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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 3RD SEPTEMBER, 2014

MANAGING RISKS IN THE CURRENT MONETARY POLICY STANCE

The Monetary Policy Committee (MPC) met on 3rd September, 2014 to review market developments and the outcomes of its previous monetary policy decisions. The Committee noted with concern that overall inflation exceeded the upper bound of the prescribed range of the medium-term target of 5 percent in both July and August 2014. Despite the recent short-term pressures partly reflecting the global strengthening of the US Dollar, the exchange rate has maintained a stable trend. In particular, the Committee noted the following outcomes in the market since its meeting in July 2014:

- The overall month-on-month inflation rose from 7.67 percent in July 2014 to 8.36 percent in August 2014 reflecting the base effect as well as the short-term effects of increases in the prices of a number of foodstuffs and some energy items. However, overall inflation averaged 7.18 percent from January to August 2014. The month-on-month non-food-non-fuel inflation increased slightly from 4.45 percent in July 2014 to 4.92 percent in August 2014.
- The exchange rate continued to be supported by resilient foreign exchange inflows through diaspora remittances and sustained foreign investor participation in the Nairobi Securities Exchange (NSE). In addition, sale of foreign exchange by the CBK to commercial banks supported exchange rate stability. The CBK level of usable foreign exchange reserves stood at USD6,376.95 million (equivalent to 4.21 months of import cover) as at 3rd September, 2014 which was above the minimum requirement of 4 months of import cover. The level of foreign exchange reserves is adequate to cushion the foreign exchange market against any temporary shocks.
- The movements in short-term interest rates were aligned to the Central Bank Rate (CBR) during the period. In addition, the liquidity management undertaken through Open Market Operations supported the stabilisation of the interbank market.
- Interest rates on Treasury bills have been declining but the market continued to show an appetite for long-term Government paper. The issuance of the Sovereign Bond in June 2014 introduced a new dimension in the public debt which has enabled appropriate benchmarking of Kenya's sovereign risk. In addition, in the long-term, the Government food security measures as spelt out in the Fiscal Year 2014/15 Budget are expected to reduce the dependence on rain-fed agriculture – which is weather dependent – and thus avoid spikes on food prices and consequently, overall supply driven inflation.
- The latest data and stress tests show that the banking sector remains resilient. As a result, the annual growth in private sector credit stood at 25.54 percent in July 2014 compared with 25.79 percent in June 2014 which was channelled mainly to productive sectors of the economy. The ratio of gross non-performing loans to gross loans decreased from 5.70 percent in June 2014 to 5.58 percent in July 2014 indicating a lowering in credit risk. In

addition, the CBK and Kenya Bankers Association have been monitoring the implementation of the Kenya Banks' Reference Rate (KBRR) and the Annual Percentage Rate (APR) frameworks by commercial banks that were introduced in July 2014. Initial data from 22 commercial banks and 6 microfinance banks indicate that new and existing loans amounting to Ksh.43 billion and covering 182,731 loan accounts had benefited from the KBRR framework by end of August 2014. In addition, the average premium that commercial banks charged above the KBRR on commercial mortgages was 3.05 percent while that on corporate loans (1–5 years) was 4.09 percent. These frameworks are designed to improve transparency in credit pricing and promote full disclosure of bank charges on new loans thereby supporting an increase in the supply of affordable credit to support investment.

- Confidence in the economy was sustained during the period. Specifically, sustained purchases of equity at the Nairobi Securities Exchange by foreign investors boosted the NSE-20 share index to rise from 4,885.04 points in June 2014 to 4,906.09 points in July 2014, and further to 5,139.39 in August, 2014. In addition, diaspora remittances remained resilient during the period, averaging USD115.32 million per month between January and July 2014 compared with USD105.22 per month in a similar period of 2013. Furthermore, the MPC Market Perception Survey conducted in August 2014 showed that the private sector expects inflation and the exchange rate to be stable in the remainder of 2014 and growth to be stronger in 2014.

On the international scene, the growth momentum of the global economy is projected to pick up in the second half of 2014. Nevertheless, the growth recovery remains uneven across the advanced and emerging market economies. A stronger growth was recorded in the second quarter of 2014 in the United States while growth in the Euro area economies and some emerging market economies was flat. The growth momentum for Kenya's main trading partners is expected to pick up in the second half of 2014. This is expected to benefit exports and support exchange rate stability. However, the geopolitical situation in the Middle East and North African region as well as in Ukraine remains a risk to the stability of international oil prices and the overall price stability objective.

The Committee concluded that the monetary policy measures in place coupled with the effective liquidity management operations will continue to moderate any pressures that might give rise to adverse inflation expectations. In addition, the impact of the base effect in September 2013 on inflation will dissipate from September 2014. The MPC therefore decided to retain the CBR at 8.50 percent given that there were no fundamental structural pressures on inflation, but will pursue a tightening bias in the money market through the CBK monetary policy operations in order to continue to anchor inflationary expectations. The CBK will continue to monitor the key macroeconomic aggregates and any emergent risks from the external and domestic economies that may impact on price stability.



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

3rd September, 2014