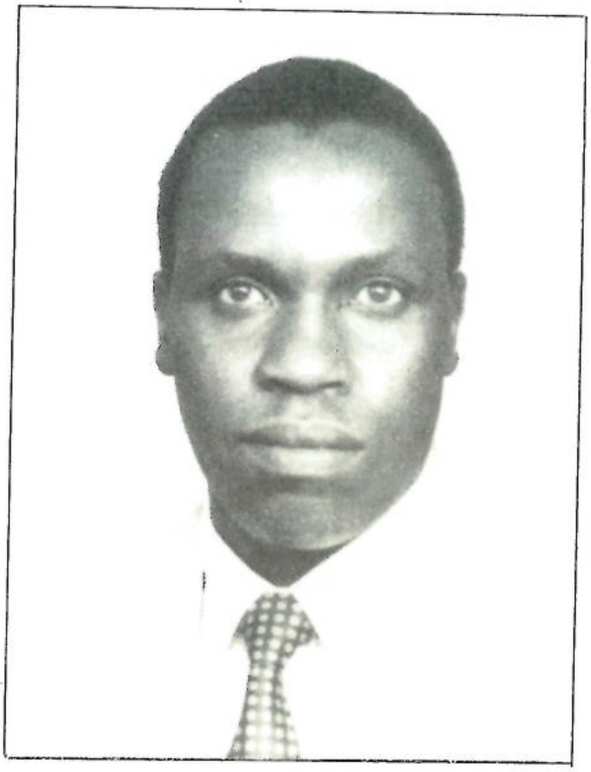
CENTRAL BANK OF KENYA

TWENTY SIXTH ANNUAL REPORT FOR THE FINANCIAL YEAR ENDED 30TH JUNE, 1992

Central Bank of Kenya

BOARD OF DIRECTORS



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Director

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Deputy Governor

Dr. Wilfred K. Koinange
Permanent Secretary
Treasury, ex-officio Director

J. T. arap Leting'
Director

T. S. Kaloki
Director

Dr. A. H. S. El-Busaidy
Director

Letter of Transmittal

Central Bank of Kenya
September 30th, 1992

Hon. Prof. George Saitoti, M.P.,
Vice-President and Minister for Finance
P.O. Box 30007
NAIROBI

Your Excellency, The Vice-President,

Twenty Sixth Annual Report of the Central Bank of Kenya

In accordance with Section 54 of the Central Bank of Kenya Act, I have the honour to present to your Excellency the Twenty Sixth Annual Report of the Central Bank of Kenya for the financial year ended June 30, 1992 together with the Statement of Audited Accounts.

Yours sincerely,

E. C. KOTUT
Chairman of the Board of Directors
and Governor of the Central Bank of Kenya

CONTENTS

General Economic Developments

1.1 Developments in the World Economy

The performance of the world economy weakened further in 1991, with real world output contracting by 0.3 per cent in contrast to an expansion of 2.2 per cent in the previous year. The deterioration mainly reflected the severe recession in the industrial countries attributed to worsening consumer confidence in most of these countries. Performance of the developing countries as a group was also less satisfactory in the year largely because of the persistently weak prices of their export commodities, reduced demand for these countries' commodities by the industrial countries and the temporary output losses associated with reforms in Eastern Europe and the former Soviet Union. At the same time, the expansion in world trade slowed down to 3.3 per cent from 4.1 per cent in 1990. Inflationary pressures eased somewhat in 1991. In the industrial countries, the inflation rate declined to 4.4 per cent from 4.9 per cent in 1990 and in the developing countries (excluding Eastern Europe and the former Soviet Union) the rate fell from 80.0 to 41.4 per cent.

1.2 Developments in the Domestic Economy

The performance of the Kenyan economy was much weaker in 1991 than in the previous year. Real gross domestic product (GDP) grew by 2.2 per cent in the year compared with 4.3 per cent in 1990 (Table 1.1). This slowdown was largely due to the drop in agricultural production caused mainly by the unfavourable weather conditions and weak world prices of the country's main export commodities. The manufacturing sector also performed less favourably, partly as a result of the contraction of the agricultural sector to which it is closely linked. The other key domestic sectors, notably, tourism and building and construction also performed less satisfactorily in the year.

On the external front, the overall balance of payments position improved in 1991, with the deficit shrinking from shs 3,401m or the equivalent of 1.7 per cent of GDP in 1990 to shs 3,065m or 1.3 per cent of GDP in the year. The improvement reflected entirely the decline in the current account deficit which fell from 5.5 per cent of GDP in 1990 to 2.7 per cent in 1991. The improvement in the current account reflected strong growth in exports of horticultural products, soda ash, pyrethrum and manufactured goods as well as the slowdown in import growth. The capital account, on the other hand, deteriorated in the year with the surplus falling 60 per cent below the previous year. This was due to the substantial reduction in new loan disbursements while debt service payments remained high. As the bulk of the deficit was financed through a rundown in foreign reserves, gross foreign exchange reserves therefore fell to shs 7,366m (equivalent to 1.9 months of imports) in December 1991 from shs 8,269m or 2.3 months of imports in December 1990.

Table 1.1

SELECTED DOMESTIC ECONOMIC AND FINANCIAL INDICATORS, 1989–1992[1]

	1989	1990	1991	1992[2]
	(Annual percentage changes)			
Gross domestic product[3]	**5.0**	**4.3**	**2.2**	**2.0**
Of which				
Agriculture	3.9	3.4	−1.1	—
Manufacturing	5.9	5.2	3.8	—
Building & Construction	5.4	5.3	2.3	—
Trade, rest. & hotels	4.4	2.3	1.3	—
Consumer price index				
Annual average	13.4	13.6	18.7	20.8
Month-on-month	13.6	14.6	20.8	35.8
Money supply	**17.8**	**12.9**	**18.9**	**20.2**
	(In per cent of GDP)			
Overall balance of payments surplus(+)/deficit (-)	0.9	−1.7	−1.3	−1.4
Of which: current account	−7.3	−5.5	−2.7	−3.5
Overall budget surplus(+)/ deficit(-)	−3.5	−4.0	−6.8	−2.9

[1]With the exception of data for gross domestic product and balance of payments which are presented on a calendar year basis, that for the other indicators covers fiscal years ending June 30.

[2]Data for government budget for fy 1991/92 are provisional while that for GDP is a projection.

[3]At constant 1982 prices.

Sources: The Central Bank of Kenya; the Treasury; and Economic Survey (1992).

