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## **PRESS RELEASE**

### **MONETARY POLICY COMMITTEE MEETING, 14<sup>TH</sup> JANUARY, 2015**

#### ***CONSOLIDATING GAINS FROM THE MONETARY POLICY STANCE***

The Monetary Policy Committee (MPC) met on 14<sup>th</sup> January, 2015 to review market developments and the outcomes of its previous monetary policy decisions. The Committee noted that overall inflation continued to decline gradually in November and December 2014, and remained within the range of the Government medium-term target of 5 percent but still above the target. Specifically, the Committee noted the following outcomes in the market since its meeting in November 2014:

- Overall month-on-month inflation declined from 6.09 percent in November 2014 to 6.02 percent in December 2014, mainly reflecting significant declines in the prices of fuel and electricity. However, these declines were partly offset by a rise in the food index during the period. The month-on-month non-food-non-fuel inflation reversed the November 2014 increase and declined from 3.77 percent to 3.65 percent in the period. This indicates that there was no significant demand driven inflationary pressure or threat to the economy.
- Despite the temporary pressures on most international currencies reflecting the global strengthening of the US Dollar, the exchange rate of the Kenya Shilling against the US Dollar has maintained its stable trend while strengthening, on average, against the Euro, Sterling Pound, Japanese Yen, and the regional currencies. The strengthening of the US Dollar partly reflects the strong performance of the US economy and changing expectations on the timing of the first US interest rate increase. However, the Kenya Shilling continued to be supported by the resilient foreign exchange inflows through diaspora remittances, increased net purchases of equity by foreign investors in the Nairobi Securities Exchange (NSE) while interventions by the Central Bank of Kenya (CBK) through direct sales of foreign exchange to commercial banks have stopped short-term volatility. The sustained confidence in the economy reflected in the massive oversubscription of the Sovereign Bond that was re-opened in December 2014 also supported the Kenya Shilling. The CBK's level of usable foreign exchange reserves increased from USD7,116.3 million (equivalent to 4.64 months of import cover) at the end of October 2014 to USD7,424.7 million (equivalent to 4.79 months of import cover) at the end of December 2014. The build-up of foreign exchange reserves was boosted by the sale to CBK by the Government of the proceeds of the re-opened Sovereign Bond in December 2014. This build-up is considered adequate to cushion the exchange rate against short-term shocks and excess volatility.

- The Government's domestic borrowing programme for the Fiscal Year 2014/15 remained consistent with the monetary policy objectives. In addition, the issuance of the Sovereign Bond in June 2014 and its subsequent re-opening in December 2014 has dampened pressure on both domestic borrowing and domestic interest rates.
- The sustained liquidity management by the CBK through Open Market Operations (OMO) has ensured stability in the interbank market. Consequently, the movements in short-term interest rates were closely aligned to the Central Bank Rate (CBR) during the period.
- The latest data and stress tests on the banking sector showed that the sector remains resilient. Although the ratio of gross non-performing loans to gross loans increased slightly from 5.4 percent in September 2014 to 5.5 percent in November 2014, the Committee noted that the banking sector has built significant capital buffers to mitigate the adverse business cycle effects. The Kenya Banks' Reference Rate (KBRR) framework was introduced in July 2014 to enhance transparency in the pricing of credit as well as improving the transmission of monetary policy signals into changes in banks' lending rates. Updated data from all commercial and microfinance banks shows that new and existing loans amounting to Ksh.732.2 billion had been converted to the KBRR framework by 28<sup>th</sup> December 2014 compared with Ksh.397.24 billion as at 19<sup>th</sup> October 2014. In addition, since the rollout of the KBRR framework in July 2014, the average lending rate for the banking sector has been on a downward trend, declining from 16.9 percent in July 2014 to 15.9 percent in November, 2014. Consequently, the spread between the average commercial banks' lending rate and the KBRR declined from 7.8 percent to 6.8 percent during the period. The full effect of KBRR can be assessed once all loans have been converted into the KBRR framework.
- The latest data from the Kenya National Bureau of Statistics shows that the economy remained resilient in the third quarter of 2014. The growth performance in the period was supported by a strong expansion of the finance and insurance sector that grew by 9.9 percent up from a revised growth of 8.3 percent in a similar period of 2013. The performance of the finance and insurance sector continued to be driven by financial innovations and inclusion. The strong performance of the construction, wholesale and retail trade, information and communication, and agriculture and forestry sectors during the period was an indication of the continued recovery of the economy.
- Confidence in the economy remains strong. Specifically, the MPC Market Perception Survey conducted in December 2014 showed that private sector firms expect inflation and the exchange rate to be stable, and growth to be stronger in 2015. Furthermore, the Survey showed that the private sector's optimism for an improved business environment in 2015 is high.



On the global scene, the world economy continues to grow at a moderate pace with recent data indicating that the United States and United Kingdom remain the main drivers to the growth. Global growth is projected at 3.8 percent in 2015 up from 3.3 percent in 2014. The lower international oil prices are expected to benefit global growth in 2015 mainly through lower production costs and consumer prices for net oil importing countries. Whilst the growth recovery in the Eurozone remains weak, the outlook for emerging markets is mixed. Emerging Asian economies are expected to benefit from the US recovery while Russia and Brazil are expected to face growth challenges. However, growth in Sub-Saharan Africa is projected to remain strong, and grow by 5.8 percent in 2015 from 5.1 percent in 2014. This is expected to boost Kenya's exports and support exchange rate stability. In addition, the commitment by the US Federal Reserve Bank to a balanced approach when it decides to begin to remove monetary policy accommodation is expected to support stability in the global currency and financial markets.

The Committee concluded that the monetary policy measures coupled with the lower international oil prices continue to deliver the desired decline in domestic prices and, hence, lower inflation. However, overall inflation has remained in the upper bound of the Government medium-term target of 5 percent. The Committee therefore decided to retain the CBR at 8.50 percent to anchor inflation expectations. This will ensure that inflation continues to decline towards the 5 percent target. The MPC will continue to monitor the key macroeconomic aggregates and any emergent risks from the external and domestic economies that may impact on price stability.

Given that the CBR has been retained at 8.50 percent by the MPC and, considering the weighted 2-month moving average of the 91-day Treasury bill rate, the CBK has revised the KBRR consistent with its commitment in July 2014 from 9.13 percent to 8.54 percent. This level of the KBRR will be effective from 14<sup>th</sup> January, 2015 until its next review in July 2015, if market conditions do not change significantly.



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

14<sup>th</sup> January, 2015