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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 9TH JUNE, 2015

MANAGING MARKET EXPECTATIONS TO ENSURE STABILITY

The Monetary Policy Committee (MPC) met on 9th June, 2015 to review market developments and the outcomes of its previous monetary policy decisions. The Committee noted that the decline in overall inflation in May 2015 was largely a reflection of significant decreases in the prices of a number of food items following the onset of the long rains. However, overall inflation remained within the upper bound of the Government target range of 2.5 percent on either side of the medium-term target of 5 percent. Specifically, the Committee noted the following outcomes in the market since its meeting in May 2015:

- Overall month-on-month inflation declined from 7.08 percent in April 2015 to 6.87 percent in May 2015. The month-on-month food inflation declined from 13.42 percent to 13.20 percent in the period. However, the month-on-month non-food-non-fuel (NFNF) inflation has risen over the last three months from 3.16 percent in March 2015 to 3.53 percent in April 2015 and 4.15 percent in May 2015. The 3-month annualised overall and NFNF inflation measures also rose in May 2015. This increase mainly reflected inflationary pressure on tradable goods on account of the pass-through from the weakening of the Kenya Shilling against the US Dollar. The key monetary aggregates: broad money supply (M3) and credit to the private sector, were slightly above their respective non-inflationary targets in April 2015. The 12-month growth rate of broad money supply stood at 16.57 percent against a target of 14.80 percent while the growth of private sector credit was 19.89 percent against a target of 19.43 percent.
- The exchange rate of the Kenya Shilling against the US Dollar had remained under pressure largely reflecting the stronger US Dollar in the global currency market, the widening current account deficit and sustained high demand for foreign exchange in April and May 2015. However, the exchange rate has stabilised in response to the active monetary policy operations leading to the tight liquidity conditions in the interbank market. This has curtailed arbitrage activities between the interbank and foreign exchange markets. In addition, the Kenya Shilling strengthened against the Euro and has continued to display relatively less volatility compared with the major regional currencies. This has been supported by sustained foreign exchange inflows through diaspora remittances which averaged USD122.18 million per month in the first four months of 2015, up from an average of USD113.60 million per month in a similar period of 2014.
- The Central Bank of Kenya (CBK) level of usable foreign exchange reserves stands at USD6,739.2 million (equivalent to 4.26 months of import cover). This level of foreign exchange reserves, together with the precautionary facility with the International Monetary Fund (IMF), provides a cushion for the foreign exchange market against any temporary shocks. The on-going implementation of measures to improve the competitiveness of Kenya's exports, including increased investment in infrastructure, will facilitate the long-term stability of the exchange rate.

- Overall liquidity conditions in the interbank market have been tight as interbank rate remained above the CBR. This is consistent with the policy stance adopted by the MPC in its meeting in May 2015. The CBK enhanced the effectiveness of its monetary policy operations in the period by raising the maximum acceptable bid rates on the Term Auction Deposits instrument by 250 basis points above the Central Bank Rate (CBR). The tight liquidity conditions in the market were also attributed to the temporary build-up of Government deposits at the CBK.
- The latest data and stress tests show that the banking sector remains resilient. The CBK commenced publication of bank specific data on the average premium above the Kenya Banks' Reference Rate (KBRR) in May 2015. Apart from increasing transparency in credit pricing, this will enhance competition in the banking sector as well as access to credit by borrowers. Updated data from all commercial and microfinance banks show that new and existing loans amounting to Ksh.877.45 billion had been converted to the KBRR framework by end of April 2015 up from Ksh.825.85 billion by end of March 2015. The average commercial banks' lending rates declined from 15.46 percent in March 2015 to 15.40 percent in April 2015 while the average deposit rate eased slightly from 6.63 percent to 6.60 percent during the period. Consequently, the interest rate spread declined slightly during the period.
- Growth is expected to remain resilient in 2015 supported mainly by private sector credit growth to key sectors of the economy, prudent macroeconomic policy and sustained public investment in infrastructure.

The outlook for the global economy remains broadly unchanged since the MPC meeting in May 2015. The global economy is projected to strengthen from 3.5 percent in 2015 to 3.8 percent in 2016 despite the temporary slowdown in the growth of the US economy in the first quarter of 2015. The Eurozone economies have shown notable signs of recovery attributed to improved private consumption and exports mainly driven by lower interest rates and a weaker Euro in response to the European Central Bank's Quantitative Easing. However, the uncertainty around the bail-out plan for Greece remains the main risk to the Eurozone growth prospects. The growth outlook in the larger emerging markets remains mixed with expected contractions in Brazil and Russia, a slowdown in China and strong performance in India. Growth in Sub-Saharan Africa is expected to remain relatively robust despite risks from the lower commodity prices in some of the oil and commodity producing countries. Global inflation is expected to remain low despite the partial recovery in international oil prices. However, the Kenya Shilling remains vulnerable to the changing global risk perceptions and associated capital flows due to the uncertainty around the timing of the US monetary policy tightening. The geo-political situation in the Middle East is a risk to the stability of international oil prices and the overall price stability objective.

The Committee concluded that the tightening bias stance adopted by the MPC and implemented through the CBK monetary operations had curtailed the rapid depreciation in the exchange rate. However, the emerging aggregate demand pressures and the persistent volatility in the global foreign exchange markets coupled with the projected recovery in international oil prices have implications on inflationary expectations and the potential of the pass-through of the past exchange rate movements on consumer price inflation. The MPC therefore decided to augment its tightening stance by raising the CBR by 150 basis points from 8.50 percent to 10.00 percent. The MPC will continue to monitor developments in the external and domestic economies and their implications on the risks to the overall price stability.

DR. HARON SIRIMA, OGW
VICE CHAIRMAN, MONETARY POLICY COMMITTEE

9th June, 2015