TABLE OF CONTENTS

Letter of Transmittal	....	ii
Preface	....	iii
Board of Directors	....	iv
Senior Management	....	v
Bank Reorganisation	....	vii
OVERVIEW	....	1
REAL SECTOR	....	5
Agriculture	....	6
Manufacturing	....	7
Energy Sector Developments	....	9
Building and Construction	....	9
Transport	....	9
Telecommunications	....	11
Tourism	....	11
Uses of Available Resources	....	12
CAPITAL FLOWS	....	14
FINANCING OF THE GOVERNMENT	....	17
PUBLIC DEBT	....	21
BANKING SECTOR DEVELOPMENTS	....	28
MICRO FINANCE SECTOR DEVELOPMENTS	....	32
MONEY SUPPLY	....	34
INFLATION	....	39
INTEREST RATES	....	41
BALANCE OF PAYMENTS	....	44
EXCHANGE RATES	....	50
NATIONAL PAYMENT SYSTEM	....	52
ECONOMIC OUTLOOK	....	59
AUDITED ACCOUNTS	....	60

LETTER OF TRANSMITTAL

In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Minister, the Annual Report of the CBK for the Financial Year 2006/07. The report contains economic and financial developments and the Audited Accounts of the CBK for the Financial Year ended June 30, 2007.

Njuguna Ndung'u

Governor

PREFACE

The financial year 2006/07 was marked by improved performance in all the key sectors of the economy. The economy which grew by 5.7 percent in 2005, improved further in 2006, growing by 6.1 percent. The good performance was due to improved production in various sectors, particularly tourism, telecommunications, manufacturing and agriculture in the face of significant improvements in the macroeconomic conditions and various policy reforms undertaken by the Government.

Monetary policy in the financial year successfully sought to achieve an underlying inflation of 5 percent by June 2007. Government commitment to fiscal discipline also contributed to price stability in the year. However, overall inflation was negatively affected by high international oil prices and unstable food prices.

The banking sector remained stable in the year. Non-performing loans and advances, net of provisions, maintained a downward trend while gross loans and advances increased, leading to better asset quality and improved profitability.

The issuance of a bond to National Bank of Kenya by the Government in June 2007 in settlement of debts owed to the institution drastically improved its non-performing loans portfolio and subsequently the non-performing loans of the whole banking system.

The outlook for the financial year 2007/08 is positive and the economy should continue to benefit from a stable macroeconomic environment and growth enhancing policy measures being implemented by the Government. Implementation of Vision 2030 from 2008 is expected to sustain the current growth momentum. As was the case in the financial year 2006/07, the Bank will continue to ensure that monetary expansion supports the desired real GDP growth without undue inflationary pressure.

BOARD OF DIRECTORS

NJUGUNA NDUNG'U
Governor and Chairman
Central Bank of Kenya

JOSEPH M. KINYUA
Permanent Secretary,
Ministry of Finance

JACINTA W. MWATELA (Mrs.)
Deputy Governor
Central Bank of Kenya

WILLIAM O. OGARA

NICHOLAS A. NESBITT

AGNES WANJIRU KAMIRI

WANZA KIOKO

JOSEPH K. WAIGURU

SENIOR MANAGEMENT

JOHN M. GIKONYO
Director, Governor's Office and Bank Secretary

JAMES OGUNDO
Executive Director, Kenya School of Monetary Studies

JONATHAN A. BETT
Director, Banking Services and National Payments Systems

JONES M. NZOMO
Director, Accounting, Budget & Expenditure Control

LAWRENCE C. KUNGU
Director, Estates, Supplies & Services

NICHOLAS B.T. A. KORIR
Director, Research Department

SENIOR MANAGEMENT

GERALD A. NYAOMA
Director, Financial Institutions Supervisions

JACKSON M. KITILI
Director, Monetary Operations and Debt Management

CHARLES O. MARANGA
Director, Administration & Human Resources

EDWIN L. OGOLA
Director, Currency Operations and Branch Administration

HEZBON MARIWA
Director, Internal Audit & Risk Management

CHARLES K. CHEPKWONY
Ag. Director, Information Management Systems

BANK REORGANISATION

APPOINTMENT OF THE GOVERNOR

Prof. Njuguna Ndung'u was appointed Governor of the Central Bank of Kenya for a renewable four-year term with effect from 4th March 2007.

