liquidity mop-up activities resulted in a decrease in advances to banks to Shs 351 million (2012: Shs 9,973 million).

Liabilities on the other hand increased to Shs 537,470 million (2012: Shs 458,731 million) due to higher liquidity as evidenced by higher deposits from banks and government at Shs 191,671 million (2012: 160,642 million) and currency in circulation at Shs 183,047 million (2012: Shs 159,216 million). The Bank instituted excess liquidity mop-up monetary policy measures resulting in investments by banks of Shs 41,589 million (2012: Shs 35,368 million). The increase was further fostered by favorable exchange rates compared to the previous year.

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2013

The directors submit their report together with the audited financial statements for the year ended 30 June 2013, which shows the state of affairs of Central Bank of Kenya (the "Bank").

Incorporation

The Bank is incorporated under Article 231 of the Constitution of Kenya, 2010.

Principal activities

The Bank is established and administered under the Constitution of Kenya, 2010 with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

Results and dividend

The surplus for the year of Shs 3,652 million (deficit 2012: Shs 25,854 million) has been added to the general reserve fund. The directors do not recommend the payment of a dividend. (2012: Shs 1.5 billion).

Board of Directors

The Board of Directors who served during the year and up to the date of this report are listed on page 76.

Auditors

The Bank is audited by the Auditor General in accordance with Section 12 of the Public Audit Act and the Central Bank of Kenya Act.

By order of the Board

C. K. Abuga
BOARD SECRETARY
23rd September 2013

CENTRAL BANK OF KENYA
STATEMENT OF DIRECTORS' RESPONSIBILITY
FOR THE YEAR ENDED 30 JUNE 2013

The directors are responsible for the preparation of financial statements for each financial year that give a true and fair view of the state of affairs of the Bank as at the end of the financial year and of the Bank's surplus. The directors also ensure that the Bank keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the Bank. They are also responsible for safeguarding the assets of the Bank.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable estimates, in conformity with International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of the Bank's surplus in accordance with International Financial Reporting Standards. The directors further accept responsibility for the maintenance of accounting records that may be relied upon in the preparation of financial statements, as well as designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement.

Nothing has come to the attention of the directors to indicate that the Bank and its subsidiary will not remain a going concern for at least twelve months from the date of this statement.

Governor

23rd September 2013

Director

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2013

REPUBLIC OF KENYA

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NAIROBI

KENYA NATIONAL AUDIT OFFICE

REPORT OF THE AUDITOR- GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2013

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Central Bank of Kenya set out on pages 11 to 47, which comprise the consolidated statement of financial position as at 30 June 2013, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information have been audited on my behalf by PricewaterhouseCoopers, auditors appointed under Section 39 of the Public Audit Act, 2003 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 13 of the Public Audit Act, 2003.

Auditor-General's Responsibility

My responsibility is to express an independent opinion on the financial statements based on the audit and report in accordance with the provisions of Section 15(2) of the Public Audit Act, 2003 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. The audit was conducted in accordance with

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International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at 30 June 2013, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Central Bank Act, Cap 491 of the Laws of Kenya.

Edward R.O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

26 September 2013

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Consolidated Statement of Comprehensive Income

	Notes	Year ended 30 June 2013 Shs' million	2012 Shs' million
Interest income	4	5,904	8,308
Interest expense	5	-4,037	-888
Net interest income		1,867	7,420
Decrease in loan impairment	16	45	2
Net interest income after loan impairment charges		1,912	7,422
Fees and commission income	2(q)	3,000	3,000
Net trading income	6	1,699	2,902
Other income	7	798	893
Operating income/(loss)		7,409	14,217
Operating expenses	8	-9,325	-12,058
Operating (deficit)/surplus before unrealised gains/(losses)		-1,916	2,159
Unrealized gains and losses:			
Foreign exchange gain/(loss)		5,623	-27,993
Fair value loss on financial assets held for trading		-55	-20
Surplus/(deficit) for the year		3,652	-25,854
Other comprehensive income			
Fair value gain on land and buildings		-	7,498
Total comprehensive income for the year		3,652	-18,356

The notes on pages 91 to 123 are an intergral part of these financial statements

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Consolidated Statement of financial position

	Notes	As at 30 June 2013 Shs' million	2012 Restated Shs' million
Assets			
Balances due from banking institutions- Local	10	55,200	60,008
Advances to banks	15	351	9,973
Balances due from banking institutions- Foreign	12	395,493	335,275
Funds held with International Monetary Fund (IMF)	14(a)	2,694	2,200
Loans and advances	16	2,645	3,560
Financial assets at fair value through profit or loss	11	77,929	42,678
Investments securities – Available-for-sale	13	6	-
Other assets	17	4,119	2,557
Property and equipment	19	12,052	11,651
Intangible assets	20	973	1,272
Retirement benefit asset	18	2,967	2,193
Due from Government of Kenya	21	35,960	38,131
Total assets		**590,389**	**509,498**
Liabilities			
Currency in circulation	22	183,047	159,216
Deposits from banks and government	23	191,671	160,642
Due to International Monetary Fund (IMF)	14(b)	118,568	101,868
Investments by banks	24	41,589	35,673
Other liabilities	25	2,595	1,332
Total liabilities		**537,470**	**458,731**
Equity and reserves			
Share capital	26	5,000	5,000
General reserve fund		39,020	35,368
Revaluation reserve		8,899	8,899
Proposed dividend		-	1,500
Total equity		**52,919**	**50,767**
Total equity and liabilities		**590,389**	**509,498**

The financial statements on pages 89 to 120 were authorised for issue by the Board of Directors on 23 September 2013 and signed on its behalf by:

Governor

Director

The notes on pages 91 to 123 are an integral part of these financial statements.

