SIXTEENTH
BI-ANNUAL REPORT OF THE MONETARY POLICY COMMITTEE

BANKI KUU YA KENYA

Central Bank of Kenya

Issued under the Central Bank of Kenya Act, Cap 491

APRIL 2016

The Bi-Annual Report is prepared by the
Members of the Monetary Policy Committee.

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LETTER OF TRANSMITTAL TO THE CABINET SECRETARY FOR THE NATIONAL TREASURY

Honourable Cabinet Secretary,

I have the pleasure of forwarding to you the sixteenth bi-annual Monetary Policy Committee (MPC) Report issued in accordance with section 4D (6) of the Central Bank of Kenya Act. The Report outlines monetary policy formulation, developments in key interest rates, inflation, and exchange rates together with other activities of the Committee in the six months to April 2016. Copies of MPC Press Statements and the Minutes of all the Meetings of the MPC between November 2015 and April 2016 are attached to the Report for your information.

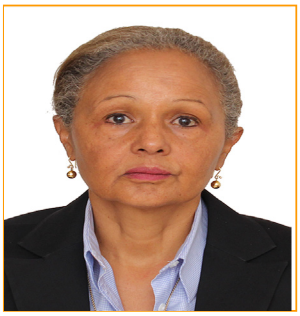
Patrick Njoroge

Dr. Patrick Njoroge
Governor, Central Bank of Kenya

TABLE OF CONTENTS

MEMBERS OF THE MONETARY POLICY COMMITTEE

Dr. Patrick Njoroge
Governor, Chairman



Mrs. Sheila M'Mbijjewe
Deputy Governor

Dr.Kamau Thugge (EBS)
PS, National Treasury
Treasury Representative

Mr. Charles G. Koori
Member

Mrs. Farida Abdul
Member

Prof. Francis Mwega
Member

Mr. John Birech
Member

LEGAL STATUS OF THE MONETARY POLICY COMMITTEE

(1) Section 4D of the Central Bank of Kenya Act states that there shall be a Committee of the Bank, to be known as the Monetary Policy Committee of the Central Bank of Kenya, which shall have the responsibility within the Bank for formulating monetary policy.

(2) The Committee shall consist of the following members:-

(a) the Governor, who shall be the chairman;

(b) the Deputy Governor, who shall be the deputy chairman;

(c) two members appointed by the Governor from among the staff;

(d) four other members who have knowledge, experience and expertise in matters relating to finance, banking, and fiscal and monetary policy, appointed by the Cabinet Secretary for the National Treasury; and,

(e) the Principal Secretary to the National Treasury, or his representative, who shall be non-voting member.

(2A) Of the two members appointed under subsection (2) (c).

(a) one shall be a person with executive responsibility within the Bank for monetary policy analysis; and

(b) one shall be a person with responsibility within the Bank for monetary policy operations.

(3) At least two of the members appointed under subsection (2)(d) shall be women.

(4) Each member appointed under subsection (2)(d) shall hold office for a term of three years and shall be eligible to be appointed for one additional term.

(5) The chairman of the Committee shall convene a meeting of the Committee at least once every two months and shall convene additional meetings if requested by at least four members in writing.

(6) At least once every six months the Committee shall submit a report to the Cabinet Secretary with respect to its activities and the Cabinet Secretary for the National Treasury shall lay a copy of each report before the National Assembly.

(7) The quorum of the Committee shall be five members, one of who must be the chairman or vice chairman.

(8) The Bank shall provide staff to assist the Committee.

EXECUTIVE SUMMARY

The sixteenth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and economic developments during the six months to April 2016. The monetary policy stance during the period was aimed at maintaining inflation within the Government's target range of 2.5 percent on either side of the 5 percent medium-term target. This is consistent with the price stability objective of the Central Bank of Kenya (CBK).

The MPC held bi-monthly meetings between November 2015 and April 2016 to review developments in the domestic and global economies, and to put in place appropriate measures to maintain price stability. The MPC retained the Central Bank Rate (CBR) at 11.5 percent throughout the period in order to continue to anchor inflation expectations, and maintain market stability. The CBR had been raised to 11.5 percent in July 2015 from 10.0 percent to augment the tight monetary policy stance adopted to address inflationary pressures attributed largely to exchange rate movements. The CBK retained the Kenya Banks' Reference Rate (KBRR) at 9.87 percent during the period in order to ensure market stability. Liquidity management operations by the CBK restored stability in the interbank market following the turbulence witnessed in the market in October 2015 due to the placement of Imperial Bank Limited into receivership and pressures on the Government domestic borrowing programme. Reverse Repos were used to address the liquidity shortages in segments of the market following the temporary placement of Chase Bank Limited in receivership on 7th April, 2016. Confidence in the banking sector was restored following the successful and quick reopening of Chase Bank on 20th April, 2016.

The monetary policy measures adopted by the CBK ensured stability in the market and maintained inflation within the target range except in December 2015 and January 2016. The 12-month overall inflation rose from 6.7 percent in October 2015 to 8.0 percent in December, and was above the Government's target range, largely due to high food prices, and the impact of the revised excise taxes implemented from 1st December, 2015. Overall inflation declined gradually thereafter to 5.3 percent in April 2016, largely due to the decline in the prices of food items and fuel. Month-on-month non-food-non-fuel inflation increased from 4.8 percent in October 2015 to 5.8 percent in April 2016 reflecting the revised excise tax. There were no evident adverse demand pressures in the economy thereby reflecting the desired impact of the monetary policy measures.

The foreign exchange market was stable in the period supported by a narrower current account deficit due to lower petroleum product imports, improved earnings from tea and horticulture exports, and significant diaspora remittances. The current account deficit eased to 6.8 percent of GDP in 2015 down from 9.8 percent of GDP in 2014. Lower prices of petroleum products coupled with stability of the exchange rate of the Shilling moderated any risks of imported inflation.

The CBK level of usable foreign exchange reserves increased to USD 7,611 million (equivalent to 5.0 months of import cover) at the end of April 2016 from USD 6,551 million (equivalent to 4.2 months of import cover) at the end of October 2015. The approval in March of new International Monetary Fund (IMF) Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) Precautionary Arrangements amounting to USD1.5 billion (SDR1.06 billion) covering 2 years, reflected confidence in the country's macroeconomic policies, and provided an additional buffer against short-term shocks.