NEW APPOINTMENTS TO CBK BOARD

Several Directors retired from the Central Bank of Kenya Board of Directors. These were Owen Njenga Koimburi, Prof. Henry Maritim, Paul Anthony Spence and George Ongaya Okoth.

Subsequently, His Excellency the President made new appointments to the Central Bank of Kenya Board of Directors during the year. Mr. Nicholas Alexander Nesbitt, Mr. Joseph Kahora Waiguru and Dr. William Otiende Ogara were appointed on 28th September 2006 while Ms. Agnes Wanjiru and Ms. Wanza Kioko were appointed on 4th January 2007.

NEW APPOINTMENTS TO MANAGEMENT

During the year, three members of the Central Bank Senior Management Team retired. These were Messrs. Hezbon Mariwa, James Oloo Ogundo and Lawrence Kungu.

Three new appointments were, consequently, made to the Central Bank Senior Management. On 22nd May 2007, Mr. Nicholas Kiritu was appointed the Director of Internal Audit and Risk Management while Ms. Elizabeth Omolo was appointed the Executive Director of the Kenya School of Monetary Studies. On 11th June 2007, Ms. Rose Detho was appointed the Director of Bank Supervision.

DEPARTMENTAL RESTRUCTURING

The functions and responsibilities of the Bank undergo review from time to time in order to enhance capacity to respond to challenges arising from changes in financial and economic developments at home and abroad. These challenges inevitably necessitate a renewed effort to strengthen the Bank's administrative competencies and operational systems, the objective being to enable the Bank to achieve its mandate more effectively and efficiently. Taking the current challenges into account, the Bank re-organized its Departmental functions and operations in order to improve and sustain the quality of service delivery and ensure prompt implementation of the Bank's assignments. Consequently, several departments of the Bank were restructured and enhanced as follows:

Human Resource and Services Department

Human Resource and Administration and Estates Management and Procurement Departments were merged and renamed Human Resources and Services Department. Consequently, Human Resource and Administration and Estates Management and Procurement became divisions in the Human Resources and Services Department.

Banking Services Department

Banking Services and NPS and External Payments and Reserves Management Departments were also merged and renamed Banking Services Department.

Governor's Office and Information Management Systems (IMS) Division

Effective 22nd May, 2007, the IMS Department was brought under Governor's Office as a Division.