The fiscal operations of the Government in fy 1991/92 resulted in an overall cash deficit of 2.9 per cent of GDP in the year, a significant improvement compared with a deficit of 6.8 per cent of GDP in the previous year. The reduction in the budget deficit in the year was due to a substantial increase in total revenue and grants as well as a subdued increase in government spending. The deficit was financed mainly through borrowing from the domestic non-bank sources which accounted for 3.0 per cent of GDP. External financing accounted for 0.1 per cent of GDP while government indebtedness to the domestic banking system was reduced by 0.2 per cent.

In the domestic financial sector, money supply increased more rapidly in fy 1991/92, rising by 20.2 per cent compared with 18.9 per cent in the previous fiscal year. The increase in the money supply in this period was entirely due to the expansion in credit to the private sector which rose by 26.0 per cent in the year compared with 19.8 in the previous year. Credit to the Government, however, declined by 1.3 per cent in the year. This, together with the drop in the net foreign assets of the banking system, lessened the effect on money supply of the sharp expansion in credit to the private sector.

The month-on-month rate of inflation, as measured by the revised consumer price index, rose from 20.8 per cent in June 1991 to 35.8 per cent in June 1992. The increase was partly due to the rise in prices of a number of food commodities occasioned by shortages and the decontrol of prices of a number of commodities. The expansion in the money supply and the budget deficit in the year also contributed to the higher inflationary pressures.

1.3 Prospects for 1992

The world economy is expected to improve somewhat in 1992 as the recovery of the economies of the industrialised countries firms up. Prospects for the developing countries as a group remain bleak as the positive effect of the recovery of the industrial countries in terms of increased demand for the developing countries' exports may take time to filter through. With respect to the Kenyan economy, the rate of growth is expected to slow down even further in 1992 largely on account of further decline in agricultural production resulting from persistent adverse weather conditions. The balance of payments is also expected to remain tight in view of the expected weak performance in exports of tea and tourism, and the low level of net capital inflows.

CHAPTER 2

Operations of the Central Bank

2.1 The Financial System

The financial system remained dynamic during fy 1991/92 despite the general slowdown in economic activity. Five new commercial banks, two of which have commenced operations, were established during the year. Over the same period, 5 additional bank branches were also opened. Consequently, by the end of June 1992, the number of operational commercial banks rose to 29 and their network of fully fledged branches increased to 237. The number of sub-branches, agencies and mobile units remained unchanged at 76 and 177 respectively. Operational representative offices were 5 by the end of June 1992. No new non bank financial institutions (NBFIs) were licensed in the year but 2 institutions which had been licensed in the previous year commenced operations. As a result, the number of NBFIs rose to 56 with a network of 110 branches at the end of June 1992. The number of operational building societies fell to 5 in the year following the winding up of one building society. Other institutions within the financial system included 7 development finance institutions, several hire purchase companies, 37 insurance companies, one Post Office Savings Bank with a countrywide branch network, various savings and credit co-operative societies, and a stock exchange.

The Central Bank continued to administer the Deposit Protection Fund whose membership remained unchanged at 82. Contributions to the Fund together with the earnings from their investments grew from shs 154.8m in fy 1990/91 to shs 243.7m in fy 1991/92. The Central Bank also continued with its supervisory role of the financial system. On-site inspection of five commercial banks, seven NBFIs and four building societies was carried out in the year.

Commercial banks experienced tight liquidity position during the year. The monthly average liquidity ratio[1] for banks stood at 17 per cent in June 1992 compared with 18 per cent in June 1991 and 20 per cent minimum requirement (Table 2.1). The average cash ratio[2] also fell from 6.3 per cent in June 1991 to 4.9 per cent in June 1992, 1.1 percentage points below the statutory requirement. Five commercial banks failed to meet the minimum cash ratio requirement in June 1992, same number of institutions as in June 1991. The tight liquidity position of commercial banks reflected largely the worsening balance of payments and the considerable reduction in government borrowing from the Central Bank. There was a significant change in the composition of liquid assets of banks, with certificates of deposit accounting for 31.7 per cent, followed by treasury bills which accounted for 24.0 per cent of the banks' total liquid assets.

The liquidity position of the NBFIs was equally tight in the year. The average liquidity ratio[3] of these institutions fell by 1.0 percentage point in fy 1991/92 to 23 per cent at the end of June 1992. Twenty five NBFIs failed to meet the minimum liquidity requirement of 24 per cent in June 1992 compared with twenty seven institutions in June 1991. The liquid assets of the NBFIs were also dominated by certificates of deposit which accounted for 35.5 per cent of the total. The other liquid assets of importance were treasury bills and balances held with domestic banks which accounted for 17.5 and 32.8 per cent of the total liquid assets, respectively.

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[1]This is the ratio of till cash, balances at the Central Bank, balances with other financial institutions, balances with banks abroad, treasury bills, other short-term government securities and negotiable instruments to total deposit liabilities.

[2]The statutory cash ratio is defined as the ratio of commercial banks' balances at the Central Bank to total deposit liabilities. Total deposits for this purpose excludes deposits held by the Central Government and non residents.

[3]This is the ratio of the sum of the balances of the NBFIs at the commercial banks and other financial institutions, vault and till cash, treasury bills, other short-term government securities and negotiable instruments to their total deposit liabilities.

Table 2.1

LIQUID ASSETS OF BANKS AND NON-BANK FINANCIAL INSTITUTIONS
(shillings million)

	1990/91	1991/92
Banks		
Vault and till cash[1]	1,760	2,203
Balances at Central Bank	2,883	2,250
Balances at banks in Kenya	285	95
Balances at other financial institutions[2]	−1,129	−2,376
Balances at banks abroad	518	768
Treasury bills	3,833	2,320
Treasury bonds	67	1,353
Certificates of Deposit	373	3,069
Foreign Exchange Bearer Certificates	–	5
Total liquid assets	8,590	9,687
Net deposit liabilities	48,830	55,485
Average liquidity ratio (%)	**18**	**17**
Non-bank Financial Institutions		
Vault and till cash	33	41
Balances at banks in Kenya	3,378	2,591
Balances at other financial institutions[2]	1,112	289
Balances at banks abroad	2	12
Treasury bills	2,563	1,380
Treasury bonds	22	790
Certificates of Deposit	571	2,806
Foreign Exchange Bearer Certificates	–	–
Total liquid assets	7,681	7,909
Total deposits	32,671	34,519
Average liquidity ratio (%)	**24**	**23**

[1]Since January 1991, cash has been redefined to include both domestic and foreign notes and coin.

[2]This has been redefined since January 1991 to include specified non-bank financial institutions, mortgage companies and building societies.

Source: Central Bank of Kenya.

2.2 The Banking Act

During fy 1991/92, further measures were introduced to strengthen the financial system. The prescribed minimum capital to assets ratio[1] for commercial banks and specified financial institutions (including mortgage companies) which is provided for under Section 18 of the Banking Act, was raised from 5.5 per cent to 7.5 per cent effective from January 1, 1992.