The CBK is taking steps to strengthen bank supervision through promoting: greater transparency supported by accurate reporting of data by banks; stronger governance with clear demarcation of responsibilities, greater accountability, fair market conduct, and stronger supervision; and, encouraging effective business models aimed at strengthening the resilience of banks, reducing costs, and supporting innovation. The CBK held bi-monthly meetings with stakeholders in the banking sector and ensured timely release of relevant data during the period. The CBK will continue to work with stakeholders to strengthen the KBRR framework in order to enhance the transmission of monetary policy signals through commercial banks' lending rates, and promote transparency in the pricing of credit. The CBK worked closely with the National Treasury to ensure coordination of monetary and fiscal policies for overall macroeconomic stability.

The CBK remains vigilant to any risks posed by developments in the domestic and global economies on its overall price stability objective. The monetary policy measures in place, the stable exchange rate, and the moderate oil prices are expected to support a stable inflation. However, the main risks to inflation relate to potential volatility in international oil prices, volatility in food prices in case of unfavourable weather conditions, together with one-off pressures attributed to implementation of taxation measures, and uncertainties in the global political arena and financial markets which may have implications on the foreign exchange market.

1. INTRODUCTION

The sixteenth bi-annual Report of the MPC covers the period November 2015 to April 2016. It reviews outcomes of the monetary policy stance adopted by the MPC in pursuit of its price stability objective, as well as other economic developments during the period.

The monetary policy measures adopted by the MPC coupled with moderate prices of food items and fuel anchored inflation expectations during the six months to April 2016. Overall month-on-month inflation returned to within the Government target range in February 2016 after exceeding the 7.5 percent upper bound of the target range in December 2015 and January 2016. The 12-month non-food-non-fuel inflation rose during the period largely due to the revised excise taxes. The lower international oil prices coupled with the stability of the Shilling mitigated any risks of imported inflation. The foreign exchange market was stable supported by a narrower current account deficit, and significant diaspora remittances. The performance of the economy remained strong, posting a growth of 5.6 percent in 2015, from 5.3 percent in 2014 largely supported by higher public infrastructural investment, lower petroleum product prices which eased pressure on energy costs, and improved weather conditions that boosted agriculture.

On the international scene, the outlook for global economic growth deteriorated and was expected to remain subdued in 2016 due to weaker growth prospects in advanced and emerging market economies. Uncertainties in the global financial markets increased due to risks posed by, among other factors, slower growth in China, the timing of the U.S. Fed's next increase in interest rates and the outcome of the referendum on U.K. membership of the European Union (Brexit). The growth outlook for Kenya's main trading partners in the region remained strong, suggesting better prospects for exports performance.

The remainder of this Report is structured as follows. Section 2 provides highlights of the monetary policy formulation in response to threats to price stability during the period; while Section 3 provides a discussion of the impact of policy on key economic indicators. Other activities of the MPC with relevance to monetary policy formulation and implementation are discussed in Section 4 while Section 5 concludes.

2. MONETARY POLICY FORMULATION

2.1 Attainment of Monetary Policy Objectives and Targets

The MPC formulated monetary policy to achieve and maintain overall inflation within the government target range as provided by the Cabinet Secretary for the National Treasury. The Government medium-term overall inflation target was 5 percent for the Fiscal Year 2015/16 with an allowable margin of 2.5 percent on either side.

The Central Bank Rate (CBR) is the base for monetary policy operations. The change in both the direction and magnitude of the CBR signals the monetary policy stance. The monetary policy stance is operationalized through various instruments including: Open Market Operations (OMO), changes in cash reserve requirements at CBK, foreign exchange market operations, and the CBK Standing Facility (Overnight Discount Window which is a lender of last resort facility). To achieve the desired level of money supply, OMO is conducted using Repurchase Agreements (Repos), Reverse Repos, and Term Auction Deposits (TAD).

Monetary policy implementation was guided by CBK targets on the Net International Reserves (NIR) and Net Domestic Assets (NDA) as the operational parameters. These targets were consistent with the performance measures under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) negotiated between the Government and the IMF to protect against exogenous shocks that might lead to balance of payments needs. The CBK met its NDA and NIR targets for December 2015 and March 2016, and was on track with respect to June targets. The NDA averaged Ksh.-268.5 billion by end March, 2016 compared to the target ceiling of Ksh.-169 billion while the NIR averaged USD6,535 million against a target floor of USD5,784 million.

The annual growth rates of broad money supply (M3) and private sector credit were consistent with the policy stance in the period. The 12-month growth in M3 slowed down from 13.9 percent in October 2015 to 7.9 percent in April 2016 reflecting the impact of the monetary policy stance. Similarly, the 12-month private sector credit growth declined from 19.5 percent to 14.4 percent in the period.

2.2 Economic Environment

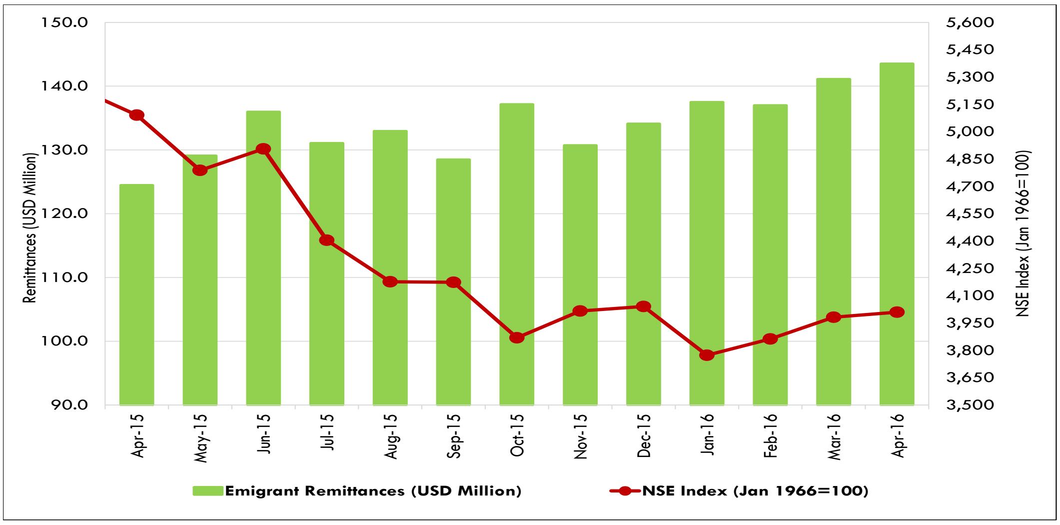
The economic environment during the six months to April 2016 was characterised by relative stability of key macroeconomic indicators. This was supported by the prudent monetary policy stance reflected in non-inflationary growth in private sector credit, and stability in the foreign exchange market.

