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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 7TH NOVEMBER, 2012

CONSOLIDATING MONETARY POLICY GAINS

The Monetary Policy Committee met on 7th November, 2012 to review market developments and evaluate the outcomes of its monetary policy stance. The Committee noted that this stance had continued to deliver the desired results of a decline in inflation and exchange rate stability. It also observed that monetary policy operations had ensured stability of short-term interest rates and the interbank market through effective liquidity management.

The Committee observed and analysed the following positive outcomes in the market since its last meeting on 5th September, 2012:

- Overall inflation continued to decline in October 2012 and was within the 5 percent target set by the Government for the fiscal year 2012/13. The overall month-on-month inflation declined from 6.09 percent in August 2012 to 5.32 percent in September 2012 and further to 4.14 percent in October 2012. The decline in inflation was reflected across all the measures of inflation as well as all income groups. Declining food prices – despite increases in fuel prices – coupled with easing demand pressures in the economy continued to support the decline in inflation. Non-food-non-fuel inflation declined from 7.16 percent in September 2012 to 6.17 percent in October 2012 which remained within the 7.5 percent upper bound of the target set by the Government for overall inflation. These developments support a low and stable outlook for inflation.
- Exchange rate stability was sustained; it fluctuated within a narrower range of Ksh.84.91 to Ksh.85.28 against the US Dollar in October 2012, compared with a range of Ksh.84.14 to Ksh.85.28 in September 2012. The level of usable foreign exchange reserves held by the Central Bank of Kenya (CBK) rose to USD5,274.9 million or 4.14 months of import cover at the beginning of November, 2012. This followed the disbursement by the International Monetary Fund of an equivalent of USD110.63 million under the Extended Credit Facility (ECF) programme. The disbursement was a consequence of the successful completion of the Fourth Review of the ECF programme and reflects confidence in the Government's economic policies. The build-up in reserves provides a further cushion to the foreign exchange market.

- The fiscal measures being implemented by the Government for the FY 2012/13 are consistent with monetary policy objectives.
- The data presented and the stress tests conducted indicated that the banking sector remains strong and stable. The 2012 half year performance of commercial banks provides further evidence in this regard. Commercial banks' lending rates had also declined slightly following the Committee's decisions to lower the policy rate during its last two meetings. The Committee noted that the ratio of gross non-performing loans to total loans had increased marginally from 4.5 percent to 4.6 percent between August and September 2012. This reflects low credit risk in the banking sector.
- The buoyancy of the Nairobi Securities Exchange (NSE) following improved participation by foreign investors indicated sustained confidence in the economy. The NSE 20 Share Index rose from 3,972 in September 2012 to 4,147 in October, 2012. Similarly, diaspora remittances remained above USD90 million per month. In addition, the MPC Market Perceptions Survey conducted in October 2012 showed that the private sector expects inflation and the exchange rate to remain stable. Furthermore, the Survey revealed that although economic growth had slowed down in the first half of 2012, the economy is expected to be resilient over the remainder of 2012, mainly as a consequence of agricultural sector recovery due to favourable weather conditions.

The Committee noted that the impact of continued volatility in international oil prices, the spill-over effects of the slowdown in global economic growth on the domestic economy, and the balance of payments pressures emanating from a high current account deficit remain the main risks to the macroeconomic outlook. Nevertheless, overall inflation was within the Government target, the exchange rate was stable and private sector credit was growing within the target growth path. Therefore, it concluded that there was adequate space for a gradual easing of the monetary policy stance while maintaining macroeconomic stability.

Given the above considerations, the Committee decided to reduce the Central Bank Rate by 200 basis points to 11.00 percent. It will also continue to monitor closely the risks to the macroeconomic outlook and take appropriate actions to maintain the required price stability.

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

7th November, 2012