A set of prudential guidelines was also prepared by the Bank to encourage self regulation among banking institutions. These included a code of conduct for directors, officers and other employees of the financial institutions; duties and responsibilities of directors, chief executives and the management of the institutions; appointment, duties and responsibilities of external auditors; and provision for bad and doubtful advances and loans.

[1]This is the ratio of the sum of paid up or assigned capital and unimpaired reserves to total assets as per audited accounts.

2.3 Management of Domestic Government Debt

The Central bank in its capacity as the fiscal agent of the Government continued to manage the domestic public debt. This involves issuing of government securities which can be traded in the money and capital markets, making interest payments on them, and discounting as well as redeeming those that mature. The debt operations in the year resulted in an increase of shs 7,358m in the total domestic government debt compared with an increase of shs 11,122m in the previous year (Table 2.2).

Table 2.2

OUTSTANDING GOVERNMENT DOMESTIC DEBT
(shillings million)

	June 1990	June 1991	June[1] 1992	Net Change
Direct advances to Government[2]	**14,406**	**21,041**	**13,250**	**−7,791**
Treasury bills	**13,311**	**11,124**	**14,881**	**3,757**
Banks	2,843	4,026	7,353	3,327
NBFIs	2,339	1,906	693	−1,213
Parastatals	6,128	3,810	5,307	1,497
Others	2,001	1,382	1,528	146
Registered treasury bonds	**15,471**	**21,051**	**23,962**	**2,911**
Banks	2,937	4,601	3,873	−728
NBFIs	225	540	1,795	1,255
Parastatals	7,623	10,335	10,923	588
Other	4,623	5,575	7,371	1,796
Bearer bonds	–	**1,704**	**11,207**	**9,503**
Government stocks	**11,112**	**10,502**	**9,480**	**−1,022**
Banks	3,375	3,363	3,166	−197
NBFIs	171	71	71	–
Parastatals	5,685	5,319	4,637	−683
Others	1,881	1,749	1,606	−142
Total government debt	**54,300**	**65,422**	**72,780**	**7,358**

[1]Provisional.
[2]Includes loans and advances from the banking system.
Source: Central Bank of Kenya.

At the end of June 1992, outstanding domestic government debt stood at shs 72,780m. As in the previous year, treasury bonds accounted for most of the domestic government debt in the year. Registered and bearer treasury bonds combined accounted for 48.3 per cent of the total outstanding domestic debt at the end of the fiscal year.

Eleven issues of registered bonds worth shs 13,500m were floated in the year. Of this amount, bonds for shs 12,117m were sold. Sales to the non-bank sector accounted for shs 10,007m while those to commercial banks accounted for shs 2,110m. Registered bonds worth shs 9,206m were redeemed during the year. Reflecting these transactions, outstanding registered treasury bonds rose by shs 2,910m to shs 23,962m at the end of June 1992. Meanwhile, the coupon rates on registered treasury bonds remained unchanged at 15.0, 16.5 and 17.0 per cent for the 1 year, 2 year and 5 year bonds, respectively.

Bearer treasury bonds which were first introduced in the market in December 1990 are, unlike the registered bonds, sold through tap issues. Sales of bearer bonds amounted to shs 14,133m in the year while redemptions amounted to shs 4,630m. This resulted in a net increase of shs 9,503m, thereby bringing the level of outstanding bearer bonds to shs 11,207m at the end of June 1992. As in the case of registered bonds, the coupon rates for bearer bonds remained unchanged at 15.0, 16.5 and 17.0 per cent for the 1 year, 2 year and 5 year bonds, respectively.

With respect to treasury bills, a total of 52 issues were made during the year. The amount floated for sale in each issue, however, varied depending on the budgetary financing requirements and monetary policy considerations. Outstanding treasury bills rose by shs 3,757m during the year to shs 14,881m. The increase was attributed mainly to the additional allotment of treasury bills to the Central Bank for Open Market Operations.

As regards government stocks, no new issues were made during fy 1991/92, but three stocks worth shs 1,022m were redeemed in the year. Consequently, the amount of stocks outstanding declined from shs 10,502m at the end of June 1991 to shs 9,480m at the end of June 1992.

2.4 Monetary and Banking Activities

Monetary policy in fy 1991/92 aimed at containing expansion in money supply and credit to levels sufficient to support economic growth without exerting undue pressure on both the balance of payments and domestic prices. The Central Bank implemented monetary policy through the use of cash reserve ratio, open market operations and credit guidelines.

2.4.1 Monetary and Credit Policy

The Central Bank relied on both direct and indirect instruments of monetary policy to regulate expansion in money supply and credit in fy 1991/92. With respect to direct instruments, the Bank mainly used credit guidelines to ensure that lending to the private and other public sectors by the commercial banks remained within the desired level. In this context, the Bank continued to enforce strictly the penalty which was introduced in 1990, requiring those commercial banks that exceed their credit limits to place a non interest earning deposit with the Central Bank equivalent to 20 per cent of the excess credit.

The Bank began using open market operations as an instrument of monetary control at the beginning of fy 1991/92. Through either sales or purchases of treasury bills in the market, the Bank influences the reserve assets of the commercial banks and ultimately their credit expansion. The introduction of open market operations marked an important step in the shift away from the use of quantitative credit controls to the use of more indirect instruments of monetary policy. Significant progress was made in the use of this instrument in the year.

2.4.2 Interest Rate Structure

Following the deregulation of interest rates in July 1991, the level of the various deposit and lending rates in fy 1991/92 were determined by the market forces. Both the level and the spread of the various deposit and lending interest rates increased rather modestly in the year contrary to the general view that the rates were likely to increase significantly after the deregulation. At the end of June 1992, average deposit rate for the entire banking industry was 13.45 per cent while the lending rates ranged between 15.71 and 21.34 per cent. At the time when the deregulation of interest rates was announced, the minimum savings deposit rate was 13.5 per cent while the highest allowed lending rate was 19.0 per cent. The smooth transition from administratively fixed to market determined interest rates was facilitated by the flexible manner in which the Bank managed interest rate policy, especially from 1986 when the Government began to take far reaching reforms in the economy. Tables 2.3 and 2.4 show the interest rate structure for commercial banks and NBFIs.

Table 2.3

INTEREST RATE STRUCTURE FOR COMMERCIAL BANKS (per cent)

	1990/91[1]	1991/92[2]
Deposit Rates		
a) Current	–	–
b) Savings	13.5	13.16–13.71
c) Time deposits		
(i) 0-3 months	13.5	11.88–16.85
(ii) 3-6 months	13.5	11.98–16.23
(iii) 6-9 months	13.5	11.57–15.67
(iv) 9-12 months	13.5	11.88–16.01
(iiv) Over 12 months	13.5	10.68–13.92
Lending Rates		
a) Not exceeding 3 years	17.0[3]	14.56–21.34
b) Three years and above	19.0	15.71–19.84

[1]Effective April 1, 1990.
[2]These are weighted average market rates.
[3]Effective September 1, 1990.
Source: Central Bank of Kenya.