Overall inflation rate remained within the prescribed target range through most of the period.

The foreign exchange market remained stable supported by a narrower current account deficit due to lower petroleum product imports, improved earnings from tea and horticulture exports, and significant diaspora remittances. The current account deficit eased to 6.8 percent of GDP in 2015 from 9.8 percent in 2014. Diaspora remittances increased from an average of USD132.5 million per month in the six months to October 2015 to an average of USD137.3 million per month in the six months to April 2016 (Chart 1a). The improved diaspora remittances were partly due to strengthening of the U.S. economy. There was also a gradual recovery of the Nairobi Securities Exchange (NSE) in the period reflecting restoration of market stability and improved confidence in the economy. The NSE index had been weighed down by the prolonged uncertainty in the global financial markets, and capital outflows from emerging and frontier market economies (Chart 1a).

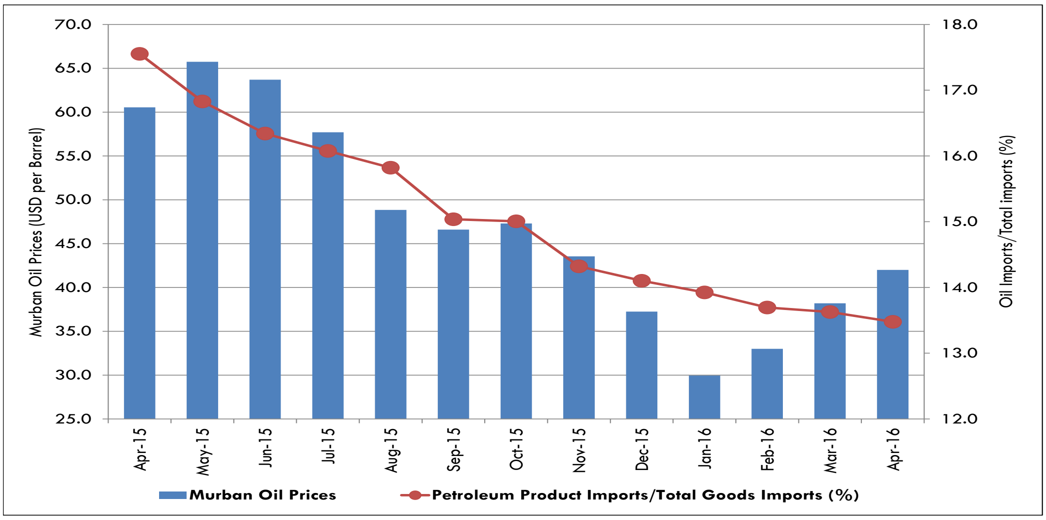
International crude oil prices remained low in the six months to April 2016 compared with historical averages, reflecting increased production in the U.S., reduced demand particularly from China and sustained production by the Organization of Petroleum Exporting Countries. Murban crude oil prices declined from USD47.3 per barrel in October 2015 to USD30.0 per barrel in February 2016, but rose slightly thereafter to USD42.0 per barrel in April (Chart 1b). As a result, the proportion of oil imports to total imports of goods declined to 13.9 percent in the six months to April 2016 from an average of 15.9 percent in the six months to October 2015 (Chart 1b). The lower petroleum product import bill coupled with a stable exchange rate continued to ease the demand for foreign exchange, and to improve the current account balance.

Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE Index (Jan 1966=100)



***Source**: Central Bank of Kenya and Nairobi Securities Exchange*

Chart 1b: Murban Oil Prices and the ratio of 12-Month Cumulative Petroleum Product Imports to Total Imports of Goods (%)



Source: *Central Bank of Kenya and Kenya Revenue Authority*

2.3 Monetary Policy Committee Meetings and Decisions

The MPC held bi-monthly meetings between November 2015 and April 2016 to review developments in the domestic and international markets, and to take appropriate measures to maintain price stability. The MPC retained the CBR at 11.5 percent during the Meetings on 17th November 2015, on 20th January 2016, and on 21st March in order to continue to anchor inflation expectations, and maintain market stability. The CBR had been raised to 11.5 percent on 7th July 2015 from 10.0 percent to augment the tight monetary policy stance adopted to address inflationary pressures attributed mainly to exchange rate movements. The CBK retained the KBRR at 9.87 percent in the period in order to ensure market stability.

Liquidity management operations by the CBK restored stability in the interbank market following the turbulence witnessed in the market in October 2015 after the placement of Imperial Bank Limited into receivership, and pressures on the Government domestic borrowing programme. Reverse Repos were used to address any liquidity shortages in segments of the market following the temporary placement of Chase Bank Limited in receivership on 7th April, 2016. The CBK introduced Reverse Repos with maturities of 14, 21 and 28 days to ensure financial stability. Confidence in the banking sector was restored following the successful and quick reopening of Chase Bank on 20th April, 2016. Open Market Operations through Term Auction Deposits and Repos were used by the CBK to withdraw liquidity from segments of the market with surpluses.

The monetary policy stance adopted by the MPC supported a non-inflationary growth in credit to the private sector. The CBK also continued to work closely with the National Treasury to ensure coordination of monetary and fiscal policies for overall macroeconomic stability. Foreign exchange market operations undertaken by the CBK through direct sale, and purchase of foreign exchange offers from banks complemented other liquidity management measures in ensuring stability in the exchange rate and managing expectations over the period covered by this Report. The official usable foreign exchange reserves buffer held by the CBK was augmented by the new SBA and SCF Precautionary Arrangements with the IMF to protect the country against potential balance of payments shocks. This bolstered the Bank's capacity to respond to shocks in the market.