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Consolidated Statement of Changes in equity

	Share capital Shs' million	Accumulated surplus Shs' million	Revaluation reserve Shs' million	Proposed dividend Shs' million	Total Shs' million
Balance at 1 July 2011	5,000	62,722	1,401	-	69,123
Deficit for the year	-	-25,854	-	-	-25,854
Other comprehensive income:					
Fair value on valuation of leasehold land	-	-	7,498	-	7,498
Total comprehensive income for the year	-	-25,854	7,498	-	-18,356
Transactions with owners					
Proposed dividends	-	-1,500	-	1,500	-
Balance at 30 June 2012	5,000	35,368	8,899	1,500	50,767
Balance at 1 July 2012	5,000	35,368	8,899	1,500	50,767
Surplus for the year	-	3,652	-	-	3,652
Other comprehensive income	-	-	-	-	-
Total comprehensive income for the year	-	3,652	-	-	3,652
Transactions with owners					
Dividends paid	-	-	-	-1,500	-1,500
Balance at 30 June 2013	5,000	39,020	8,899	-	52,919

The notes set out on pages 91 to 123 form an integral part of these financial statements

The revaluation reserve relates to unrealized gains on valuation of land and buildings.

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Consolidated Statement of cash flow

	Notes	Year ended 30 June 2013 Shs' million	2012 Shs' million
Net cash generated from operating activities	27	65,029	61,786
Cash flows from investing activities			
Purchase of property plant and equipment	19	(1,230)	(1,924)
Purchase of intangible assets	20	(46)	(319)
Proceeds from disposal of property and equipment		11	5
Net (purchase)/sale of financial assets			
- held for trading		(55,933)	(19,630)
- held to maturity		(7,331)	(7,211)
- available-for-sale		(6)	-
- funds held with International Monetary Fund (IMF)		(494)	531
Net cash used in investing activities		(46,527)	(28,548)
Cash flows from financing activities			
Proceeds from due to International Monetary Fund (IMF)		16,700	15,353
Dividends paid		(1,500)	(2,641)
Net cash from financing activities		15,200	12,712
Increase in cash and cash equivalents		40,960	45,950
Cash and cash equivalents at start of year		367,466	321,516
Cash and cash equivalents at end of year	28	408,426	367,466

The notes on pages 91 to 123 are an intergral part of these financial statements

CENTRAL BANK OF KENYA
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Notes

1 General information

Central Bank of Kenya (the "Bank") is established by and derives its authority and accountability from the Central Bank of Kenya Act Cap 491 of the Laws of Kenya (the "CBK Act"). The Bank is wholly owned by the Government of Kenya and is domiciled in Kenya. The Bank acts as banker, advisor and agent of the Government of Kenya.

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS). The measurement basis applied is the historical cost basis, except where otherwise stated in the accounting policies below. The financial statements are presented in Kenya Shillings (Shs), rounded to the nearest million.

Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

Amendment to IAS 1, 'Presentation of Financial Statements' as regards presentation of other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The application of this amendment will not have a material impact on the Bank's financial statements.

There are no other IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on 1 July 2012 that would be expected to have a material impact on the Bank.

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 July 2012, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except the following:

Standard	Title	Applicable for financial years beginning on/after
IFRS 9	Financial instruments	1 January 2015
IFRS 10	Consolidated financial statements	1 January 2013
IFRS 12	Disclosure of interests in other entities	1 January 2013
IAS 19 (R)	Employee benefits	1 January 2013
IFRS 13	Fair value measurement	1 January 2013

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Notes (continued)

2 Summary of significant accounting policies (continued)

Changes in accounting policy and disclosures (continued)

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank (continued)

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. Issued in November 2009 and October 2011, it replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The directors are yet to assess IFRS 9's full impact and intend to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015.

IFRS 10, 'Consolidated financial statements' - is a new standard that replaces the consolidation requirements in SIC-12 Consolidation—Special Purpose Entities and IAS 27 Consolidated and Separate Financial Statements. The standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

The revised definition of control focuses on the need to have both power and variable returns before control is present. The Bank will need to consider the new guidance.

IFRS 12, 'Disclosure of Interests in other entities'- includes the disclosure requirements for all forms of interests in other entities, including interests in subsidiaries, associates, joint arrangements, special purpose entities and other off balance sheet vehicles. The Bank is yet to assess IFRS 12s full impact.

IAS 19 (Revised), 'Employee benefits', was amended in June 2011. The impact on the Bank will be to immediately recognise all past service costs and to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit asset. The adoption of the standard will result in a significant increase in the retirement benefits asset on the Bank's statement of financial position when the unrecognised actuarial gains are recognised on 1 July 2013.

IFRS 13, 'Fair value measurement', aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The application of IFRS 13 may enhance fair value disclosures in certain circumstances.

Other amendments and interpretations to standards became mandatory for the year beginning after 1 July 2012 but had no significant effect on the Bank's financial statements.

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Notes (continued)

2 Summary of significant accounting policies (continued)

(b) Consolidation

Kenya School of Monetary Studies is a subsidiary to the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

The group uses the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

The excess of the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between group entities are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

(c) Functional currency and translation of foreign currencies

i. Functional and presentation currency

Items included in the financial are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency'). The financial statements are presented in Kenya Shillings ("Shs") which is the Bank's functional currency.

ii. Transactions and balances

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/(losses)'.

(d) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in investments by banks.

Securities purchased under agreements to resell ('reverse repos') are recorded as advances to banks. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

The Bank from time to time mops up money from the financial market ('repos') or injects money into the market ('reverse repos') with maturities of 4-7 days. The Bank engages in these transactions with commercial banks only. These have been disclosed in the financial statements as 'advances to banks' and 'investments by banks'.

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Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities

i. Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale financial assets. The directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consist of debt host and embedded derivatives that must be separated.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as Fair value loss on financial assets held for trading '. Interest income and expense and dividend income and expenses on financial assets held for trading are included in interest income' and ‘interest expense’ respectively.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

The Bank operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The loans are granted to staff at an interest rate of 3% per annum which generally below the prevailing market interest rates. Loans issued at non market rates are initially be measured at fair value (by discounting the related cash flows using market rates of interest) and subsequently carried at amortised cost. The difference between the fair value of the loans and the carrying amount at inception is treated as a long term employee benefit and is accounted for as a deferred cost. The resulting loan adjustment account is released to interest income over the loan period in line with the unwinding of the discount, while the deferred cost is expensed to staff costs as the services are rendered to the Bank over the period of the loan.