Table 2.4

INTEREST RATE STRUCTURE FOR NON-BANK FINANCIAL INSTITUTIONS, BUILDING SOCIETIES AND AGRICULTURAL FINANCE CORPORATION
(per cent)

	1989/90	1990/91
Deposit Rates		
a) Hire Purchase Companies and Merchant Banks	13.5 – 17.0	13.5 – 18.0
b) Building Societies	13.0 – 15.0	13.0 – 15.0
Lending Rates		
a) Hire Purchase Companies and Merchant Banks	19.0	19.0
b) Building Societies	18.0	19.0
c) Agricultural Finance Corporation		
(i) Loans for purchase of land	12.0	12.0
(ii) Seasonal crop loans	14.0	14.0
(iii) All other loans	13.0	13.0

Source: Central Bank of Kenya.

2.4.3 Rediscount Policy

The rediscount window at the Central Bank remained open during the year. Treasury bills, other government securities and other eligible securities with maturities not exceeding three months continued to be rediscounted on demand. The rediscount rate on treasury bills and other government securities and the discount rate on direct advances to commercial banks against government securities remained unchanged at 2.5 percentage points above the latest weighted average treasury bill rate for amounts not exceeding shs 50m. However, to ensure that commercial banks which run overdrafts with the Central Bank in excess of shs 50m are appropriately sanctioned, since May 1, 1992, the marginal cost was raised by 1.0 percentage point for additional increments of shs 50m in advances and rediscounts of treasury bills and other government securities. The discount margin for advances against other eligible securities remained unchanged at 3.5 percentage points above the latest weighted average treasury bill rate. The lending rates of the Central Bank are shown in Table 2.5.

The activity in the rediscount market increased in fy 1991/92, with the transactions effected at face value rising to shs 2,716.7m from shs 2,237.9m in the previous year. Advances against government securities and other credit instruments rose by shs 5,549.5m in fy 1991/92 compared with a decline of shs 358.4m in fy 1990/91.

Table 2.5

CENTRAL BANK LENDING RATES

	1990/91	1991/92
a) Rediscount rate on treasury bills and other government securities	2.5 percentage points above latest maximum treasury bill tender rate	2.5 percentage points above latest weighted average treasury bill rate[1]
b) Discount rate on advances against government securities	2.5 percentage points above latest maximum treasury bill tender rate	2.5 percentage points above latest weighted average treasury bill rate[1]
c) Discount rate on advances against other eligible securities	3.5 percentage points above latest maximum treasury bill tender rate	3.5 percentage points above latest weighted average treasury bill rate

[1]In May 1992, the margin was raised by 1 percentage point for additional increments of shs 50m in advances and rediscounts above the first shs 50m.

Source: Central Bank of Kenya.

Issue of Currency

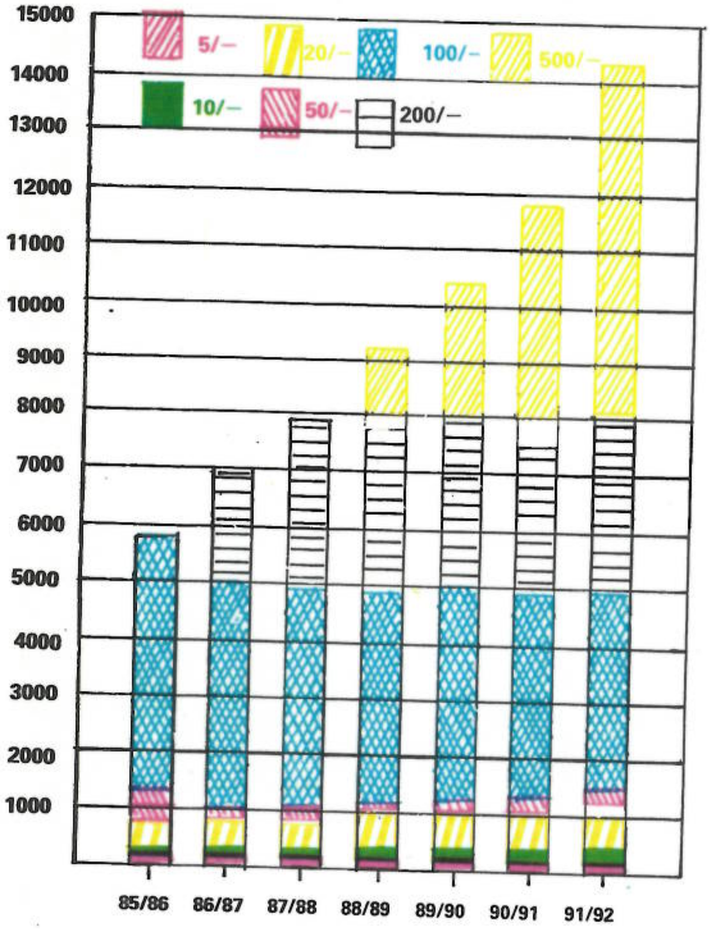
One of the principal objectives of the Central Bank is to regulate the issue of notes and coin. In this regard, the Bank ensures that at all times there is sufficient supply of notes and coin to meet the requirements of the public. In addition, the Bank withdraws and replaces those notes that are worn out. In fy 1991/92, currency in circulation rose by 21.0 per cent to shs 14,695m at the end of June 1992. At this level, currency accounted for 33.9 per cent of the total liabilities of the Bank compared with 33.5 per cent in June 1991.

The number of notes in circulation increased from 132.2m in June 1991 to 150.0m in June 1992. In value terms, the notes rose by 21.4 per cent above the June 1991 level to shs 14,296m in June 1992. The ratio of notes to the total currency in circulation in value terms rose marginally to 97.3 per cent in June 1992 from 97.0 per cent at the end of June 1991. Chart 1 shows the value of bank notes in circulation.

The coins in circulation in value terms amounted to shs 400m in June 1992, 10.0 per cent above the June 1991 level. One and five shilling coins accounted for 32.0 and 33.8 per cent, respectively, of the increase in the total value of coin during the year. The value of coins in circulation is shown in Chart 2.