3. IMPACT OF POLICY ON KEY ECONOMIC INDICATORS

3.1 Inflation

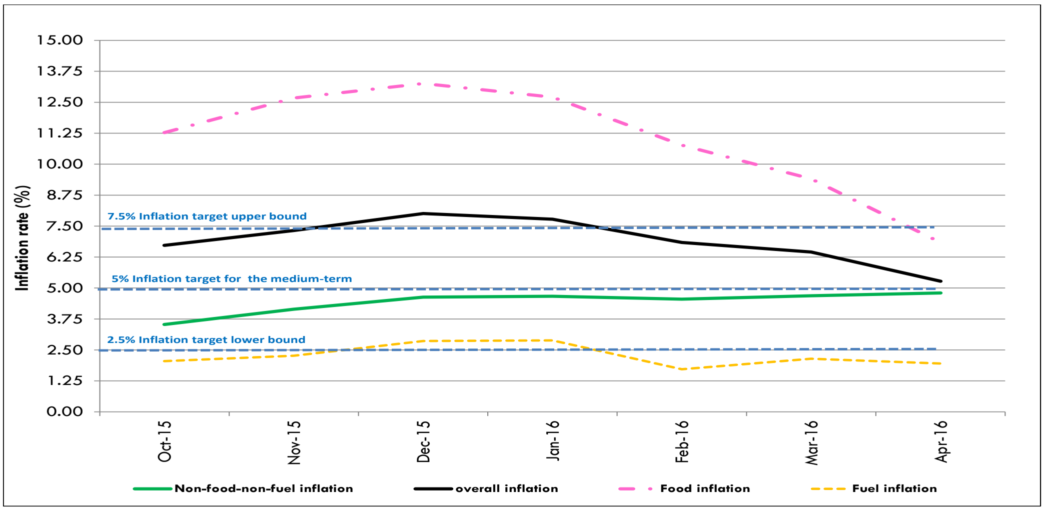
The 12-month overall inflation rose from 6.7 percent in October 2015 to 8.0 percent in December, and was above the upper bound of the Government's target range (Chart 2a). These developments reflected high food prices, and the impact of the revised Excise taxes implemented from 1st December, 2015. The contribution of food inflation to overall inflation rose from 4.6 percentage points in October to 5.4 percentage points in December while the CPI category alcoholic beverages, tobacco and narcotics contribution rose to 0.3 percentage points, reflecting the revised excise tax introduced in December 2015 (Table 1). Nevertheless, reductions in food and fuel prices contributed to the decline in overall inflation to 5.3 percent in April 2016, which was within the Government's target range.

Month-on-month non-food-non-fuel (NFNF) inflation increased from 4.8 percent in October 2015 to 5.8 percent in April, 2016, largely due to the revised excise tax introduced in December 2015. The alcoholic beverages, tobacco and narcotics category contributed 1.1 percentage points to NFNF inflation between December 2015 and April 2016. There were no evident adverse demand pressures in the economy reflecting the impact of the monetary policy measures. In particular, growth in credit to private sector was consistent with the targets for the period. The lower prices of petroleum products relative to historical averages, coupled with stability of the exchange rate of the Shilling, moderated any risks of imported inflation.

The monetary policy measures in place, the stable exchange rate, and moderate petroleum products prices are expected to moderate inflationary pressure. The main risks to inflation relate to volatility in international oil prices, volatility in food prices in case of unfavourable weather conditions, pressures attributed to implementation of taxation measures in the Government Budget, and uncertainties in global financial markets particularly with respect to Brexit, which may have implications on the foreign exchange market.

Although global inflation remained low in the six months to April 2016 largely due to lower commodity prices, a modest pick-up in global inflation is expected in 2016 with most advanced countries continuing to implement accommodative monetary policy to support growth. The three major economies in the East African Community region displayed similar trends in their inflation rates (Chart 2b). These trends largely reflected a similar composition of the CPI basket, which is largely affected by the movements in food and energy prices. South Africa's inflation rose significantly in the period reflecting the pass-through effects of exchange rate depreciation, and pressure on food prices following the severe drought experienced in the Southern Africa region.

Chart 2a: 12-Month Inflation in Broad Categories (%)



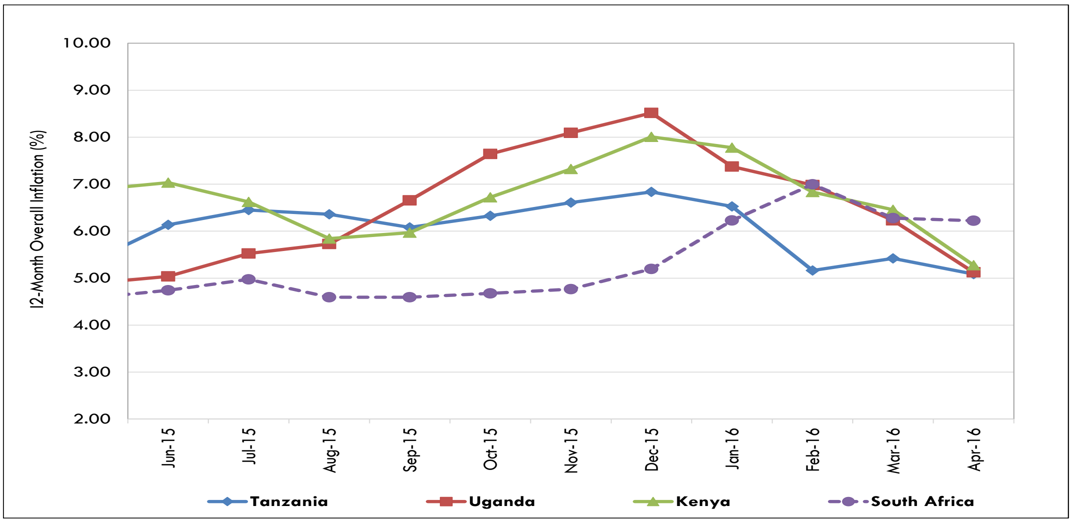
***Source**: Kenya National Bureau of Statistics and Central Bank of Kenya*

Table 1: Contributions to 12-Month Overall Inflation (%)

	Food & Non-Alcoholic Beverages	Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Housing, Water, Electricity, Gas and other Fuels	Furnishings, Household Equipment and Routine Household Maintenance	Health	Transport	Communication	Recreation & Culture	Education	Restaurants & Hotels	Miscellaneous Goods & Services	Total
Weight	**0.360**	**0.021**	**0.074**	**0.183**	**0.062**	**0.031**	**0.087**	**0.038**	**0.023**	**0.031**	**0.045**	**0.045**	**1.000**
Oct-15	4.6	0.1	0.3	0.7	0.3	0.1	-0.1	0.0	0.1	0.1	0.2	0.3	6.7
Nov-15	5.2	0.1	0.3	0.7	0.3	0.1	-0.1	0.0	0.1	0.1	0.2	0.4	7.3
Dec-15	5.4	0.3	0.3	0.8	0.3	0.1	-0.1	0.0	0.0	0.1	0.3	0.3	8.0
Jan-16	5.2	0.3	0.3	0.8	0.3	0.2	0.0	0.0	0.1	0.1	0.3	0.2	7.8
Feb-16	4.5	0.3	0.3	0.5	0.3	0.2	0.0	0.1	0.1	0.1	0.3	0.4	6.8
Mar-16	4.0	0.3	0.3	0.6	0.3	0.1	0.0	0.1	0.1	0.1	0.3	0.4	6.5
Apr-16	2.9	0.3	0.3	0.6	0.2	0.1	-0.1	0.1	0.1	0.1	0.3	0.4	5.3