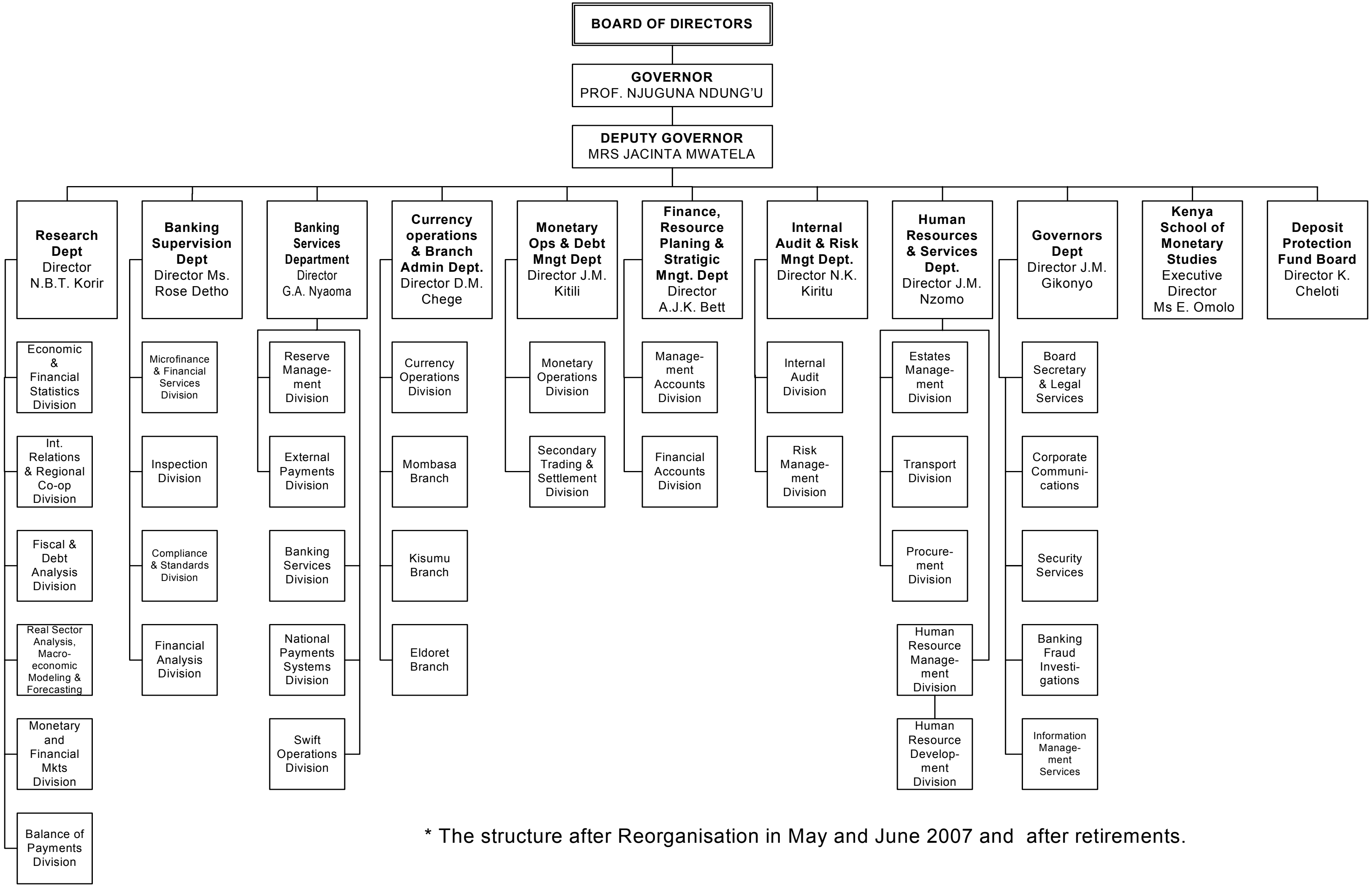
Finance, Resource Planning and Strategic Management

Finance and Resource Planning Department was renamed Finance, Resource Planning and Strategic Management Department to accommodate the new strategic planning function.

PERFORMANCE MANAGEMENT SYSTEM

On 11th June 2007 the Bank commissioned a Special Assignment for a new Performance Management System, which will be launched in the 2007/08 financial year.

CENTRAL BANK OF KENYA ORGANISATION STRUCTURE*



* The structure after Reorganisation in May and June 2007 and after retirements.

OVERVIEW

In spite of the drought experienced early in the year, Kenya's economy grew by 6.1 percent in 2006 compared with 5.7 percent in 2005. The good performance in 2006 was sustained in the first half of 2007. The sectors that contributed largely to this performance were agriculture, manufacturing, building and construction, tourism and telecommunications.

In the agriculture sector, there was improved performance in the production of major cash crops during the fiscal year 2006/07. Horticulture, tea and coffee output increased by 3.4 percent, 26.8 percent and 4.9 percent respectively. Sugarcane deliveries also increased by 0.4 percent from 4,953,329 metric tonnes in 2005/06 to 4,971,553 metric tonnes in 2006/07. Overall, the agricultural sector grew by 5.4 percent in 2006 compared with 6.9 percent in 2005. The deceleration in growth was mainly attributed to the adverse impact of drought in 2006.