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Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

i. Financial assets (continued)

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.

Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value remeasurements are included in other comprehensive income.

ii. Financial liabilities

The Bank's holding in financial liabilities represents mainly deposits from banks and government and other liabilities. Such financial liabilities are initially recognised at fair value and subsequently measured at amortised cost.

Cash Reserve Ratio are statutory deposits taken from commercial banks and non-bank financial institutions for liquidity management as part of monetary policies in accordance with the Kenyan Banking Act and are interest free.

iii. Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial instruments is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

CENTRAL BANK OF KENYA
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Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

iv. De-recognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

v. Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2013	2012
				Shs' million.	Shs' million.
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank Reserve Asset Management Programme (RAMP) financial assets	26,263	25,765
			Fixed income securities	51,608	16,839
		Designated at initial recognition	Gold holdings	58	74
	Loans and receivables	Loans and advances to banks		-	-
		Loans and advances to staff		2,645	3,560
		Due from Government	Government loan	28,960	30,874
			Overdraft facility to Government	7,000	7,257
		Investment in debt securities	Term deposits	395,493	335,275
	Available-for-sale	Investment securities	SWIFT shares	6	-
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Term auction deposits	30,983	22,064
			Cash reserve ratio and current account deposits	113,647	105,371
			Repurchase agreements	10,606	13,609
		Deposits from Government institutions		78,024	55,271

vi. Impairment of financial assets

a. Loans and receivables

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss on loans carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount, and for a collateralised loan, after taking into account any value of the security which has been realised.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

vi. Impairment of financial assets (continued)

a. Available for sale financial assets

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

If any such evidence exists for available-for-sale financial assets, impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

vii. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(f) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

(g) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Bank is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Land and buildings are stated at valuation less accumulated depreciation. Valuations are carried out every three years.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is de-recognised. All other repair and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

Freehold land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Leasehold land	Over the period of the lease
Buildings	20 years
Motor vehicles	4 years
Furniture and equipment	5-10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in 'other income' in profit or loss. When revalued assets are sold, the amounts included in other reserves are transferred to the general reserve.

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Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

i. it is technically feasible to complete the software product so that it will be available for use;
ii. management intends to complete the software product and use or sell it;
  - there is an ability to use or sell the software product;
  - it can be demonstrated how the software product will generate probable future economic benefits;
  - adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and

iii. the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

(i) Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(j) Employee benefits

The Bank operates a defined benefit and defined contribution pension schemes. The schemes are funded through payments to trustee-administered funds on a monthly basis.

On the defined contribution scheme, the Bank pays fixed contributions to the scheme. The payments are charged to the profit or loss in the year to which they relate. The Bank has no further payment obligation once the contributions have been paid.

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on age, years of service and compensation.

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Notes (continued)

2 Summary of significant accounting policies (continued)

(j) Employee benefits (continued)

The assets of the scheme are held by the Bank in an independent trustee administered fund. The asset recognised in the statement of financial position in respect of the defined benefit pension scheme is the fair value of the scheme's assets less the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of Kenya treasury bonds that have terms to maturity approximating to the terms of the related pension liability.

The asset recognised in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to profit or loss over the employees' expected average remaining working lives.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The Bank and all its employees contribute to the National Social Security Fund, which is a defined contribution scheme.

A defined contribution plan is a retirement benefit plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank's contributions to the defined contribution scheme are charged to the profit or loss account in the year in which they fall due.

The estimated monetary liability for employees' accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

(k) Income tax

Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation at a rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(m) Dividend payable

The Central Bank of Kenya Act (Cap 491) allows the Bank to retain at least 10% of realized income after taking into account expenses. In addition to this, the Board of Directors in the year 2007 set a policy that all dividends shall be net of unrealized income and other revaluations gains in addition to the retention allowed by the Act.

Dividends on ordinary shares are charged to equity in the period in which they are declared.

(n) Share capital

Ordinary shares are classified as 'share capital' in equity.

(o) Leases

Bank as lessee

The leases entered into by the Bank are primarily operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Bank as lessor

The group leases certain property, plant and equipment where it does not transfer substantially all the risks and benefits of ownership of the assets. The operating leases generate rental income which is recorded in the income statement on a straight-line basis over the period of the lease.

(p) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
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Notes (continued)

2 Summary of significant accounting policies (continued)

(q) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided.

The Bank earns from the Government a commission of 1.5% of amounts raised through its agency role in the issuance of Treasury bills and bonds. The annual commission income is limited to Shs 3 billion as per the agreement between the Bank and Treasury effective 1 July 2007. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.

(r) Commitments on behalf of the Kenya Government and National Treasury

The Bank issues Treasury Bonds and Bills on behalf of the National Treasury. Commitments arising on such transactions on behalf of Kenya Government and National Treasury are not included in these financial statements as the Bank is involved in such transactions only as agent.

(s) Currency in circulation

Notes and coins in circulation are measured at cost. Currency in circulation represents the nominal value of all bank notes and coins held by the public and commercial banks.

(t) Inventories

The Bank's inventory is comprised of new currency not issued. Inventories are stated at the sum of the production costs. Cost is determined using the first-in, first-out (FIFO) method.

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the profit or loss from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition.

Useful lives of the various banknotes denominations are currently estimated as follows:

Shs 1,000	2 years
Shs 500	2 years
Shs 200	2 years

The useful life for all other denominations is estimated at 1 year.

(u) Loan due from the Government of Kenya

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act to limit the Bank's lending to Government of Kenya to 5% of Government of Kenya audited revenue.

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the Government agreed to repay the loan at Shs 1.11 billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

The loan due from the Government of Kenya is categorised as a loan and receivables and is measured at amortised cost.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

2 Summary of significant accounting policies (continued)

(v) Funds held at/ due to International Monetary Fund (IMF)

Kenya has been a member of the International Monetary Fund (IMF) since 1966. The Bank is the designated depository for the IMF's holdings of Kenya's currency. IMF currency holdings are held in the No. 1 and No. 2 Accounts, which are deposit accounts of the IMF with the Bank.