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

Chart 2b: 12-Month Inflation in the Selected EAC Countries and South Africa (%)



***Source**: Websites of respective central banks*

3.2 Exchange Rates

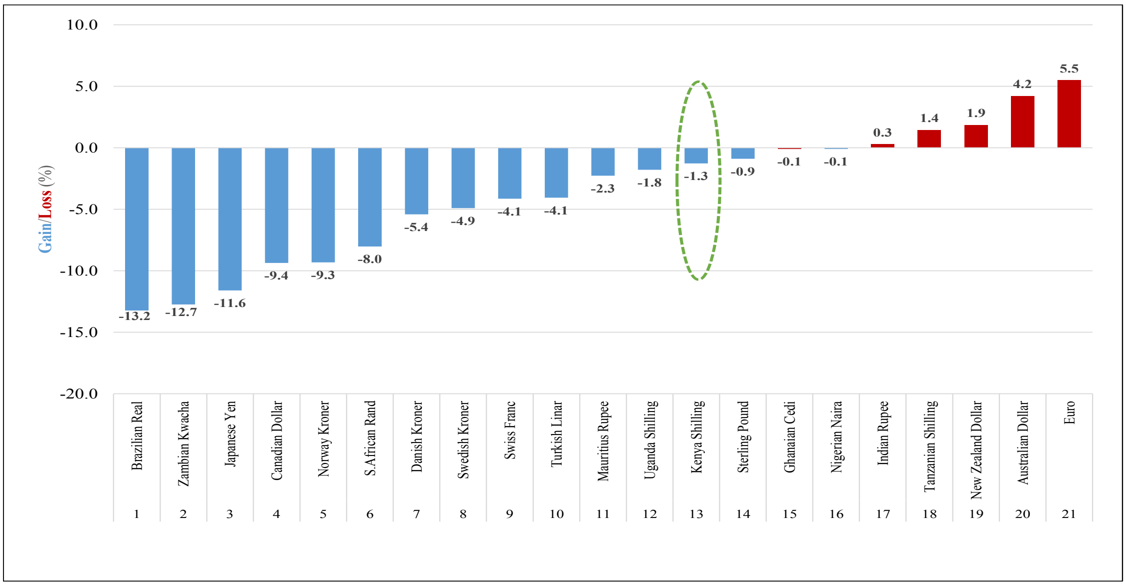
The foreign exchange market was stable in the six months to April 2016 supported by a narrower current account deficit due to lower petroleum products imports, improved earnings from tea and horticulture exports, and significant diaspora remittances. Most of the major international and regional currencies, except the South African Rand, were generally stable against the U.S. dollar between January and April 2016, reflecting relative stability in the global financial markets (Chart 3a and 3b).

The financial markets were turbulent towards the end of 2015 following uncertainty in the financial markets attributed to the timing of the increase in U.S. interest rates, and concerns on the growth outlook in the major emerging market economies. The Shilling strengthened on average against the Sterling Pound in the period largely due to the uncertainty around the outcome of the referendum on the U.K. exit from the European Union (Brexit). The Euro was also volatile against the U.S. dollar reflecting sluggish growth performance, and Brexit concerns. In the region, the South African Rand was volatile against the U.S. dollar due to the drop in commodity prices, widening trade deficit attributed to weak growth in its main trading partners including China, and labour unrests in the mining sector which have affected growth.

The stability of the foreign exchange market in Kenya also reflects improved market discipline, and the resilience and diversified nature of the economy relative to its peers. The spillover effects from global stock markets volatility have been minimal due to low level of foreign ownership of Government securities and equity, which accounted for about 4.4 percent and 21.7 percent, respectively, as at March 2016.

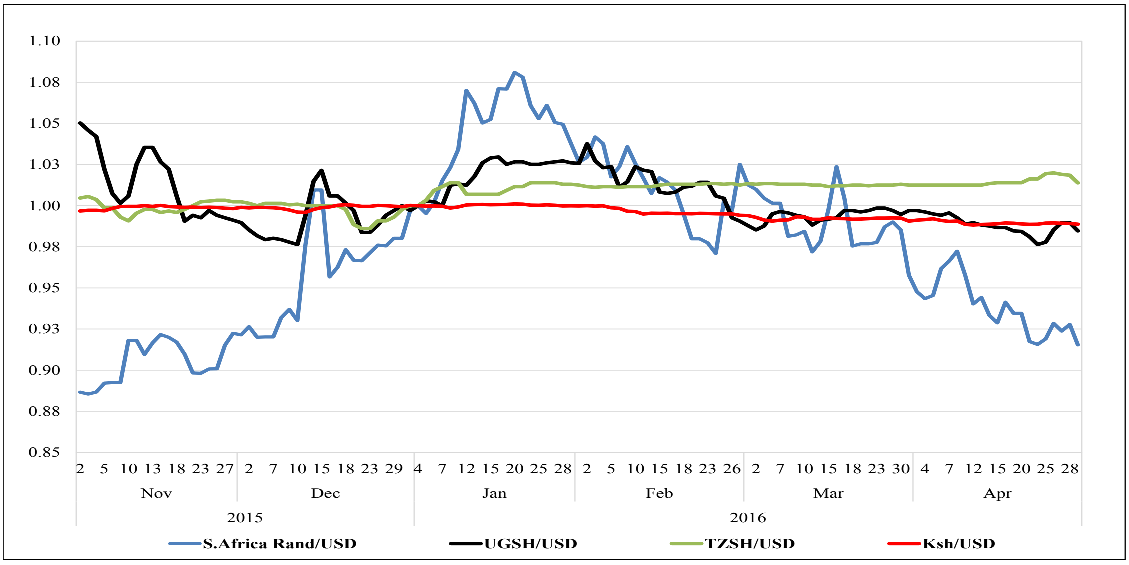
The CBK level of usable foreign exchange reserves increased to USD7,611 million (equivalent to 5.0 months of import cover) at the end of April 2016 from USD6,551 million (equivalent to 4.2 months of import cover) at the end of October 2015. These reserves provided a buffer against short-term shocks. In addition, the approval in March 2016 of new SBA and SCF IMF Precautionary Arrangements amounting to USD1.5 billion (SDR1.06 billion) covering 2 years, provided an additional buffer against short-term shocks, while also endorsing the country's macroeconomic policies.

