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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING, 5TH JUNE, 2012

SUSTAINING STABILITY IN THE FACE OF EXTERNAL SHOCKS

The Monetary Policy Committee met on 5th June, 2012 to review the relevant market developments and to evaluate the outcomes of its monetary policy stance. The Committee observed that the monetary policy measures adopted continued to deliver a gradual decline in inflation. However, the global foreign exchange markets witnessed a resurgence of turbulence in May 2012 mainly attributed to the instability in the Euro Zone. As a consequence, the US Dollar has strengthened globally as investors shift from Euro to US Dollar denominated assets. Several emerging market currencies and those in the region, including the Kenya Shilling, weakened against the US Dollar as a result of these developments.

The Committee observed the following other important developments in the market since its last meeting in May 2012:

- Overall month-on-month inflation continued to decline, dropping from 13.06 percent in April 2012 to 12.22 percent in May 2012. The decline in inflation was mainly attributed to a reduction in food prices.
- The average exchange rate fluctuated between Ksh.83.27 and Ksh.86.83 against the US Dollar in May 2012. The Central Bank of Kenya (CBK) enhanced its Open Market Operations while at the same time selling US Dollars to banks to stabilise the exchange rate. Given the magnitude of the instability in the global foreign exchange market and the balance of payments pressure in Kenya, the CBK continues to monitor closely this segment of the financial market.
- The Government successfully met the conditions for disbursement of the USD600 million syndicated loan in the fiscal year 2011/12 and has already received the first tranche. The disbursement has improved the CBK foreign exchange reserves position and provided a further cushioning against external shocks affecting the exchange rate.
- Private sector credit growth declined from an annual growth of 24.01 percent in March 2012 to 22.61 percent in April 2012, an indication of continued easing of demand pressures on inflation.
- The Economic Survey released by the Kenya National Bureau of Statistics in May 2012 showed that the economy remains resilient and registered an annual growth of 4.4 percent in 2011.

However, the Committee noted that there were still potential threats and risks to both consumer prices and exchange rate stability that could increase inflationary pressure. The following drivers were considered:

- Non-food-non-fuel inflation increased from 9.94 percent in April 2012 to 10.27 percent in May 2012. In addition, the overall 3-month annualised inflation increased from 9.22 percent in April 2012 to 10.57 percent in May 2012. Furthermore, inflation is still above the short-term target of 9 percent.

- The Kenya Shilling remains vulnerable to external shocks due to the current account deficit, estimated at 11.4 percent of GDP in April 2012, and the instability in the Euro Zone. There could be significant pass-through effects to domestic inflation if the exchange rate weakens. Although international crude oil prices declined from USD127.0 per barrel in March 2012 to USD121.20 per barrel in April 2012, they remain high. In addition, the oil import bill continues to account for a large proportion of the current account deficit.
- Despite the enhanced Open Market Operations undertaken in May 2012, excess liquidity conditions have persisted in the market thereby posing a risk to demand driven inflation pressure and exchange rate stability.

Given the above considerations, the Committee observed that there is need to expand the monetary policy instruments in use to address both the inflationary pressures and exchange rate dynamics. These instruments should help bring inflation towards the Government short-term target of 9 percent, restore exchange rate stability, and address the threat posed by the excess liquidity in the market. The Committee therefore decided to retain the Central Bank Rate at 18.0 percent while introducing longer tenor Term Auction Deposits as an additional instrument for liquidity management. The MPC will continue to monitor closely foreign exchange activities in the market and take appropriate measures to sustain exchange rate stability.

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

5th June, 2012