Borrowings from and repayments to the IMF are denominated in Special Drawing Rights (SDRs). The SDR balances in IMF accounts are translated into Shillings at the prevailing exchange rates and any unrealized gains or losses are accounted for in accordance with accounting policy on foreign currencies.

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository. The security issued is in part payment of Kenya's quota of IMF shares.

(w) Comparatives

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

Notes (continued)

3 Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

i. Post-retirement benefits

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 18 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

ii. Loans and advances

Critical estimates are made by the management in determining the recoverable amount of impaired loans and receivables.

iii. Fair value of financial assets

The fair value of financial instruments that are not traded in an active market and off market loans are determined by using valuation techniques.

iv. Property and equipment

Land and buildings are carried at fair value; representing open market value determined periodically by internal professional valuers.

(ii) Critical judgements in applying the entity's accounting policies

In the process of applying the Bank's accounting policies, management has made judgements in determining:·

- the classification of financial assets and leases·
- whether assets are impaired.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

4 Interest income

	2013 Shs' million	2012 Shs' million
Cash and cash equivalents	-	32
Financial assets - held to maturity	1,150	1,194
Loans and advances	4,479	6,778
Financial assets - held for trading	275	304
	5,904	8,308
Interest income from loans and advances comprises:		
Loan due from Government Debt	892	929
Government overdraft	2,960	3,664
Staff loans	113	103
Reverse repos	368	1,403
Local commercial banks overnight loans	6	521
Foreign commercial banks overnight loans	29	8
Other interest income	111	150
	4,479	6,778

5 Interest expense

	2013	2012
Interest on monetary policy issues – investments by banks	4,033	880
Interest paid to IMF	4	8
	4,037	888

6 Net trading income

	2013	2012
Net gain on sale of foreign exchange currencies	1,772	3,116
Net loss on held for trading financial assets trading	(73)	(214)
	1,699	2,902

7 Other income

	2013	2012
Licence fees from commercial banks and foreign exchange bureaux	218	181
Penalties from commercial banks and foreign exchange bureaux	17	34
Rent income	2	1
Kenya School of Monetary Studies operating income-hospitality services and tuition fee	416	444
Gain on disposal of property and equipment	11	27
Miscellaneous income	134	206
	798	893

CENTRAL BANK OF KENYA
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FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

		2013 Shs' million	2012 Shs' million
8	**Operating expenses**		
	Employee benefit expenses (Note 9)	3,566	3,838
	Currency production expenses	2,396	1,216
	Property maintenance and utility expenses	903	765
	Depreciation (Note 19)	823	191
	Amortisation (Note 20)	345	78
	Provision for impairment loss on other assets (Note 17)	153	4,686
	Auditors' remuneration	6	6
	Banking expenses	-	1
	Loss on financial assets at fair value through profit or loss	16	2
	Transport and travelling	178	161
	Office expenses	190	199
	Postal service expense	136	131
	Legal and professional fees	112	102
	Other administrative expenses	501	682
		9,325	12,058
9	**Employee benefits expense**		
	Wages and salaries	3,483	2,908
	Employer contribution to the retirement benefit scheme	174	365
	Medical expenses	168	229
	Other staff costs	273	198
	Directors' emoluments (Note 29)	68	69
	Net cost on retirement benefit obligations (defined benefit) (Note 18)	-600	69
		3,566	3,838
10	**Balances due from banking institutions - Local**		
	Current accounts	31,995	39,031
	Special project accounts	13,240	12,878
	Domestic foreign currency cheque clearing	9,965	8,099
		55,200	60,008
	All balances due from banking institutions – local are recoverable within one year		
11	**Financial assets at fair value through profit or loss**		
	a. Designated at initial recognition		
	Gold holdings	58	74
	Movements in gold holdings are due to mark to market movements.		
	b. Held for trading		
	Fixed income securities	51,608	16,839
	Fixed income securities under World Bank RAMP	26,263	25,765
		77,871	42,604
		77,929	42,678

CENTRAL BANK OF KENYA
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FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

12 Balances due from banking institutions- Foreign	**2013 Shs' million**	**2012 Shs' million**
Foreign denominated term deposits	395,347	335,227
Accrued interest on term deposits	146	48
	395,493	335,275

All balances due from banking institutions – foreign are recoverable within one year.

13 Investments securities – Available-for-sale

Unlisted equity securities	6	-
At start of year	-	-
Additions	6	-
At end of year	6	-

The fair value of the investment in unlisted company is estimated as being equivalent to the purchase price. The investment in Available for sale securities is recoverable after a year.

14 Funds held at/ due to International Monetary Fund (IMF)

	2013 SDR million	**2013 Shs' million**	**2012 SDR million**	**2012 Shs' million**
(a) Assets				
IMF balances (SDR asset account)	16	2,694	17	2,200
(b) Liabilities				
International Monetary Fund Account No. 1	19	2,531	21	2,711
International Monetary Fund Account No. 2	-	1	-	1
International Monetary Fund – PRGF Account	634	82,493	521	66,183
IMF-SDR Allocation account	260	33,543	260	32,973
	913	118,568	802	101,868

The National Treasury is the Government of Kenya's Fiscal Agent. Commitments arising on transactions between IMF, Kenya Government and National Treasury are not included in these financial statements as the Bank is not the Government's fiscal agent.