Chart 3a: Performance of Selected Currencies against the U.S. dollar (January to April 2016)



***Source**: Central Bank of Kenya*

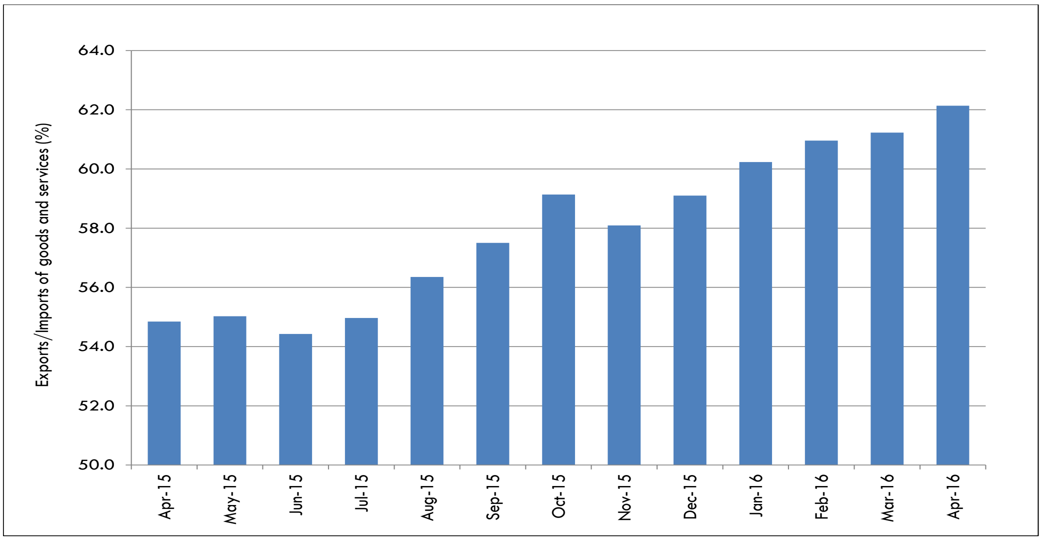
Chart 3b: Normalised Exchange Rates of Major Currencies in the Region against the U.S. dollar (2nd January 2016 = 1)



***Source**: Central Bank of Kenya*

The demand for foreign exchange to finance imports of petroleum products eased in the six months to April 2016 largely due to lower international oil prices. As a result, the 12-month cumulative proportion of imports of goods and services financed by exports of goods and services increased from an average of 56.2 percent in the six months to October 2015 to 60.3 percent in the six months to April 2016 (Chart 4). Although the value of imports of machinery and transport equipment declined by 15.6 percent in the year to April 2016, its share in total imports remained largely unchanged at around 30.7 percent. This partly reflected imports of equipment towards construction of the Standard Gauge Railway.

Chart 4: Percentage of 12-Month Imports of Goods and Services financed by Exports



Source*: Kenya National Bureau of Statistics*

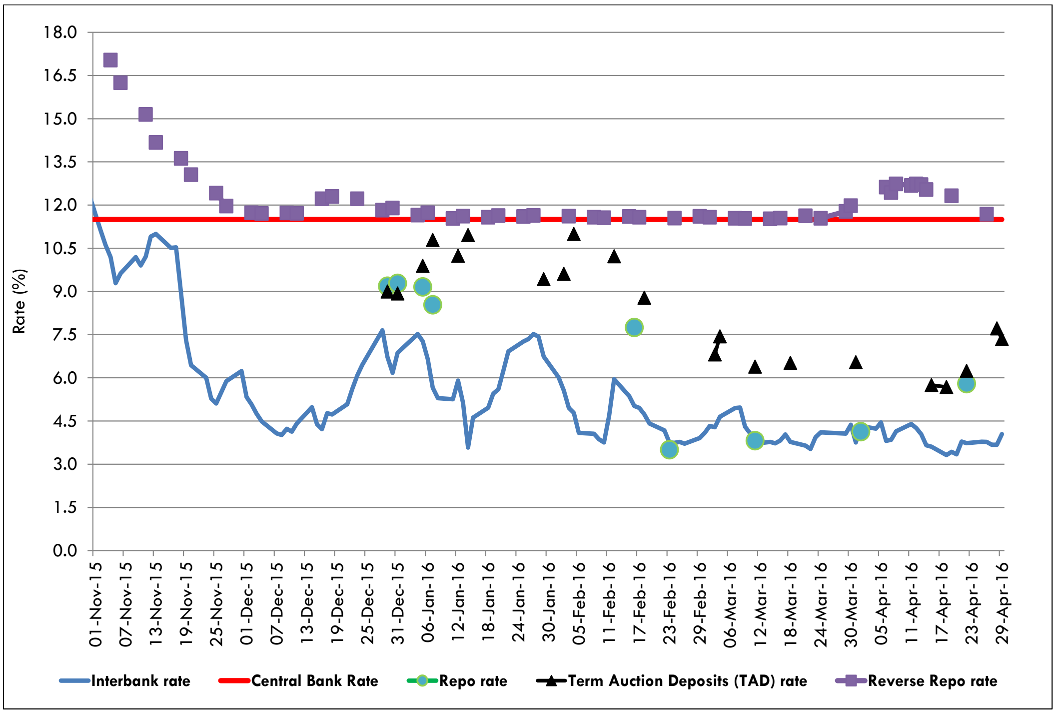
3.3 Interest Rates

The interbank rate remained below the CBR during the six months to April 2016 reflecting improved liquidity conditions in the market. Liquidity management operations by the CBK ensured stability in the interbank market. The CBK used Reverse Repos to address the resultant temporary liquidity shortages in segments of the market following the temporary placement of Chase Bank Limited in receivership. Open Market Operations through Term Auction Deposits and Repos were also used by CBK to withdraw liquidity from segments of the market with surpluses (Chart 5a).

The CBK continued to explore strategies for enhancing the use of Horizontal Repos towards redistributing liquidity in the interbank market. The value of Horizontal Repos transacted rose to Ksh 70.6 billion in the six months to April 2016 compared with Ksh. 4.5 billion in the six months to October 2015, while the number of transactions increased to 213 from 25.

