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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 6TH MAY, 2015

MANAGING RISKS IN THE MONETARY POLICY PATH

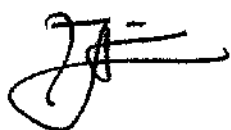
The Monetary Policy Committee (MPC) met on 6th May, 2015 to review market developments and the outcomes of its previous monetary policy decisions. The Committee noted that despite upward pressure from food prices attributed mainly to delayed rainfall, overall inflation remained within the Government target range in March and April 2015. Specifically, the Committee noted the following outcomes in the market since its meeting at the end of February 2015:

- Overall month-on-month inflation rose from 6.31 percent in March 2015 to 7.08 percent in April 2015. The month-on-month food inflation rose significantly from 10.96 percent to 13.42 percent. The month-on-month non-food-non-fuel inflation rose slightly from 3.16 percent to 3.53 percent in the period. The key monetary aggregates including the broad money supply (M3) and the credit growth to the private sector were within their respective non-inflationary targets.
- The exchange rate of the Kenya Shilling against the US Dollar came under pressure on account of a stronger US Dollar in the global currency markets and an enhanced, but seasonal, demand for foreign exchange by the local corporate sector largely associated with dividend and profit remittances. The Kenya Shilling has displayed relatively less volatility since the start of 2015 compared with other major international and regional currencies. In addition, the Kenya Shilling continues to be supported by sustained foreign exchange inflows through diaspora remittances averaging USD121.38 million per month in the first quarter of 2015, and the lower petroleum product import bill attributed to the decline in international oil prices since mid-2014. The Committee noted that the current value of the Kenya Shilling to the US Dollar had adjusted to the slight misalignment in line with fundamentals in the economy. The Central Bank of Kenya (CBK) level of usable foreign exchange reserves stood at USD6,859.58 million (equivalent to 4.40 months of import cover) at the end of April 2015. This level of foreign exchange reserves coupled with the precautionary facility with the International Monetary Fund will cushion the foreign exchange market against any temporary shocks.
- Short-term interest rates continued to be aligned to the Central Bank Rate (CBR) while the monetary policy operations supported interbank market stability. However, liquidity conditions were tight in April 2015 on account of Open Market Operations and the temporary build-up of Government deposits at the CBK.
- The Government domestic borrowing programme for the Fiscal Year 2014/15 is consistent with the monetary policy objectives. Specifically, domestic borrowing has not crowded-out private sector borrowing.

- The latest data and stress tests show that the banking sector remains strong. The CBK is working with stakeholders in the banking sector to implement measures aimed at enhancing transparency in the pricing of credit. Updated data from all commercial and microfinance banks show that new and existing loans amounting to Ksh.825.85 billion had been converted to the Kenya Banks' Reference Rate (KBRR) framework by end of April 2015 up from a revised level of Ksh.707.34 billion by end of January 2015. Commercial banks' average lending rates declined gradually from 16.91 percent in July 2014 to 15.46 percent in March 2015 while the average deposit rate rose slightly from 6.59 percent to 6.63 percent over the period. Consequently, the average interest rate spread declined from 10.33 percent to 8.82 percent during the period. This trend is expected to continue as more loans are issued under the KBRR framework.
- The latest data from the Kenya National Bureau of Statistics showed that overall real GDP growth was 5.1 percent in the fourth quarter of 2014, and the contribution of the financial and insurance sector remained strong. Notably, the sector grew by 10.3 percent in the fourth quarter of 2014 from 5.4 percent in a similar period of 2013.
- Confidence in the economy remains strong. The MPC Market Perception Survey conducted in April 2015 showed that a majority of the private sector firms remained optimistic for an improved business environment and stronger growth in 2015.

On the international scene, the growth of the global economy is projected to strengthen from 3.5 percent in 2015 to 3.8 percent in 2016, bolstered mainly by a stronger growth in the US and lower international oil prices. Global growth is also expected to be supported by the accommodative monetary policy adopted by most advanced economies, including Quantitative Easing (QE) in the Eurozone and Japan. However, the growth recovery is expected to remain uneven across the advanced and emerging market economies. Sub-Saharan Africa economies are projected to grow by 5.1 percent in 2016 from 4.5 percent in 2015 driven mainly by the improving global demand. The growth momentum for Kenya's main trading partners is expected to remain resilient thereby benefiting exports and supporting exchange rate stability. Global inflation is projected to remain low in 2015 on account of lower commodity prices. However, the uncertainty around the timing of the first interest rate increase in the US following the tapering of QE, and the geo-political situation in the Middle East remain a risk to the stability of both the global currency markets and international oil prices. These underlying risks have potential to undermine the overall price stability objective.

The Committee concluded that there were no demand driven threats to inflation. However, the recent developments in the global and domestic foreign exchange markets have triggered inflationary expectations and present a threat to the price stability objective of the CBK. The MPC will therefore pursue the current tightening bias stance in the money market through the CBK monetary policy operations in order to anchor inflationary expectations. Consequently, the MPC decided to retain the CBR at 8.50 percent and will continue to monitor any emergent risks from the external and domestic economies that may impact on price stability.



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