Kenya's quota in IMF of SDR 271.4 million (2012: SDR 271.4 million) and allocations of SDR 258.3 million (2012: 259.6 million) are not included in the financial statements of the Bank as these are booked in the National Treasury with the Government fiscal agent.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

15 Advances to banks

	2013 Shs' million	2012 Shs' million
Treasury bonds discounted	333	3,298
Treasury bills discounted	8	6,578
Accrued interest	10	97
	351	9,973

All advances to banks are recoverable within one year

16 Loans and advances

	2013	2012
Due from banks under liquidation	3,656	3,706
Advances to employees	2,667	3,577
	6,323	7,283
Allowance for impairment	-3,678	-3,723
Net advances	2,645	3,560
Movement in the loan impairment allowance is as follows:		
At start of year	3,723	3,725
Decrease in impairment allowance	-45	-2
At end of year	3,678	3,723

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the "lender of last resort" to financial institutions in difficulty. Commercial banks did not utilise this facility in the year under review (2012: Nil). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

17 Other assets

	2013 Shs' million	2012 Shs' million
Prepayments	115	250
Deferred currency expenses	3,477	1,659
Sundry debtors	5,212	5,001
Items in the course of collection	154	333
	8,958	7,243
Provision for impairment	-4,839	-4,686
	4,119	2,557
All other assets balances are recoverable within one year		
Movement in the impairment allowance is as follows:		
At start of year	4,686	-
Increase in impairment allowance	153	4,686
At end of year	4,839	4,686

CENTRAL BANK OF KENYA
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FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

18 Retirement benefit asset	2013 Shs' million	2012 Shs' million
Present value of funded obligations	13,065	12,673
Fair value of plan assets	(21,173)	(17,103)
Present value of net asset	(8,108)	(4,430)
Unrecognised actuarial gains	5,141	2,237
	(2,967)	(2,193)
The amounts recognised in statement of comprehensive income are as		
Current service costs	311	565
Interest costs	1,707	1,071
Expected return on plan assets	(2,358)	(1,492)
Net actuarial (gains)/losses recognised	(79)	24
Past service costs	-	625
Adjustment for previous year values	(181)	(724)
Total expenses included in employee benefits expense (Note 9)	(600)	69
Movements in the net defined benefit asset recognised are as follows:		
At start of year	2,193	1,897
Net income/(expense) recognised in the profit or loss (Note 9)	600	(69)
Employer contributions	174	365
At end of year	2,967	2,193
Actual return on plan assets	4,082	608
Movements in the plan assets are as follows:		
At start of year	17,103	15,872
Expected return on scheme assets	2,358	1,492
Actuarial gain	2,087	565
Employer contributions (Note 9)	174	365
Employee contributions	60	-
Benefits expenses paid	(428)	(467)
Adjustment for previous year values	(181)	(724)
At end of year	21,173	17,103
Movements in the plan benefit obligation are as follows:		
At start of year	12,673	12,137
Current service cost net of employees' contributions	311	565
Interest cost	1,707	1,072
Employee contributions	60	-
Actuarial gain	(1,258)	(1,259)
Past service cost	-	625
Benefits paid	(428)	(467)
At end of year	13,065	12,673

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2013
Notes (continued)

18 Retirement benefit asset (continued)

The principal actuarial assumptions at the reporting date were:		
Discount rate (p.a.)	13.7%	12.5%
Salary increase (p.a.)	13.7%	10.5%
Expected return on plan assets (p.a.)	11.7%	12.5%
Future pension increases	3.0%	3.0%

Historical information	2013 Shs' million	2012 Shs' million	2011 Shs' million	2010 Shs' million	2009 Shs' million
Fair value of plan assets	21,173	17,103	15,872	14,868	11,678
Present value of funded obligations	(13,065)	(12,673)	(12,137)	(11,550)	(9,582)
Retirement benefit asset	8,108	4,430	3,735	3,318	2,096
Unrecognised actuarial gains	(5,141)	(2,237)	(1,838)	(1,424)	(671)
	2,967	2,193	1,897	1,894	1,425

Plan assets are distributed as follows:

	2013 Shs' million	2012 Shs' million
Quoted shares	39%	32%
Investment in properties	13%	16%
Government of Kenya Treasury bills and bonds	27%	43%
Commercial paper and corporate bonds	6%	7%
Offshore investments	8%	-
Fixed and term deposits	7%	3%
	100%	100%

19 Property and equipment

Year ended 30 June 2012	Freehold land and Buildings Shs' million	Leasehold land and buildings Shs' million	Work in progress Shs' million	Motor Vehicles Shs' million	Furniture and Equipment Shs' million	Total Shs' million
Cost or valuation						
At start of year	1,010	300	325	263	5,444	7,342
Additions	25	-	869	102	196	1,192
On revaluation	5,057	1,455	-	-	-	6,512
Disposals	-	-	-	(55)	(2)	(57)
At end of the year	6,092	1,755	1,194	310	5,638	14,989
Accumulated						
At start of year	986	300	-	214	2,993	4,493
Charge for the year	19	6	-	24	142	191
On revaluation	(986)	(300)	-	-	-	(1,286)
On disposal	-	-	-	(58)	(2)	(60)
At end of the year	19	6	-	180	3,133	3,338
Net carrying value*	6,073	1,749	1,194	130	2,505	11,651

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FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

19 Property and equipment (continued)

Year ended 30 June 2013						
Cost or valuation						
At start of year	6,092	1,755	1,194	310	5,638	14,989
Additions	-	-	819	63	348	1,230
Disposals	-	-	-	(21)	(2)	(23)
At end of year	6,092	1,755	2,013	352	5,984	16,196
Accumulated						
At start of year	19	6	-	180	3,133	3,338
Adjustments	-	-	-	2	4	6
Charge for the year	303	33	-	50	437	823
On disposal	-	-	-	(21)	(2)	(23)
At end of the year	322	39	-	211	3,572	4,144
Net carrying value	5,770	1,716	2,013	141	2,412	12,052

The net book value of freehold land, leasehold land and buildings had they not been revalued would be immaterial.

***Opening net carrying value**

	Shs' million
Net carrying value as previously stated	12,083
Prior year adjustment	(432)
Net carrying value as restated	11,651

The prior year adjustment relates to correction of errors in capitalisation of property and equipment items in FY 2012 and thus a third balance sheet is not presented.

Property and Equipment were revalued by internal professional valuers in the prior year on an open market basis and the revaluation has been included in the revaluation reserve.