Chart 1

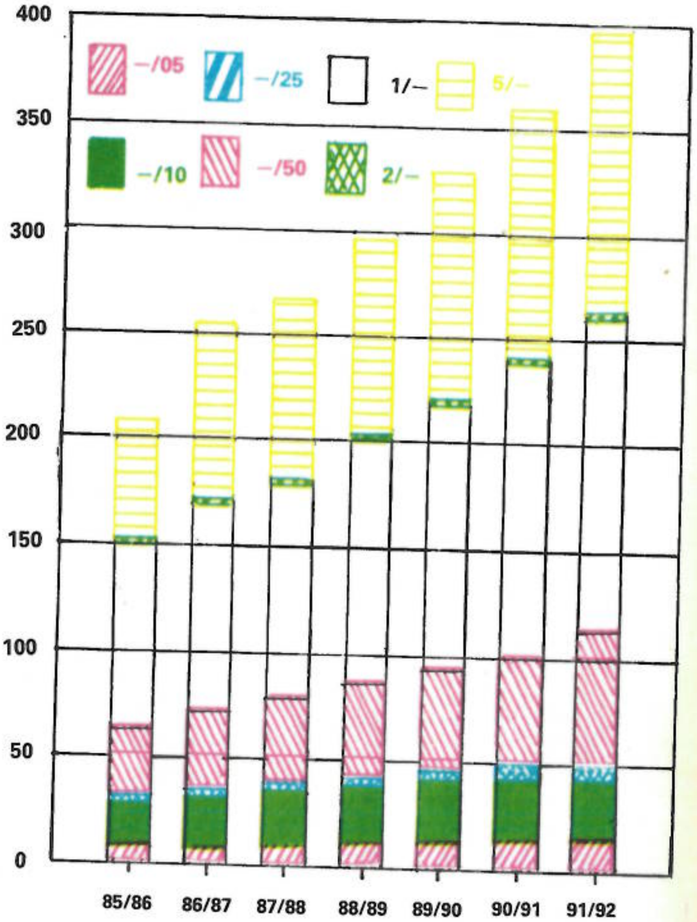
VALUE OF BANK NOTES IN CIRCULATION
(shillings million)



Source: Central Bank of Kenya.

Chart 2

VALUE OF COINS IN CIRCULATION
(shillings million)



Source: Central Bank of Kenya.

CHAPTER 4

Trade and Exchange Arrangements

4.1 Introduction

External trade and exchange policies continued to focus on the attainment of a viable external payments position and a high and sustainable rate of economic growth. In line with these objectives, various reforms continued to be implemented to further liberalize the trade and payments system. A new convertible foreign exchange bearer certificate (CFEBC) denominated in US dollars was introduced to supplement the one which had been introduced earlier in 1990 but denominated in Kenya shillings. The innovation was intended to make the certificate more attractive and to consequently minimize capital flight as well as to attract foreign exchange presently outside the domestic banking system. Efforts were also made to encourage foreign equity investment. To preserve the competitiveness of Kenya's exports and stimulate domestic production, the Central Bank continued to manage the shilling exchange rate flexibly.

4.2 Import Policy

The Government policy of liberalizing imports continued in 1991 through further tariff reforms and relaxation of import controls. Currently, there are three main import schedules all of which attract varying tariff levels. Schedule I contains high priority capital goods, raw materials, and intermediate inputs. The items under this schedule enjoy automatic licensing at lower tariffs. Items on Schedule II require government or ministerial approval before a licence can be issued. Items covered under this schedule include crude oil, fertilizer and food and are not subject to import duty. Items on Schedule III are sub divided into three groups, namely, IIIA, IIIB, and IIIC. Items on Schedule IIIA are final goods such as electric and optical appliances. Like items on Schedule I, imports on Schedule IIIA enjoy automatic licensing but are subject to higher import tariff rates than the former. Items falling under Schedule IIIB are lower priority goods and as such, are subject to much higher tariffs than imports under Schedules I, II, and IIIA; and sometimes government or ministerial approval is required before a licence can be issued. They include such items as ceramic tiles and building bricks. Items on Schedule IIIC are low priority goods whose desired importation is continuously reviewed. During the year, a large quantity of previously restricted imports under this schedule were transferred to schedule IIIB with equivalent tariffs. Reflecting further liberalization of the import regime, the import duty rate was reduced by 30 percentage points. This was done with a view to reducing the level of protection of the domestic industry and to encourage competition and efficiency in the sector.

4.3 Export Policy

The Government continued to implement policies and programmes that were intended to encourage production for export. Some of the key export promotion programmes in place include the Export Compensation Scheme, the Manufacturing Under Bond (MUB), the Export Processing Zones (EPZs), the Duty Exemption programme and the pre-shipment export financing facility. Improvements were made in the administration of these programmes in order to make them more effective in promoting, particularly non-traditional exports. A total of 300 firms currently benefit from the Export Compensation scheme and since the introduction of Manufacturing Under Bond scheme, 55 companies have been granted approval to operate under the scheme. Out of the total number of firms approved to operate under MUB, 17 are fully operational. At present, 8 firms are operating in the privately established Export Processing Zone in Nairobi. During the year, approval was given for the establishment of a privately developed Export Processing Zone in Nakuru. The pre-shipment export financing scheme became fully operational in the year, thereby enhancing the ability of the banks to extend credit to the small and non-traditional exporters. Under the Duty Exemption Scheme, approximately 40 exporters received exemption from duty on imported inputs in the year.

4.4 Tourism

Tourism continued to be the major foreign exchange earner for the country. Consequently, the industry enjoyed increased government support in form of maintenance of infrastructural facilities in the tourist areas as well as promotion in international trade fairs and exhibitions. During the year, bilateral relations between Kenya and South Africa improved and direct flight connections by the national carriers of the two countries commenced. This development is expected to benefit the Kenyan tourism industry.

4.5 Capital Movements

The decline in loan capital inflows experienced in 1990 continued into 1991. Over the same period, capital outflows in terms of loan repayments continued to rise. As in the previous year, capital movements were more pronounced in official capital. The declining inflows and the rising outflows in the absence of any new debt write off or concessions resulted in a worsening of the overall capital account position.

In an effort to encourage direct foreign investment, the government changed the incentives and concessions given to foreign investors. In addition to incentives granted under the Manufacturing Under Bond and Export Processing Zones schemes, the corporate tax rate was further lowered to 35 per cent for the resident companies and to 42.5 per cent for branches of foreign companies. The general liberalization of the economy also continued with further removal of price controls on a range of items and the relaxation of exchange controls.

4.6 Foreign Exchange Reserves

The Bank continued to endeavour to maintain an adequate level of foreign exchange reserves. However, external debt service payments continued to exert considerable pressure on the foreign exchange reserves. This was exacerbated by the substantial reduction in new disbursements of foreign loans. As a result, gross foreign exchange reserves of the Central Bank barely changed in the year, rising by 1.1 per cent to shs 4,376m at the end of June 1992.