The manufacturing sector continued to expand in the year 2006, and grew by 6.9 percent compared with 4.7 percent in 2005. The growth was mainly in food, beverages and tobacco manufacturing sub-sectors. Favorable weather conditions, especially in the last quarter of 2006 led to improved supply of raw materials that supported agro-based industries, especially dairy and the grain milling sub sectors.

Growth in the building and construction sector decelerated from 7.6 percent in 2005 to 6.3 percent in 2006. Cement consumption, a major input in the construction industry, increased by 8.9 percent from 1,249,392 tonnes in the third quarter of 2005/06 to 1,360,542 tonnes in the same period in 2006/07.

Telecommunications sector remained vibrant in the fiscal year 2006/07 with the mobile telephone sub-sector remaining one of the fastest growing sub-sectors in the economy. Mobile telephone subscribers increased by 43.5

percent, mainly supported by increased network roll-out by operators as they improved access to the rural areas.

In fiscal year 2006/07, the tourism sector maintained a steady growth momentum with tourist arrivals growing by 14.3 percent.

Due to significant increase in tax revenue and lower than budgeted Government expenditure, Government budgetary operations in the fiscal year 2006/07 resulted in a lower budget deficit (including grants) of Ksh 21.6 billion or 1.2 percent of GDP on commitment basis, compared with Ksh 51.5 billion or 3.3 percent of GDP in the fiscal year 2005/06.

Despite the rise in the stock of debt during the fiscal year 2006/07, the overall debt stock relative to GDP dropped from 51.1 percent in June 2006 to 43.8 percent in June 2007. External debt to GDP ratio declined from 27.9 percent to 21.7 percent while domestic debt to GDP ratio fell from 23.2 percent to 22.1 percent during period. The drop in the debt to GDP ratio during the period was attributed mainly to faster growth in GDP.

The banking sector remained stable in the year, mainly due to favourable macroeconomic conditions during the period and stringent supervisory oversight. Non - performing loans and advances, net of provisions, maintained a downward trend while gross loans and advances increased leading to better asset quality and improved profitability.

Monetary policy over the financial year 2006/07 was directed towards achieving and maintaining inflation at 5 percent. Accordingly, the CBK set out the path for both reserve money and money supply to grow by 14.3 percent and 13.1 percent, respectively.

Inflation was lower during the fiscal year 2006/07 than the fiscal year 2005/06. The average annual overall inflation declined from 11.1 percent during the year ending June 2006 to 10.4 percent in the year ending June 2007.

However, month-on-month overall inflation increased from 10.9 percent in June 2006 to 11.1 percent in June 2007, mainly due to volatility in food and energy prices. The annual average underlying inflation was 4.56 percent and hence within the CBK target .

Furthermore, short-term interest rates were lower in June 2007 than in June 2006. The average interest rate on the 91-day Treasury bill declined from 6.6 percent in June 2006 to 6.5 percent in June 2007. The average interest rate on the 182-day Treasury bill declined from 7.3 percent to 7.2 percent over the same period. The lending and deposit interest rates were also lower, on average, in June 2007 than in June 2006. The overall deposit rate decreased from 4.4 percent in June 2006 to 4.2 percent in June 2007, while the average lending rate declined from 13.8 percent to 13.1 percent over the same period.

Kenya's balance of payments resulted in a lower surplus of US$ 372 million during the fiscal year 2006/07 compared with US$ 847 million in the fiscal year 2005/06. This largely reflected the widened current account deficit following increased merchandise imports.