The methods and significant assumptions applied in arriving at the revalued amounts are as follows:

- The Bank's residential properties are all owner-occupied. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property based on the going rentals for similar properties within the same location.

- The Bank has taken into account comparables values of similar properties (plot, construction standards, design, (lay out), size, location, – current sale prices of vacant plots and those developed) to derive the market prices. These were obtained from market transactions of comparable properties.

CENTRAL BANK OF KENYA
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FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

20 Intangible assets

Year ended 30 June 2012	Software Shs' million	Work-in-Progress Shs' million	Total Shs' million
Cost			
At start of year	236	1,157	1,393
Additions	11	168	179
Transfer from work in progress	1,325	(1,325)	-
At end of the year	1,572	-	1,572
Accumulated amortisation			
At the start of the year	222	-	222
Amortisation for the year	78	-	78
At end of the year	300	-	300
Net carrying value*	1,272	-	1,272

Year ended 30 June 2013	Software Shs' million	Work-in-Progress Shs' million	Total Shs' million
Cost			
At start of year	1,572	-	1,572
Additions	46	-	46
At end of the year	1,618	-	1,618
Accumulated amortisation			
At start of year	300	-	300
Amortisation for the year	345	-	345
At end of the year	645	-	645
Net carrying value	973	-	973

***Opening net carrying value**

	Shs' million
Net carrying value as previously stated	1,412
Prior year adjustment	(140)
Net carrying value as restated	1,272

The adjustment relates to correction of errors in capitalisation of intangible assets items in FY 2012 and thus a third balance sheet is not presented.

CENTRAL BANK OF KENYA
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Notes (continued)

21 Due from Government of Kenya

	2013 Shs' million	2012 Shs' million
Overdraft	7,000	7,257
Government loan	28,960	30,874
	35,960	38,131

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at the Bank at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit stands at Shs 34,186,643,828 (2012: Shs 25,373,202,658) based on the Government financial statements for 2010/2011 (2012: 2009/2010), which are the latest audited financial statements at the date of approval of these financial statements.

22 Currency in circulation

	2013 Shs' million	2012 Shs' million
Kenya bank notes	177,488	154,325
Kenya coins	5,553	4,885
Commemorative coins	6	6
	183,047	159,216
Movement in the account was:		
At start of year	159,216	147,718
Deposits by banks	(403,689)	(385,210)
Withdrawals by banks	427,520	396,708
At end of year	183,047	159,216

23 Deposits

Local commercial banks clearing accounts and cash ratio reserve	104,366	97,790
Local banks foreign exchange settlement accounts	9,248	7,541
External banks foreign exchange settlement accounts	33	40
Other public entities and project accounts	19,954	17,587
Government of Kenya	58,070	37,684
	191,671	160,642

24 Investment by banks

Term auction deposits	30,983	22,064
Repos sold to commercial banks	10,606	13,609
	41,589	35,673

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Notes (continued)

25 Other liabilities

	2013 Shs' million	2012 Shs' million
Impersonal accounts	248	204
Sundry creditors*	926	179
Bonds pending payables	620	214
Refundable deposits	677	586
Leave accrual	76	101
Gratuity to staff members	48	48
	2,595	1,332

*The sundry creditors balance as at 30 June 2012 has been restated to correct errors in the capitalisation of property and equipment and intangible assets as below. The errors relate to FY 2012 and thus a third balance sheet is not presented.

	Shs' million
As previously stated	751
Prior year adjustment on property and equipment (Note 19)	(432)
Prior year adjustment on intangible assets (Note 20)	(140)
As restated	179

26 Share capital

	Authorised share capital Shs' million	Ordinary shares Shs' million
Balance at 1 July 2011, 30 June 2012 and 30 June 2013	5,000	5,000

Ownership of the entire share capital is vested in the Principal Secretary to the National Treasury.

27 Cash generated from operations

Reconciliation of net surplus /(deficit) to cash flows from operations

	2013 Shs' million	2012 Shs' million
Surplus/(deficit) for the year	3,652	(25,854)
Adjustments for:		
Depreciation (Note 19)	823	191
Amortisation (Note 20)	345	78
Gain on disposal of property and equipment	(11)	(2)
Net interest income	(1,867)	(7,420)
Net cost on defined benefit asset (Note 9)	(600)	(69)
Interest received	5,893	8,223
Interest paid	(4,026)	(803)
Changes in working capital:		
Loans and advances	915	19,825
Other assets	(1,562)	3,237
Currency in circulation	23,831	11,498
Deposits	31,029	24,850
Other liabilities	691	(7,641)
Investments by banks	5,916	35,673
	65,029	61,786

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Notes (continued)

28 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include:

	2013 Shs' million	2012 Shs' million
Balances due from banking institutions - Local (Note 10)	55,200	60,008
Balances due from banking institutions- Foreign	347,349	294,462
Financial assets - held for trading	5,526	3,023
Advances to banks (Note 15)	351	9,973
	408,426	367,466

29 Related party transactions

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya, the ultimate owner of the Bank, and the Deposit Protection Fund Board (a corporation established by law as a deposit insurance scheme to provide cover for depositors and act as a liquidator of failed member institutions. It is managed by a Board comprising the Governor of the Central Bank of Kenya as the Chairman.)

The main transactions include ordinary banking facilities to government ministries included in Note 23 and lending to government of Kenya included in Note 21.

(i) Loans

The Bank extends loan facilities to the Governor and the Deputy Governor and other key management personnel The advances are at preferential rates of interest determined by the Bank.

Loans to executive directors	2013 Shs' million	2012 Shs' million
At start of the year	6	3
Loans advanced during the year	11	6
Loan repayments	(4)	(3)
At end of the year	13	6
Loans to key management personnel		
At start of the year	87	76
Loans advanced during the year	20	44
Loan repayments	(30)	(33)
At end of the year	77	87

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Notes (continued)

29 Related party transactions (continued)	2013 Shs' million	2012 Shs' million
ii) Directors' emoluments:		
Fees to non executive directors	15	16
Other remuneration to executive directors	53	53
	68	69
iii) Remuneration to senior management	172	164
iv) Post–employment pension to senior management	11	5
v) Government of Kenya		
Due from Government of Kenya (Note 21)	35,960	38,131

Transactions entered into with the Government include:

i. Banking services;
ii. Management of issue and redemption of securities at a commission and;
iii. Foreign currency denominated debt settlement and other remittances at a fee.