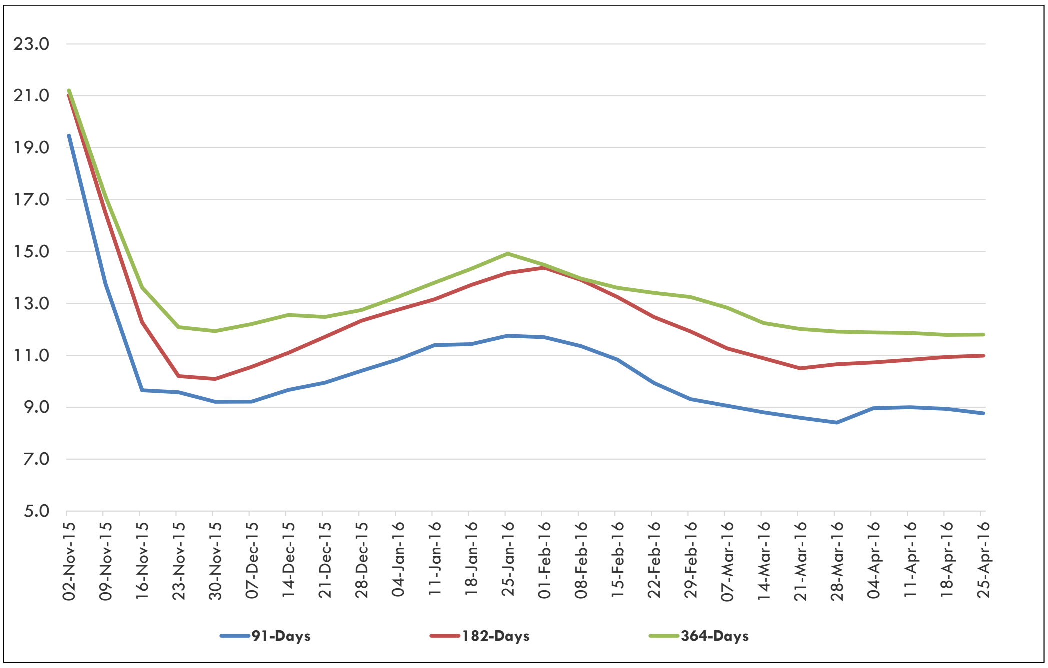
The interest rates on Government securities eased during the six months to April 2016 partly due to reduced pressure on the Government domestic borrowing programme following rationalisation of expenditures (Chart 5b). Consequently, the National Government budget deficit was expected to narrow in FY2015/16 thereby easing pressure on interest rates.

Chart 5a: Trends in Short-Term Interest Rates (%)



***Source**: Central Bank of Kenya*

Chart 5b: Interest rates on Treasury Bills (%)



***Source**: Central Bank of Kenya*

3.4 Banking Sector Developments

The banking sector saw restored resilience and stability in the six months to April 2016. However, the CBK continued to closely monitor the sector, particularly concerning liquidity and credit risks. Bank liquidity and its distribution improved during the period, but was temporarily disrupted by the placement of Chase Bank Limited under receivership in April 2016. Nevertheless, the successful and quick reopening of Chase Bank restored confidence in the sector. The CBK's enforcement of existing regulations particularly with respect to the classification of loans, strengthened and increased transparency of the banking sector in the period. However, the ratio of gross non-performing loans to gross loans was 8.2 percent in April 2016, partly reflecting reclassification of loans in line with the required reporting standards. Non-performing loans are expected to moderate as the impact of reclassification eases.

The CBK retained the KBRR at 9.87 percent in January 2016 in order to ensure market stability. The average commercial banks' lending rates increased to 18.0 percent in April 2016 from 16.6 percent in October 2015 (Table 2). The increase in lending rates was reflected across all the bank category. However, the average deposit rate decreased during the period reflecting improved liquidity conditions. The spreads for large banks remained comparably higher due to market power enabling them to lower deposit rates.

The CBK is taking steps to strengthen bank supervision through promoting: greater transparency supported by accurate reporting of data by banks; stronger governance with clear demarcation of responsibilities, greater accountability, fair market conduct, and stronger supervision; and, encouraging effective business models aimed at strengthening the resilience of banks, reducing costs, and supporting innovation.

The CBK also continued to work with stakeholders including the Kenya Bankers Association (KBA) to strengthen the framework for the determination and implementation of the KBRR. This will also improve the transmission of monetary policy signals through commercial banks' lending rates. Bi-monthly meetings were held between the CBK and Chief Executive Officers of commercial banks, through the KBA, to discuss various issues through the post-MPC meeting forums. This has continued to facilitate moral suasion and provided a regular feedback mechanism.

Table 2: Trends in Commercial Bank Interest Rates and Spreads by Bank Size (%)

	Average Lending rates (%)				Average Deposit rates (%)				Average Spread (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Sep-15	17.7	17.0	16.5	16.8	7.5	7.9	6.5	7.3	10.1	9.2	10.0	9.5
Oct-15	17.8	16.3	16.5	16.6	9.1	8.0	6.5	7.5	8.7	8.3	10.0	9.0
Nov-15	18.7	17.2	16.9	17.2	9.4	8.2	6.4	7.4	9.3	9.1	10.5	9.8
Dec-15	19.0	18.6	18.0	18.3	9.4	8.0	7.4	8.0	9.6	10.6	10.6	10.3
Jan-16	18.8	18.3	17.5	18.0	8.8	7.8	6.7	7.5	9.9	10.5	10.9	10.4
Feb-16	18.2	18.2	17.5	17.9	8.4	7.8	6.8	7.5	9.8	10.4	10.7	10.4
Mar-16	18.1	18.0	17.5	17.8	8.9	7.6	6.2	7.2	9.2	10.5	11.3	10.6
Apr-16	18.0	18.4	17.6	18.0	8.0	7.5	6.0	6.9	9.9	10.9	11.6	11.0

Source: *Central Bank of Kenya*

3.5 Credit to Private Sector

Growth in bank credit to the private sector remained strong in the six months to April 2016. However, consistent with the tight policy stance adopted by the MPC, the 12-month growth in overall private sector credit slowed down from 19.8 percent in October 2015 to 14.3 percent in April 2016 (Table 3). The credit was channelled largely towards key sectors of the economy including agriculture, trade, transport and communication, building and construction and real estate. However, there was notable slow down in credit growth to business services and manufacturing during the period.

The monetary policy measures adopted by the MPC are expected to continue supporting a non-inflationary credit expansion to the key sectors of the economy in the remainder of 2016.