The balance of payments surplus resulted in a build up of gross foreign assets of the banking system from US$ 2,909 million at the end of June 2006 to US$ 3,767 million at the end of June 2007. Of this, gross official foreign exchange reserves held by the CBK amounted to US$ 2,723 million (equivalent to 4.4 months of imports) at the end of June 2007, which was an increase from US$ 2,353 million at the end of June 2006.

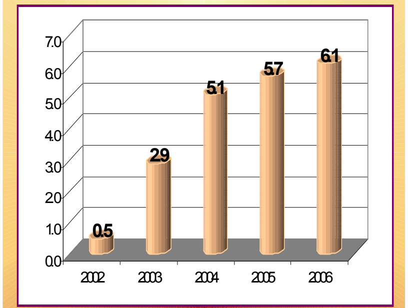
The Kenya shilling appreciated against major world currencies in the fiscal year 2006/07. The shilling gained by 9.3 percent against the US dollar to exchange at an average of Ksh 66.6 per US dollar in June 2007 compared with Ksh 73.4 per US dollar in June 2006. Against the currencies of the East African Community member states, the Kenya shilling gained by 11.1 percent against the Tanzania shilling to exchange at Tsh 19.0 per Kenya shilling in June 2007, but depreciated by 1.4 percent against the Uganda shilling to Ush 25.0 per Kenya shilling in June 2007.

In the period under review, the Bank's Board of Directors approved the Policy Framework for Oversight Payments Systems in Kenya. The policy outlines the Bank's role, objectives, scope, importance and methodology for payment system oversight in Kenya. Finalisation and adoption of this policy framework enabled the Bank to meet the Bank of International Settlements (BIS) core principles for Systemically Important Payments Systems (SIPS). The Bank further developed the benchmark document for overseeing payments systems in Kenya. In view of the passage of time and the ever changing business environment, the Ministry of Finance requested the Bank to review the draft National Payments System (NPS) and Electronic Funds Transfer (EFT) bills. The Master Repurchase Agreement and the Intra-day Liquidity Facility agreements were also developed during the year.

1. REAL SECTOR

Real GDP Growth

CHART 1A: REAL GDP GROWTH RATES, 2002 - 2006 (%)



Sources: Economic Survey & Central Bank of Kenya

In spite of the drought in early 2006, the economy grew by 6.1 percent in 2006 compared with 5.7 percent in 2005 as shown in Chart 1A. The increased GDP growth was mainly due to increased capacity utilisation especially in tourism and manufacturing sectors.

Sustaining the good economic performance in the medium to long term will require increased investments in infrastructure and different sectors as envisioned under Vision 2030.

