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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 5TH SEPTEMBER, 2012

CONTINUING TO CONSOLIDATE MONETARY POLICY GAINS TO SUPPORT ECONOMIC ACTIVITY

The Monetary Policy Committee met on 5th September, 2012 to review market developments and evaluate the outcomes of its monetary policy stance. The Committee noted that the monetary policy stance continued to deliver the desired results on inflation and stability in the foreign exchange market.

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

- Overall inflation declined in August 2012 to 6.09 percent and was within the upper band of 7.5 percent set by the Government for the fiscal year 2012/13. All the categories and measures of inflation, including those for all income groups, declined in August 2012, reflecting the trend of declining inflationary pressure. The overall inflation declined from 10.05 percent in June 2012 to 7.74 percent in July 2012 and further to 6.09 percent in August 2012. The decline in the overall inflation was supported by a continued reduction in food and fuel prices as well as easing demand pressures in the economy. Non-food-non-fuel inflation declined from 8.48 percent in July 2012 to 7.84 percent in August 2012 while the 3-month overall inflation also declined in the period. These developments supported a positive outlook for a continued decline in inflation.
- The exchange rate remained stable, fluctuating within a narrower range of Ksh.83.90 to Ksh.84.32 against the US Dollar in August 2012, compared with a range of between Ksh.83.93 and Ksh.84.53 in July 2012. The foreign exchange reserves position of the Central Bank of Kenya (CBK) stood at USD5,136 million or 4.2 months of import cover at the end of August 2012. This will cushion the market against external shocks and enhance confidence in the economy.
- Short-term interest rates remained generally stable following the downward adjustment of the Central Bank Rate (CBR) during the last MPC meeting. In addition, sustained Open Market Operations have ensured effective liquidity management and orderly behaviour in the interbank market.
- The data presented and stress tests indicated that the banking sector remains strong and stable. Credit risk remains low as depicted by the ratio of gross non-performing loans to total loans which remained unchanged at 4.5 percent between June and July 2012. The CBK has continued to engage the Kenya Bankers Association to put in place contingency measures to deal with threats of loan defaults. Furthermore, the CBK has provided avenues that reduce the cost of

doing business for banks. For example banks have integrated with mobile phone financial services platforms that have lowered the transaction costs immensely and have also moved into the agency banking network, with huge cost reductions. Credit Reference Bureaus have lowered the costs of information search and risk assessment for banks' existing and potential customers. The Committee noted that interest rate spreads remained high suggesting that these cost reductions had yet to be fully transferred to bank customers and the economy at large through declining cost of credit.

- The country's policy environment remains strong as depicted by the latest sovereign credit rating by Fitch Ratings which affirmed Kenya's rating at "*B+ with stable outlook*". In addition, the MPC Market Perceptions Survey conducted in August 2012 showed that the private sector expects inflation to continue declining; the exchange rate to remain stable; and the economy to be resilient in 2012.

The Committee also recognised that there remain risks to those elements relevant to monetary policy in maintaining macroeconomic stability. These include vulnerability to international oil prices and any likely impact of drought affecting world food prices. The slowdown in global economic growth was also noted to have a dampening effect on both domestic growth and the balance of payments. Going forward, the CBK will continue to monitor these risks and take appropriate actions.

Based on the above considerations the Committee decided to reduce the CBR by 350 basis points to 13.0 percent.



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

5th September, 2012