(vi) Deposit Protection Fund Board

The Bank has a close working relationship with the Deposit Protection Fund Board, an entity incorporated under the Banking Act, and provides it with staff and office accommodation. Certain costs incurred on behalf of the Deposit Protection Fund Board are fully reimbursed to the Bank.

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was Shs 20 million (2012: Shs 14million).

(vii) Kenya School of Monetary Studies

The Kenya School of Monetary Studies is a registered legal entity wholly owned by the Bank and has been consolidated in these financial statements.

30 Financial risk management objectives and policies

The Group's activities expose it to a variety of financial risks, including credit risk and the effects of changes in debt and equity market prices, foreign currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance.

Risk management is carried out by the finance department under policies approved by the Board of Directors. Other organs that monitor the assessment and management of risks within the Bank include: Board Audit Committee, Internal Audit Department and Risk Management Unit.

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Notes (continued)

30 Financial risk management objectives and policies (continued)

(a) Strategy in using financial instruments

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-debt government and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate volatilities. The Bank can only intervene in the foreign exchange market when there are sharp exchange rate movements which are likely to destabilize the financial market.

Governed by the Bank's reserve management policy of safe investment, liquidity and return, respectively, the Bank, with a prudent approach, subjects its foreign exchange reserves to investments in international markets.

In this framework, almost all the financial risks to which the Bank is exposed arise while fulfilling its duties of managing foreign exchange reserves and rendering certain banking services to the banking sector and the Government of the Republic of Kenya.

The Bank is exposed to credit, market and liquidity risks due to the aforementioned operations. The financial risks that arise during the management of foreign exchange reserves are the outcome of an investment choice. Nevertheless, the Bank endeavours to minimize such risks by managing them with a conservative approach.

Foreign exchange reserves are managed by observing the investment criteria defined in the Bank's Guidelines on Foreign Exchange Reserves Management.

(b) Risks facing the Bank

The following are the main types of risks that the Bank is exposed to in the course of executing its operations:

- Financial risks include:
  - Credit risk
  - Market risk:
    - Interest risk
    - Foreign currency exchange risk
  - Liquidity risk
- Non financial risks include:
  - Operational risk
  - Human resource risk
  - Legal risk
  - Reputation risk

i. Credit risk

Credit risk arises from investment securities, balances due from banking institutions, funds held with IMF, loans and advances as well as other assets. The Bank has no significant concentrations of credit risk except for the lending to the Government of Kenya.

Management of the credit risk is through the choice of depository banks. The Bank's choice of depository banks is confined to top international banks that meet the set eligibility criteria of financial soundness on long-term credit rating (A), short-term credit rating (AA), composite rating and capital adequacy.

The amount that best represents the Group's maximum exposure to credit risk is per the statement of financial position.

The Bank does not grade the credit quality of these assets. None of the balances have had their terms renegotiated. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors. Provisions of Shs 83 million (2012: Nil) have been recorded due to impaired balances to related parties.

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Notes (continued)

30 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

The following amounts in loans and advances and other assets are neither past due nor impaired or individually impaired. All other financial instruments operate within their contractual terms.

	Neither past due nor impaired 2013 Shs' million	Individually impaired 2013 Shs' million	Neither past due nor impaired 2012 Shs' million	Individually impaired 2012 Shs' million
Advances to employees	2,646	22	3,560	67
Due from banks under liquidation	-	3,656	-	3,656
Sundry debtors	4,004	4,839	2,307	4,686
	6,650	8,617	5,867	8,409
Allowance for impairment				
- other assets (Note 17)	-	(4,839)	-	(4,686)
- loans and advances (Note 16)	-	(3,678)	-	(3,723)
	6,650	(8,517)	5,867	(8,409)
	6,650	-	5,867	-

There were no past due but not impaired balances as at 30 June 2013 (2012: Nil).

ii. Market risk

The Group takes on exposure to market risks, which is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios.

Market risks arising from trading and non-trading activities are concentrated in Bank Treasury and are monitored by management with oversight from the Monetary Policy Committee.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with commercial banks or the market.

Non-trading portfolios primarily arise from the interest rate management of the Bank's investment and monetary policy assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's held-to-maturity and World Bank RAMP financial assets.

Interest rate risk

The Bank's interest rate risk arises from interest bearing investments, loans and advances to commercial banks and investments by banks. Borrowings issued at variable rates expose the Bank to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the Bank to fair value interest rate risk.

The tables below summarise the Bank's financial assets and liabilities and analyses them into the earlier of contractual maturity or repricing.

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

As at 30 June 2013	**1 – 3 months**	**3-12 months**	**1 - 5 years**	**Over 5 years**	**Non-interest Bearing**	**Total**
	Shs' million	**Shs' million**	**Shs' million**	**Shs' million**	**Shs' million**	**Shs' million**
Assets						
Balances due from banking institutions - Local	-	-	-	-	55,200	55,200
Advances to banks	351	-	-	-	-	351
Financial assets at fair value	5,526	12,602	33,581	25,623	597	77,929
Balances due from banking institutions - Foreign	347,349	42,471	-	-	5,673	395,493
Funds held with International Monetary Fund (IMF)	-	-	-	-	2,694	2,694
Investments securities – Available-for-sale	-	-	-	-	6	6
Loans and advances	2	37	824	1,782	-	2,645
Other assets	-	-	-	-	4,004	4,004
Due from Government of Kenya	73	1,110	1,110	33,667	-	35,960
Total financial assets	353,301	56,220	35,515	61,072	68,174	574,282
Liabilities						
Deposits from banks and government	-	-	-	-	191,671	191,671
Due to International Monetary Fund (IMF)	-	-	-	-	118,568	118,568
Investments by banks	41,589	-	-	-	-	41,589
Other liabilities	-	-	-	-	2,595	2,595
Total financial liabilities	41,589	-	-	-	312,834	354,423
Interest sensitivity gap	311,712	56,220	35,515	61,072	-244,660	219,859