TABLE 1.1: GROSS DOMESTIC PRODUCT AND SECTOR SHARE AT CONSTANT 2001 PRICES

	Shares in Real GDP (%)		Ksh Millions		
MAIN SECTORS	**2006**	**2003**	**2004**	**2005**	**2006**
Agriculture, Forestry and Fishing	25.88	280,854.00	285,763.00	305,500.00	322,074.00
Manufacturing	9.93	105,822.00	110,544.00	115,699.00	123,626.00
Wholesale and retail trade, repairs	9.20	92,604.00	100,481.00	106,009.00	117,524.00
Hotels and Restaurants	1.44	9,899.00	13,741.00	15,572.00	17,895.00
Financial Services	3.72	42,064.00	42,657.00	43,869.00	46,265.00
Construction	3.03	31,530.00	32,932.00	35,446.00	37,665.00
Transport, storage and communications	10.89	104,915.00	112,251.00	122,243.00	135,466.00
Government	11.84	143,467.00	145,738.00	146,618.00	147,359.00
Others of which:	11.37	130,608.00	134,457.00	137,740.00	141,514.00
Domestic services	*0.33*	*3,855.00*	*3,932.00*	*4,011.00*	*4,091.00*
Real estate, renting and business services	*5.50*	*61,864.00*	*63,740.00*	*65,882.00*	*68,402.00*
Other financial services indirectly measured	*-0.96*	*-10,315.00*	*-10,801.00*	*-11,261.00*	*-11,989.00*
Electricity and water supply	*2.22*	*27,074.00*	*27,877.00*	*27,898.00*	*27,635.00*
Mining and quarrying	*0.45*	*5,213.00*	*5,195.00*	*5,334.00*	*5,554.00*
Community, social and personal services	*3.84*	*42,917.00*	*44,514.00*	*45,876.00*	*47,821.00*
Total GDP at basic 2001 prices	**87.54**	**941,763.00**	**978,564.00**	**1,028,696.00**	**1,089,388.00**
Taxes less subsidies on products	12.46	113,895.00	130,772.00	144,088.00	155,059.00
Real GDP at 2001 market prices	**100.00**	**1,055,658.00**	**1,109,336.00**	**1,172,784.00**	**1,244,447.00**
			Growth Rates %		
Agriculture, forestry and fishing		2.6	1.6	6.9	5.4
Manufacturing		6.0	4.5	4.7	6.9
Wholesale and retail trade, repairs		1.5	8.5	5.5	10.9
Hotels and Restaurants		-20.30	38.8	13.3	14.9
Financial Services		1.5	1.4	2.8	5.5
Building and construction		1.0	4.4	7.6	6.3
Transport, storage and communications		3.5	7.0	8.9	10.8
Government		13.1	5.7	2.8	2.5
Others:		22.0	11.9	15.2	19.6
Domestic services		*2.0*	*2.0*	*2.0*	*2.0*
Real estate, renting and business services		*2.3*	*3.0*	*3.4*	*3.8*
Other financial services indirectly measured		*-3.30*	*4.7*	*4.3*	*6.5*
Electricity and water supply		*14.0*	*3.0*	*0.1*	*- 0.9*
Mining and quarrying		*3.5*	*- 0.4*	*2.7*	*4.1*
Community, social and personal services		*3.5*	*- 0.4*	*2.7*	*4.1*
Real GDP growth		2.9	5.1	5.7	6.1
*** Memorandum Items: Tourism earnings/[1]**		**26,381.78**	**38,453.45**	**43,674.98**	**49,571.45**
GDP at Market Prices		1,055,658.00	1,109,338.00	1,172,784.00	1,244,445.00
Overall GDP deflator		108.00	116.00	123.00	131.98

/[1] These data are based on reported foreign exchange earnings from tourism compiled by commercial banks and consolidated by the CBK. The annual earnings are then deflated by the annual average CPI less food CPI to get Tourism earnings at 2001 prices

Sources: Central Bank of Kenya and Kenya National Bureau of Statistics

Agriculture

The agricultural sector grew at a lower pace of 5.4 percent in 2006 than the growth of 6.9 percent in 2005. The deceleration was largely attributed to the drought in early 2006. However, the second half of 2006 and first half of 2007 registered marked improvement in the sector. There was improved performance in the production of major cash crops during the fiscal year 2006/07 as shown in Table 1.2. The improvement was largely attributed to favourable rains in the financial year 2006/07, supported by the impact of reforms implemented in the recent past.

TABLE 1.2: OUTPUT GROWTH IN KEY CROPS

PRODUCT	Jun 2003/04	Jun 2004/05	Jun 2005/06	Jun 2006/07
Tea				
Output (MT)	327,281	321,440	295,791	375,226
Output Growth %	16.83%	-1.78%	-7.98%	26.81%
Horticulture				
Output (MT)	137,084	160,729	162,099	167,652
Output Growth %	-0.38%	17.25%	0.85%	3.43%
Coffee				
Output (MT)	58,795	51,436	47,995	50,346
Output Growth %	4.53%	13.03%	-6.14%	4.90%
Sugarcane				
Output (MT)	458,881	4,751,432	4,953,329	4,971,553
Output Growth %	926.00%	4.45%	4.25%	0.37%

Sources: Kenya National Bureau of Statistics, Horticultural Crop Development Authority, Tea and Coffee Boards and Sugar Boards

Tea output increased by 26.8 percent, from 295,791 metric tonnes in year 2005/06 to 375,226 metric tonnes in 2006/07, attributable to good weather conditions.