4.7 Exchange Rate Policy

During the year, the Central Bank continued to manage the shilling exchange rate flexibly in order to preserve the country's external competitiveness. The shilling remained pegged to a basket of currencies of the major trading partners of Kenya. The nominal exchange rate of the shilling was adjusted throughout the year in line with developments in the international currency markets. The movement in the shilling exchange rate is shown in Table 4.1.

Table 4.1

SELECTED FOREIGN EXCHANGE MEAN RATES[1]
(In Kenya Shillings)

Currency	1990	1991	1992
US dollar	23.1304	28.6553	32.3075
Pound sterling	40.2122	46.7941	61.4973
Deutschemark	13.8298	15.9640	21.2298
French Franc	4.1190	4.7061	6.3150
100 Italian Lira	1.8859	2.1437	2.8069
100 Japanese Yen	15.1080	20.7948	25.6959

[1]Mean exchange rate position for end June.
Source: Central Bank of Kenya.

CHAPTER 5

Foreign Exchange Bearer Certificates

In October 1991, the Central Bank introduced convertible Foreign Exchange Bearer Certificates (CFEBCs) denominated in US dollars to supplement the earlier ones which were denominated in Kenya shillings. The certificates are intended to minimize capital flight and to help tap the foreign exchange outside the domestic banking system.

The CFEBCs are issued by the Central Bank and other authorised dealers in Kenya on an agency basis in denominations of US dollar 500, 1,000, 5,000 and 10,000. The certificates are purchased in convertible currency at face value by both residents and non residents. The CFEBCs do not in themselves constitute actual foreign exchange but give the holder the right to purchase the face value, plus interest at the ruling bid rate of the London interbank lending offer rate (LIBOR) if held for a minimum period of three months from the date of issue, of the foreign exchange denominated in the certificate without any exchange control restrictions. The certificates are negotiable and as such, can easily be transferred from one holder to another.

The introduction of CFEBCs represents a partial liberalisation of the exchange system. In line with this development, the requirement for visitors and returning residents to declare on arrival the amount of currency brought into the country was abolished. Since these certificates are not subject to exchange control, they have become very popular and an important additional source of foreign exchange. The certificates are traded in the banking system and Nairobi Stock Exchange as well as in public auctions which have emerged within the short period they have been in existence. The volume of transactions in these certificates has grown steadily since their introduction. By the end of June, the total sales had risen to US$ 226,113,000 while the redemptions amounted to US$181,795,000, leaving an outstanding net balance of US $44,318,000. In the secondary market, the average premium paid for these certificates has fluctuated between 25 and 40 per cent during the last six months to June 1992.

CHAPTER 6

Administrative Developments

6.1 Board of Directors

The terms of office for both the Governor and the Deputy Governor expired on January 11, 1992 and His Excellency the President re- appointed Mr. Eric C. Kotut and Mr. Wanjohi Muriithi as Governor and Deputy Governor, respectively, for further terms of four years, respectively, effective January 12, 1992. On February 24, 1992, the Deputy Governor, Mr. Muriithi, was appointed Executive Chairman, National Bank of Kenya, while Mr.Eliphaz Riungu, who was until then the Chief Banking Manager, was appointed the new Deputy Governor. The Bank takes this opportunity to congratulate both Mr. Riungu and Mr. Muriithi and to wish them every success in their new appointments. The Bank further wishes to record its appreciation to Mr. Muriithi for his distinguished service to the Bank, first as the Exchange Controller and later as Deputy Governor.

During the year, two new members of the Board were appointed. Professor P. M. Mbithi, the Permanent Secretary in the Office of the President, Secretary to the Cabinet and Head of the Public Service, was appointed to the Bank Board for a term of four years effective January 8, 1992. At the same time, Dr. W. K. Koinange, joined the Board on being appointed Permanent Secretary to the Treasury to replace Mr. C. S. Mbindyo. In September 1991, Mr. M. K. A. Cheserem resigned as Director after taking a new appointment in

Malawi. The Bank takes this opportunity to welcome Prof. P. M. Mbithi and Dr. W. K. Koinange to the Board. The Bank also wishes to record its appreciation to Messrs Mbindyo and Cheserem for their invaluable service to the Bank.

6.2 Presidential Visit

His Excellency the President and Commander in Chief of the Armed Forces of the Republic of Kenya, Hon. Daniel Toroitich Arap Moi, C.G.H, M.P. visited the Bank on December 10, 1991 and attended a luncheon hosted in his honour by the Governor. During this ceremony, His Excellency the President was presented with a cheque for shs 3,064,492,064.00, being the dividend due to the Treasury for the year ended June 30, 1991. The President was also presented with a shs 1,000 commemorative silver coin and a documentary film and book entitled "Kenya – Land of Opportunity" which were produced by the Central Bank to mark its Silver Jubilee. The film and the book provide a succinct description of Kenya's achievements since independence and its future prospects.

6.3 Central Bank Silver Jubilee

The 25th Anniversary of the Bank, which fell due on September 16, 1991, was celebrated during the year. To mark the occasion, a press supplement and a new Bank Logo were released. The supplement, which appeared in all English local dailies and the Weekly Review, presented a historical review of banking in Kenya, and highlighted the various reforms which are being implemented to promote the development of a sound and efficient financial system. In addition, the documentary film on "Kenya – Land of Opportunity" was transmitted nationwide on television.

As part of these celebrations, on December 13, 1991, the Deputy Governor, on behalf of the Governor, presented certificates of long service and other mementos to sixteen members of staff each of whom had served the Bank for a period of over 25 years.

6.4 International Visits And Travels

The Governor, Mr. E.C. Kotut, attended meetings with correspondent Banks in London between October 30 and November 7, 1991. Later, in November 1991, he accompanied His Excellency the Vice President and Minister for Finance to the Consultative Group Meeting in Paris, France.

The former Deputy Governor, Mr. Wanjohi Muriithi, attended the 12th Biennial Meeting of the Association of African Central Banks (AACB) in Harare, Zimbabwe held between July 27 and August 2, 1991. He also represented the Bank at the IMF/IBRD Annual Meetings in Bangkok, Thailand, in October 1991. The Deputy Governor also represented the Governor at the 25th Anniversary Celebrations of the Bank of Tanzania in December 1991.

Senior staff members also travelled out of the country in the year. Mr. T.K.B. Kuruna, Exchange Controller, attended, as part of a government delegation led by the Assistant Minister for Finance, Hon. M. Keah, the African Development Bank Group Annual Meeting in Dakar, Senegal, in May 1992. Mr. L.W. Wairagu, Principal, Foreign Department, attended the Preferential Trade Area (PTA) Meetings in Mbabane, Swaziland, in October 1991. Between April 22 and May 6, 1992, both Mr. E.P. Mwangi, Principal, Currency Division and Mr. S.N. Karanja, Head of Security Division, attended an international conference on Frauds and Counterfeits in Ottawa, Canada.

