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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 5TH JULY, 2012

CONSOLIDATING MONETARY POLICY GAINS TO SUPPORT ECONOMIC ACTIVITY

The Monetary Policy Committee met on 5th July, 2012 to review market developments and evaluate the outcomes of its monetary policy stance. The Committee observed that the monetary policy measures adopted continued to deliver favourable macroeconomic outcomes. Inflation has continued to decline while the exchange rate remains stable. This follows the recent turbulence in the global foreign exchange markets which was mainly attributed to instability in the Eurozone and the effects of oil prices.

The following important developments in the market were observed and analysed by the Committee since its last meeting on 5th June 2012:

- All the main categories and measures of inflation declined in June 2012 indicating easing inflationary pressure and a return to price stability. The overall month-on-month inflation declined from 12.22 percent in May 2012 to 10.05 percent in June 2012 mainly arising from a reduction in food and fuel prices. The overall 3-month annualised inflation declined from 10.57 percent to 1.67 percent in the period. This reversed the upward trend which was a concern to the Committee in its previous meeting. In addition, the non-food-non-fuel inflation declined from 10.27 percent in May 2012 to 9.31 percent in June 2012. These factors endorsed a positive outlook of a continued decline in inflation and a return to stability.
- The average exchange rate fluctuated within a narrower range of between Ksh.84.79 and Ksh.86.12 against the US Dollar in June 2012, compared with a range of between Ksh.83.27 and Ksh.86.83 in May 2012. The foreign exchange reserves position of the Central Bank of Kenya (CBK) improved further in June 2012 following the receipt by the Government of the second tranche of the USD600 million syndicated loan.
- The Term Auction Deposits with flexible tenors introduced by the Committee in June 2012 as an additional instrument for liquidity management have enhanced the CBK's open market operations and stabilised the interbank rate around the Central Bank Rate (CBR).
- The fiscal measures announced by the Government during the Budget Statement for the fiscal year 2012/13 are consistent with monetary policy objectives. The borrowing plan will ensure that domestic debt remains within the thresholds set in the Medium Term Debt Management Strategy. The country's policy environment remains strong. The latest Country Policies and Institutional Assessment (CPIA) rating of 3.8 by the World Bank places Kenya fourth overall in Sub-Saharan Africa in terms of policy reform and institutional quality.

- Confidence in the economy remains strong as indicated by the continued recovery of the Nairobi Securities Exchange index. In addition, the MPC Market Perceptions Survey conducted in June 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 however noted that there are still potential threats and risks to both consumer prices and exchange rate stability that could increase inflationary pressure. The following threats were considered:

- The current account deficit which eased slightly from an estimated 11.4 percent of GDP in April 2012 to 11.3 percent in May 2012 remains high and continues to pose a threat to exchange rate stability as well as the pass-through effects to domestic prices.
- The outlook for global economic growth has weakened in recent weeks as some of the risks around the eurozone crisis have materialised while the credibility of the relief packages is yet to be established. There has been a substantial deterioration in global financial conditions and slowdown in economic activity in emerging-market economies. These developments continue to pose a risk to the demand for Kenya's exports as well as foreign earnings from tourism, their receipts have traditionally supported the exchange rate.

In view of the above considerations, the Committee noted that the implementation of its monetary policy framework is working. Furthermore, it observed that inflation had declined significantly towards the Government short-term target of 9 percent. It concluded that the range of monetary policy instruments in use was robust and should continue to bring inflation towards the medium-term target and sustain general price stability. The Committee therefore decided to reduce the CBR by 150 basis points to 16.5 percent.

In light of the improved market stability, the Committee also decided to revert to its bi-monthly meetings. The Committee will continue to closely monitor developments in the market and take appropriate monetary policy measures to dampen inflationary pressure and sustain price stability in the economy.

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

5th July, 2012