Table 3: 12-Month Growth in Private Sector Credit Across Sectors (%)

	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16
Agriculture	17.2	12.5	14.6	20.1	23.5	20.1	15.1
Manufacturing	20.2	20.8	22.2	16.1	18.8	21.2	4.8
Trade	23.6	22.2	23.2	25.9	23.1	22.1	20.3
Building & construction	37.6	34.0	32.2	25.0	20.0	23.5	21.9
Transport & communication	32.1	32.3	31.7	28.9	26.3	21.1	25.1
Finance and insurance	26.4	28.5	21.2	19.4	18.0	19.5	16.3
Real estate	9.8	10.6	7.6	6.2	7.4	12.5	17.4
Mining & quarrying	-15.5	-22.8	-11.3	-9.3	1.7	10.4	7.2
Private households	17.0	15.5	12.6	14.0	11.7	9.7	17.2
Consumer durables	18.0	15.3	14.3	16.0	13.2	13.9	7.4
Business services	24.1	19.3	20.9	17.8	19.6	14.9	2.8
Other activities	16.1	17.6	15.5	14.4	4.7	3.6	9.4
Total	**19.8**	**18.7**	**18.0**	**17.2**	**16.1**	**16.0**	**14.3**

Source: *Central Bank of Kenya*

4. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC engaged the Chief Executive Officers of commercial banks through the KBA on various issues through the post MPC meeting forums held between November 2015 and April 2016. The Committee continued to improve on the information gathering processes through the market Perception Surveys and communication with key stakeholders on the MPC decisions to obtain feedback. MPC Press Releases were simplified to make them better focused to the public, media, financial sector and other stakeholders. The MPC Chairman also held a press conference after MPC Meetings to brief the media on measures undertaken by the CBK to support macroeconomic and financial stability. The media and public understanding of monetary policy decisions and their expected impact on the economy continued to improve as can be noted by increased analysis and coverage in the press.

MPC members participated in conferences locally over the period covered by this Report as part of enhancing their responsibility, and to share experiences. The members also held meetings with the IMF Review Mission in December 2015, as well as with various investors in order to brief them on economic developments and the outlook for the economy. They participated in forums organised by the World Bank and IMF to launch country and regional economic reports.

5. CONCLUSION

The monetary policy measures adopted by the MPC have continued to anchor inflation expectations, and support stability in the foreign exchange market. The implementation of measures to promote foreign direct investment, tourism and export competitiveness will ensure the long-term stability of the exchange rate. Such measures would support the overall price stability objective of the CBK. The MPC will continue to monitor developments in the domestic and global economy and take appropriate measures to sustain price stability.

APPENDIX: CHRONOLOGY OF EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2015 - APRIL 2016)

Date	Events
November 2015	The CBR was retained at 11.50 percent in order to anchor inflation expectations
December 2015	Commencement of normalisation of U.S. monetary policy. The Federal Fund Rate was raised by 50 basis points
January 2016	The CBR was retained at 11.50 percent in order to anchor inflation expectations
	The CBK reviewed the Kenya Banks' Reference Rate (KBRR) and decided to retain it at its current level of 9.87 percent in order to ensure market stability
March 2016	The CBR was retained at 11.50 percent in order to continue to anchor inflation expectations and enhance the credibility of its policy stance.
April 2016	Chase Bank Limited was placed under receivership by the CBK on 7th April. The Bank was successfully re-opened on 20th April, following the appointment of KCB by the KDIC as the receiver manager

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the month-on-month movement of indices of all consumer price items of goods and services sampled by the KNBS. It is affected by commodity components in the market that may experience sudden inflationary spikes such as food or energy.

Reserve Money: These are CBK's monetary liabilities comprising currency in circulation (currency outside banks and cash held by commercial banks in their tills) and deposits of both commercial banks and non-bank financial institutions held with the CBK. It excludes Government deposits.

Money Supply: Money supply is the sum of currency outside banks and deposit liabilities of commercial banks. Deposit liabilities are defined in narrower and broader terms as follows: narrow money (M1); broad money (M2); and extended broad money (M3). These aggregates are defined as follows:

M1 Currency outside banking system + demand deposits

M2 M1 + time and savings deposits + certificates of deposits + deposit Liabilities of Non-Bank Financial Institutions (NBFIs)

M3 M2 + residents' foreign currency deposits

Central Bank Rate (CBR): This is the lowest rate of interest that the CBK charges on overnight loans to commercial banks. It is reviewed and announced by the Monetary Policy Committee at least every two months as part of its decisions. It is used by the commercial banks as a reference interest rate hence transmits to the financial sector and signals the CBK's monetary policy stance.

Kenya Banks' Reference Rate (KBRR): This is the base rate for all commercial banks' lending. It is currently computed as an average of the CBR and the weighted 2-month moving average of the 91-day Treasury bill rates.

Cash Ratio Requirement (CRR): This is the ratio of deposits of commercial banks and non-bank financial institutions maintained with the CBK (as reserves) to commercial banks total deposit liabilities. The ratio is fixed by CBK as provided for by the law.

CBK Discount Window: The CBK Discount Window is a collateralised facility of last resort for banks. It has restrictive guidelines controlling access.

The Discount Window plays a significant role in ensuring banking sector stability by offering overnight liquidity as a last resort. It is anchored on the CBR with a prescribed penalty.

Open Market Operations (OMO) : The act of buying or selling of government securities from or to commercial banks by the Central Bank in order to achieve a desired level of bank reserves. OMO is carried out in the context of an auction where commercial banks bid through the Reuters dealing system or by phone/fax.

Repurchase Agreement (Repo): Repos/reverse repos are agreements between the CBK and commercial banks to purchase/sell Government securities from/to commercial banks at agreed interest rates (REPO rate) for a specified period with an understanding that the commercial bank will repurchase/resell the security from/to the CBK at the end of the period. The period can be varied by the CBK.

Term Auction Deposits (TAD): The TAD is used in exceptional market conditions when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options. The CBK seeks to acquire deposits through a transfer agreement from commercial banks at an auction price but with no exchange of security guarantee.

Horizontal Repo: This is an interbank Repo instrument which recognises Government securities as collateral for borrowing. The instrument has a variable tenor and allows commercial banks without credit lines with other banks to access credit from the interbank market.

Interbank Market: The interbank market is a critical channel for distributing liquidity that reduces the need for banks to access the CBK Overnight Discount Window. However, since not all banks have credit lines