6.5 Staff Training And Development

During the year, a total of 254 members of staff were sponsored to various courses and seminars conducted in the country and abroad. Of this number, 56 were sponsored for overseas courses.

6.5.1 Overseas Courses and Seminars

The then Chief Banking Manager, Mr. Riungu, attended the Central Banking seminar at the Federal Reserve Bank of New York and the Offshore Banking seminar in Cyprus. The Principal, Development Division, and another senior Officer from the same Division were attached to the Monetary Authority of Singapore while an Assistant Principal from the Kisumu Branch attended a Senior Management Development Programme organized by the Eastern and Southern African Management Institute (ESAMI) in Harare, Zimbabwe. The Assistant Principal, Administration Division, attended the Commonwealth Central Banking Course in the United Kingdom.

Two officers from Bank Supervision Department were sponsored for Inspection Officers Course organized by the Reserve Bank of India, while two others from Exchange Control Department attended the 24th International Commercial Banking Course organized by the State Bank of Pakistan in Karachi. An Assistant Principal and another senior officer in Foreign Department attended Banking training programmes organized by the Surrey Summer School in the United Kingdom. Two officers from Research Department attended a course on "Techniques of Macroeconomic Management" organized by the African Centre for Monetary Studies (ACMS) in Dakar, Senegal, while another officer from the Deposit Protection Fund attended a seminar on "Legal Issues and Problems" organized by the International Law Institute in Rome, Italy.

During the year, four officers from Research Department attended various courses offered by the IMF Institute in Washington, D.C. More staff were sponsored to ESAMI to attend various management courses.

6.5.2 Local Courses and Seminars

Bank staff participated in various courses/seminars organized locally. A number of staff members attended a "Training for Trainers" seminar organized by the African Development Bank and the Institute of Certified Public Accountants (Kenya). Five senior members of staff attended a Debt Management course organized by the office of the Vice-President and Ministry of Finance. A number of staff members attended a regional course on Financial Analysis and Programming in Nairobi in March 1992. The course was organised by the Bank in conjunction with the IMF and the United Nations Development Programme (UNDP).

In an effort to continue providing excellent services to the public, the Bank sponsored thirty two officers for Public/Customer Relations courses conducted by various institutions/consultancy firms while twelve employees attended secretarial courses at various levels. The Bank utilized facilities offered by the College of Banking and Finance to hold an induction course for the new staff in the Banks Supervision Department. A number of employees continued to attend evening classes conducted at the College specifically for the Banking Diploma. The Bank also sponsored staff at various local training institutions for courses which included Policy Analysis, Computer Applications in Bank Operations, Advanced Credit, Development Banking, Debt Management, Human Resources Management, Accounting, Tellers, Occupational Health Care and Stock Control and Stores Management.

6.5.3 Postgraduate/Professional Courses

During the year, four members of staff were released for postgraduate studies in various disciplines. Out of the four, two were sponsored by the Bank, while the others won scholarships offered by the British Council and the University of Nairobi.

With regard to professional courses, two members of staff completed the CPA programmes while three others completed the Chartered Institute of Bankers (CIB) Diploma.

6.6 Computerization

During the year, the Bank continued to computerize its operations. New systems were developed to assist in the maintenance of General Ledger accounts and the administration of the Kenya Government Stocks. Feasibility studies and design work were also carried out in the other areas of the Bank that are to be computerized. In order to improve the performance of the systems already installed, the Bank upgraded the initial configuration of the mainframe computer to have more storage and higher processing speed.

The Bank also continued to receive technical assistance from the Swedish International Development Agency in support of the on-going computerization of the management of foreign exchange. The Swedish Consultants completed the systems for External Debt management in Exchange Control Department and the dealing position management in Foreign Department.

6.7 Sports

Inter-departmental sports competitions were held in August 1991 to identify potential players to participate in the annual Kenya Institute of Bankers inter-bank competitions. Later in September 1991, the Central Bank earned the second position in the inter- bank competitions. The Banki Kuu Basketball team continued to dominate events in the National League. The team emerged as the runners-up in the highly competitive 1991 National League.

6.8 Other Developments

6.8.1 Kisumu Branch

The Kisumu Branch building and staff houses were completed in March 1992 and handed over in readiness for occupation.

6.8.2 Headquarters Building

Excavation work for the foundation of the Headquarters Building started in the year in preparation for the main construction work to commence.

CHAPTER 7

Balance Sheet and Accounts 1991/92

The Balance Sheet as at 30th June, 1992 and the Profit and Loss Account for the year ended June 30, 1992 appear in the appendix on pages 16 and 17.

7.1 Assets and Liabilities

The Bank's total assets increased by shs 7,101m in the year to shs 43,332m at the end of June 1992. The foreign exchange holdings of the Bank rose by shs 49m, direct advances to the Government fell by shs 7,967m while advances and discounts to commercial banks increased by shs 6,417m. The Bank's holdings of non bearer Treasury Bonds remained unchanged at shs 1,900m in fy 1991/92 while bearer Treasury Bonds went up by shs 963m. The Bank's holdings of Government Stocks and Treasury Bills fell by shs 167m and shs 145m, respectively, while bills acquired by the Bank for open market operations amounted to shs 5,061m. Uncleared effects fell by shs 271m while Other Assets and Revaluation Accounts rose by shs 428m and shs 2,732m, respectively.

Currency in circulation increased by shs 2,553m. Deposits of Kenya banks and those of external banks declined by shs 417m and shs 378m, respectively during the financial year. Deposits of the International Monetary Fund (IMF) increased by shs 2,311m while other deposit liabilities rose by shs 1,410m.

The Government's share of the Bank's profits for fy 1991/92 increased by shs 1,059m over fy 1990/91, while other liabilities and provisions increased by shs 106m. The Bank's capital remained unchanged at shs 500m during fy 1991/92. In accordance with section 9 (1) of the Central Bank of Kenya Act, shs 458m was transferred to the General Reserve Fund from the net annual profits of the Bank in fy 1991/92. As a result, the Capital and Reserves of the Bank increased to shs 2,058m at the end of June 1992.

7.2 Income, Expenditure and Profits Appropriation

Total gross receipts in fy 1991/92 amounted to shs 6,373m, an increase of shs 1,294m above the previous year. Earnings from foreign investments declined by shs 48m to shs 154m in the year while receipts from domestic investments rose by shs 1,342m to shs 6,219m. Total recurrent expenditure and provisions increased by shs 118m in the year to shs 1,792m. Administrative expenses accounted for shs 623m of the total recurrent expenditure. Interest and charges paid to the IMF accounted for shs 335m, while supervision of foreign trade and currency expenses took shs 357m and shs 324m, respectively. Other expenses and provisions accounted for shs 153m. Net annual profits as specified under Section 9(2) of the Central Bank of Kenya Act, amounted to shs 4,581m for fy 1991/92 compared with shs 3,405m in fy 1990/91.