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

As at 30 June 2012	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions - Local	-	-	-	-	60,008	60,008
Advances to banks	9,973	-	-	-	-	9,973
Financial assets at fair value	3,023	6,895	18,372	14,019	369	42,678
Balances due from banking institutions - Foreign	294,462	36,004	-	-	4,809	335,275
Funds held with International Monetary Fund (IMF)	-	-	-	-	2,200	2,200
Loans and advances	3	50	1,109	2,398	-	3,560
Other assets	-	-	-	-	2,307	2,307
Due from Government of Kenya	881	1,110	1,110	35,030	-	38,131
Total financial assets	308,342	44,059	20,591	51,447	69,693	494,132
Liabilities						
Deposits from banks and government	-	-	-	-	160,642	160,642
Due to International Monetary Fund (IMF)	-	-	-	-	101,868	101,868
Investments by banks	35,673	-	-	-	-	35,673
Other liabilities	-	-	-	-	1,332	1,332
Total financial liabilities	35,673	-	-	-	263,842	299,515
Interest sensitivity gap	272,669	44,059	20,591	51,447	(194,149)	194,617

As at 30 June 2013, an increase/decrease of 10 basis points would have resulted in a decrease/increase in profit of Shs 700 million (2012: Shs 630 million

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Monetary Policy Committee sets limits on the level of exposure by currency which is monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2013. Included in the table are the Bank's financial instruments categorised by currency:

	USD	GBP	EUR	SDR	Others	Total
	Shs' million	Shs' million	Shs' million	Shs' million	Shs 'million	Shs' million
As at 30 June 2013						
Assets						
Balances due from banking institutions - Local	30,243	1,283	43	-	23,631	55,200
Financial assets at fair value	77,929	-	-	-	-	77,929
Balances due from banking institutions - Foreign	279,846	81,997	33,650	-	-	395,493
Funds held with International Monetary Fund (IMF)	-	-	-	2,694	-	2,694
Total financial assets	388,018	83,280	33,693	2,694	23,631	531,316
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	118,568	-	118,568
Deposits from banks and government	8,195	1,161	1,189	-	-	10,545
Total financial liabilities	8,195	1,161	1,189	118,568	-	129,113
Net position	379,823	82,119	32,504	-115,874	23,631	402,203

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk

Foreign exchange risk (continued)

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs 'million	Total Shs' million
As at 30 June 2012						
Assets						
Balances due from banking institutions - Local	33,907	13,542	12,194	-	365	60,008
Financial assets at fair value	42,678	-	-	-	-	42,678
Balances due from banking institutions - Foreign	209,375	56,302	69,598	-	-	335,275
Funds held with International Monetary Fund (IMF)	-	-	-	2,200	-	2,200
Total financial assets	285,960	69,844	81,792	2,200	365	440,161
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	101,868	-	101,868
Deposits from banks and government	6,353	810	1,178	-	-	8,341
Total financial liabilities	6,353	810	1,178	101,868	-	110,209
Net position	279,607	69,034	80,614	-99,668	365	329,952

As at 30 June 2013, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank's profit would have been:

- USD Shs 18,991 million (2012: Shs 13,980 million)
- Euro Shs 1,625 million (2012: Shs 4,031 million)
- British Pound Shs 4,106 million (2012: Shs 3,452 million)
- SDR Shs 5,794 million (2012: Shs 5,093 million)

Notes (continued)

30 Financial risk management objectives and policies (continued)

iii. Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, Treasury maintains flexibility in funding by maintaining availability under committed credit lines.

Management monitors rolling forecasts of the Bank's liquidity reserve on the basis of expected cash flow.

The table below analyses the Bank's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	On demand Shs' million	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Total Shs' million
As at 30 June 2013						
Currency in circulation	-	-	-	-	183,047	183,047
Deposits from banks and government	178,259	-	13,412	-	-	191,671
Due to International Monetary Fund (IMF)	-	-	-	-	118,568	118,568
Investments by banks	-	41,631	-	-	-	41,631
Other liabilities	-	-	2,595	-	-	2,595
Total financial liabilities	178,259	41,631	16,007	-	301,615	537,512
As at 30 June 2012						
Currency in circulation	-	-	-	-	159,216	159,216
Deposits from banks and government	147,764	-	12,878	-	-	160,642
Due to International Monetary Fund (IMF)	-	-	-	-	101,868	101,868
Investments by banks	-	35,710	-	-	-	35,710
Other liabilities	-	-	1,904	-	-	1,904
Total financial liabilities	147,764	35,710	14,782	-	261,084	459,340

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Notes (continued)

30 Financial risk management objectives and policies (continued)

Fair value of financial instruments

IFRS 7 specifies a fair value hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Bloomberg).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

	Level 1 Shs' million	Level 2 Shs' million	Level 3 Shs' million	Total Shs' million
As at 30 June 2013:				
Financial assets at fair value	77,871	58	-	77,929
Investment securities – Available-for-sale	-	-	6	6
Total assets	77,871	58	6	77,935
As at 30 June 2012:				
Financial assets at fair value	42,604	74	-	42,678
Investment securities – Available-for-sale	-	-	-	-
Total assets	42,604	74	-	42,678

Changes in level 3 instrument are disclosed in Note 13 to the financial statements.

31 Contingent liabilities and commitments

The Bank is party to various legal proceedings with total claims up to Shs 7.3 billion (2012: Shs 267 million). Based on legal advice, the directors believe that no loss will arise from these legal proceedings. Appropriate provisions have been made where a liability is considered probable.

At 30 June 2013, the Bank did not have capital commitments (2012: Shs 53 million) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

	2013 Shs' million	2012 Shs' million
Not later than 1 year	16	16
Later than 1 year and not later than 5 years	40	66
	66	82