



CENTRAL BANK OF KENYA

PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 8TH JULY, 2014

MAINTAINING STABILITY IN THE MONETARY POLICY PATH

The Monetary Policy Committee (MPC) met on 8th July, 2014 to review market developments and the outcomes of its previous monetary policy decisions. The Committee noted that overall inflation remained within the upper bound of the prescribed range of the medium-term target of 5 percent in May and June 2014. The exchange rate has remained generally stable, despite the recent short-term seasonal pressures attributed mainly to corporate dividend payments. The Committee noted the following outcomes in the market since its meeting at the end of April 2014:

- The overall month-on-month inflation increased marginally from 7.30 percent in May 2014 to 7.39 percent in June 2014 mainly driven by the base effect and also reflecting an increase in the prices of some foodstuffs, fuel and electricity. Similarly, month-on-month non-food-non-fuel inflation increased slightly from 4.35 percent to 4.47 percent.
- The exchange rate has remained stable supported mainly by foreign exchange inflows through diaspora remittances and increased foreign investor participation in the Nairobi Securities Exchange as well as enhanced confidence following successful issuance of the Sovereign Bond in June 2014. It fluctuated within a narrow range of Ksh.87.38 and Ksh.87.92 against the USD in June 2014 compared to a range of Ksh.86.87 and Ksh.87.86 in May 2014. The CBK level of usable foreign exchange reserves increased from USD6,308.23 million (equivalent to 4.28 months of import cover) at the end of April 2014 to USD6,501.37 million (equivalent to 4.34 months of import cover) as at 7th July, 2014. The build-up in foreign exchange reserves provides adequate cushion for the exchange rate against temporary shocks. This build-up of foreign exchange reserves will continue as the Government utilizes the proceeds of the Sovereign Bond.
- The fiscal measures spelt out in the Government Budget for the Fiscal Year 2014/15 are consistent with the monetary policy objectives. Specifically, the successful issuance of the Sovereign Bond is expected to dampen pressure on both Government domestic borrowing and interest rates.
- The latest stress tests and data show that the banking sector remains solvent and resilient. As a result, the annual growth in private sector credit increased from 23.87 percent in April 2014 to 24.99 percent in May 2014. The Committee observed that credit growth was mainly towards productive sectors of the economy. The ratio of gross non-performing loans to gross loans decreased from 5.7 percent in April 2014 to 5.6 percent in May 2014 indicating a lowering in credit risk. This, coupled with the expected decline in domestic interest rates, will boost investment in the economy.
- A notable development in the banking sector during the period was the introduction of a Kenya Banks' Reference Rate (KBRR) developed as an outcome of discussions between the stakeholders, CBK and led by The National Treasury. The KBRR was developed as part of the recommendations to enhance the supply of private sector credit and mortgage finance in Kenya by facilitating a transparent credit pricing framework. It will be the base rate for all commercial banks' lending. Given that one of the components of the KBRR is the CBR, this framework is expected to enhance the transmission of monetary policy signals through commercial banks' lending rates. It will be computed as an average of the CBR and the weighted 2-month moving average of the 91-day Treasury bill rates. The KBRR will be reviewed and announced by the CBK through MPC Press Releases after every six months (if conditions do not drastically change) from the effective date and operationalized through a Banking Circular.
- The latest data from the Kenya National Bureau of Statistics shows that the financial intermediation sector continued to contribute significantly to growth in the first quarter of 2014; it grew by 8.3 percent in the first quarter of 2014 compared with 12.1 percent in a similar period of 2013. The Committee noted that the implementation of the infrastructure development proposals in the Fiscal Year 2014/15 Budget coupled with increasing capacity of the Counties to utilise their funding efficiently will enhance the capacity for future growth.
- Confidence in the economy remains strong. Specifically, the latest sovereign rating by Moody's conducted in May 2014 placed Kenya at "B1 with stable outlook". In addition, the entry into the international capital markets through issuance of a Sovereign Bond has boosted Kenya's rating and enhanced the capacity for a faster rollout of public investments. It will also help to benchmark the country's credit and facilitate access to international capital markets by corporate entities thereby enhancing investment. The Committee noted that the Bond was massively oversubscribed at 440 percent while the realised yields were comparably lower relative to those on recent issues of similar bonds in the region. Part of the proceeds of the Bond have already been utilised to retire the USD600 million syndicated loan. Similarly, purchases of equity at the Nairobi Securities Exchange by foreign investors maintained the long-term upward trend from January 2013 when the purchases amounted to an equivalent of Ksh.5 billion, rising to Ksh.11.5 billion in June 2014. Diaspora remittances also remained resilient during the period, rising from USD113.41 million in April 2014 to USD119.66 million in May 2014. Furthermore, the MPC Market Perception Survey conducted in June 2014 showed that the private sector maintained their optimism for a strong growth in 2014 while inflation and the exchange rate were expected to remain stable for the remainder of 2014.

On the global scene, the first quarter of 2014 data showed that the global economy was picking up although this recovery remains uneven across advanced and emerging market economies. The growth outlook for the global economy and that of Kenya's main trading partners is improving with most indicators suggesting a pickup in economic activity while their inflation rates remain low. This will boost Kenya's exports and support exchange rate stability. In addition, global long-term interest rates have continued to decline suggesting that interest rates may remain low over the long-term thereby dampening the threat of excessive volatility in the global currency and financial markets. However, the persistent instability in the Middle East and North African region remains a threat to the stability of international oil prices and the overall price stability objective. The Committee concluded that the monetary policy measures had continued to deliver the desired price stability as overall inflation remains within the target range. In addition, the rise in overall inflation has slowed down. It therefore decided to retain the CBR at 8.50 percent so as to continue anchoring inflationary expectations and maintain price stability. 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.

Considering the above CBR set by the MPC and the weighted 2-month moving average of the 91-day Treasury bill rate, the CBK has computed and set the KBRR at 9.13 percent. This level of the KBRR will be effective from 8th July, 2014 until its next review in January 2015 (if conditions do not drastically change).

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

OPERATIONALIZATION OF THE KBRR

The Central bank will issue a Circular to all banks to operationalize the KBRR as follows:-

1. The KBRR of 9.13 percent shall be effective from, 8th July, 2014, and will remain at this level until its next review in January 2015 (if market conditions do not drastically change).
2. All banks and mortgage finance companies will price their flexible rate loans using the KBRR as the base rate.
3. For individual banks, the interest rate they charge their customers will be $KBRR + K$. We expect banks and mortgage finance companies to vary their lending rates to be as close as possible to the KBRR.
4. Banks and mortgage finance companies will disclose to their respective borrowers and the Central Bank the breakdown of any deviation, K , from the KBRR, thereby enhancing transparency in pricing of credit and mortgages.
5. All flexible/variable credit facilities applied for shall be priced using the new KBRR framework.
6. Existing flexible/variable credit facilities shall be transitioned to the new KBRR framework by 30th June 2015.

PROF. NJUGUNA NDUNG'U, CBS
GOVERNOR, CENTRAL BANK OF KENYA

8th July, 2014