7.3 Revaluation Account

The account reflects a debit balance of shs 6,229m as at 30th June, 1992 compared with a debit balance of shs 3,497m as at 30th June, 1991. A revaluation loss of shs 2,847m arose from the revaluation of IMF Special Drawing Rights (SDR) Deposits. However, gains of shs 22m and shs 93m were made from the revaluation of Gold and Foreign Deposits and Securities. The net revaluation loss, therefore, amounted to shs 2,732m during the year.

Balance Sheet As

CENTRAL BANK OF KENYA
LIABILITIES

			1991
	shs	*shs*	*shs*
CURRENCY IN CIRCULATION			
Notes		14,295,769,535	11,778,626,075
Coin		399,670,469	363,209,881
		14,695,440,004	12,141,835,956
DEPOSITS			
Government of Kenya	—		—
Banks—Kenya	3,430,111,949		3,847,493,039
—External	155,394,196		532,682,046
I.M.F.	14,845,256,033		12,534,269,787
Others	3,469,696,056		2,060,258,476
		21,900,458,234	18,974,703,348
GOVERNMENT OF KENYA — BALANCE OF PROFITS		4,122,592,020	3,064,492,064
OTHER LIABILITIES AND PROVISIONS		556,374,889	450,315,233
TOTAL LIABILITIES AND PROVISIONS		41,274,865,147	34,631,346,601
CAPITAL		500,000,000	500,000,000
GENERAL RESERVE FUND		1,557,590,083	1,099,524,303
	shs	43,332,455,230	36,230,870,904

PROFIT AND LOSS ACCOUNT FOR

TRANSFERRED TO GENERAL RESERVE FUND		458,065,780	340,499,118
BALANCE PAYABLE TO THE GOVERNMENT OF KENYA		4,122,592,020	3,064,492,064
	shs	4,580,657,800	3,404,991,182

The annexed notes form part of the Accounts.

REPORT OF THE AUDITORS PURSUANT TO SECTION

We have audited the above Balance Sheet and Profit and Loss Account and have obtained all and the Accounts which are in agreement therewith, comply with the requirements of the
The profit for the year ended on 30th June, 1992 has been ascertained in accordance with annexed notes give, in our opinion, a true and fair view of the state of affairs of the Bank at

Nairobi
30th September, 1992

PEAT, MARWICK
Joint

	shs	shs	shs
;OLD AND FOREIGN EXCHANGE			
Balances with Banks and Cash	3,631,853,525		3,375,999,124
Treasury Bills	—		288,951,912
Other Investments	657,853,805		588,886,456
Holdings of Special Drawing Rights	86,608,481		73,324,029
Total Foreign Exchange		4,376,315,811	4,327,161,521
;ECURITIES ISSUED OR GUARANTEED BY KENYA GOVERNMENT		3,065,270,971	3,232,231,771
)IRECT ADVANCES TO KENYA GOVERNMENT		11,948,243,611	19,914,614,461
·ENYA TREASURY BONDS		1,899,933,180	1,899,933,180
·ENYA TREASURY BILLS		9,725,468	154,690,955
)MO — KENYA TREASURY BILLS		5,060,872,300	—
·ENYA GOVERNMENT BEARER BONDS		962,767,063	47,317
·DVANCES AND DISCOUNTS		6,507,651,076	90,500,000
JNCLEARED EFFECTS		1,818,333,920	2,088,936,327
)THER ASSETS		1,454,183,836	1,025,872,092
;EVALUATION ACCOUNT		6,229,157,994	3,496,883,280
	shs	43,332,455,230	36,230,870,904

E. C. KOTUT
Governor

'HE YEAR ENDED JUNE 1992

;ET PROFIT: After charging current expenditure, writing down fixed assets and providing for contingencies and movements in reserves	4,580,657,800	3,404,991,182
	4,580,657,800	3,404,991,182

4 OF THE CENTRAL BANK OF KENYA ACT

ıe information and explanations which we considered necessary. Proper books have been kept
:entral Bank of Kenya Act.
ection 9 of the Central Bank of Kenya Act, and on this basis the Accounts together with the
0th June, 1992 and of the result of its operations for the year to that date.

;ELLHOUSE MWANGI ERNST & YOUNG
ˡuditors

NOTES TO THE ACCOUNTS

1 **EXCHANGE RATES**

Foreign exchange balances have been converted at the rates ruling at 30th June, 1992.

2 **EXCHANGE DIFFERENCES**

Differences on exchange have been dealt with as follows:—

a) **Profit and Loss Account**

Differences arising from dealings in foreign exchange have been transferred to Profit and Loss Account.

b) **Revaluation Account**

Differences arising from revaluation of Gold in accordance with Note 3 below, and from changes in exchange rates during the year, with the exception of those referred to in Note (a) above, and the amount which at 30th June, 1992 was required to maintain the value of local currency held by the International Monetary Fund in terms of Special Drawing Rights, have been transferred to the Revaluation Account set up under Section 51 of the Act.

3 **VALUATION OF GOLD**

Gold reserves, included in Other Investments, were revalued at 50 per cent of market price at 30th June, 1992. The revaluation gain arising, amounting to shs 21,705,581.25, has been transferred to the Revaluation Account.

4 **REVALUATION OF INVESTMENTS**

Foreign and local securities are valued at the lower of cost or market value. To determine the lower of cost or market value, investments are grouped into their respective currencies and only if the group total market value is lower than cost is a provision made against that group. At 30th June, 1992, the overall market value of investments under the following Balance Sheet headings were:—

Other Investments:—
Foreign Securities shs 218,188,208.30
(1991 shs 170,897,687.80)
Gold shs 843,547,398.30
(1991 shs 843,547,398.30)
Securities issued or guaranteed by the Kenya Government shs 3,133,086,292.15 (1991 shs 3,302,134,102.15).

5 **FORWARD EXCHANGE**

Commitments for forward exchange operations at 30th June, 1992 were equivalent to shs 1,511,809,525.55 for forward sales and shs 368,632,900.20 for forward purchases (1991 shs 72,497,672.30 and shs 418,805,800.80)

6 **GOLD AND FOREIGN EXCHANGE**

Included under Gold and Foreign Exchange are amounts totalling shs 2,531,027,380.10 (1991 shs 1,118,577,356.60) which represent external funds held by the Central Bank on behalf of the Government and Other Public Entities. The corresponding liabilities are held under Deposits and Other Liabilities and Provisions.