The coffee sub-sector performance improved in 2006/07. As shown in Table 1.2, coffee production increased by 4.9 percent compared with a decline of 6.1 percent in 2005/06. The improved performance was due to Government efforts to boost productivity in this sub-sector through streamlining management of cooperative societies and writing off non-performing loans advanced to the societies. Favourable weather conditions in coffee growing areas also boosted production.

In the horticulture sector, output increased by 3.4 percent from 162,099 metric tonnes in 2005/06 to 167,652 metric tonnes in 2006/07. Output of flowers and vegetables increased by 7.1 percent and 5.6 percent respectively, while output of fruits decreased by 11.3 percent during the period.

The share of flowers, vegetables and fruits remained unchanged at around 53 percent, 38 percent and 9 percent, respectively, in June 2007.

Sugarcane deliveries increased by 0.4 percent, from 4,953,329 metric tonnes in 2005/06 to 4,971,553 metric tonnes in 2006/07. Processed sugar output, however, declined by 6.3 percent from 506,589 metric tonnes in 2005/06 to 474,942 metric tonnes in 2006/07. Similarly, total sales of sugar during the period decreased by 5.8 percent from 498,739 metric tonnes in 2005/06 to 469,961 metric tonnes in 2006/07.

Milk deliveries to the dairy processing factories increased by 13.9 percent from 349,759 million litres in 2005/06 to 398,261 million litres in 2006/07. As in the previous financial year, the improved production was attributed to improved regulatory framework in the sector with the revival of the Kenya Cooperative Creameries, and a growing regional market for Kenya's dairy produce.

The recent implementation of structural reforms aimed at improving efficiency and productivity in the coffee, pyrethrum, sugar, cotton and livestock industries, among other sub-sectors, by the Government, is expected to increase output and eventually reduce poverty and unemployment in rural areas.

Manufacturing

The manufacturing sector grew by 6.9 percent in 2006 with improved growth in manufacturing of food, beverages and tobacco. The favourable weather conditions, especially in the second quarter of 2006/07, led to an improved supply of raw materials to the agro-based industries especially dairy and grain milling sub-sectors. As a result of improved economic activity, electricity and fuel consumption increased by 7.3 percent and 1.2 percent, respectively, in 2006/07.

In tandem with increased use of other raw materials, imports of key intermediate inputs, particularly crude oil, chemicals, machinery and transport equipment grew by 9.3 percent, 25.4 percent and 47.4 percent respectively, in the year to June 2007. As shown in Table 1.3, output of cigarettes grew by 10.2 percent, from 12,048,634 milles in 2005/06 to 13,280,558 milles in

2006/07, while beer production increased by 17.7 percent from 278,905,000 litres to 328,345,000 litres during the period.

Likewise, output of soda ash increased by 5.8 percent from 364,760 metric tonnes to 385,756 metric tonnes in the fiscal year 2006/07. Production of cement went up 7.7 percent from 1,584,647 tonnes in the three quarters of 2005/06 to 1,706,173 tonnes in the same period in 2006/07.

TABLE 1.3: PRODUCTION OF SELECTED MANUFACTURED GOODS

PRODUCT	Jun 2003/04	Jun 2004/05	Jun 2005/06	Jun 2006/07
Processed Sugar				
Output (MT)	509,245	507,306	506,589	474,942
Output Growth %	13.15%	-0.38%	-0.14%	-6.25%
Cement Production				
Output (MT)	1,691,483	1,975,464	2,104,918	
Output Growth %	3.18%	16.79%	6.60%	
Soda Ash				
Output (MT)	355,540	357,521	364,760	385,756
Output Growth %	6.98%	0.56%	2.02%	5.76%
Milk				
Output ('000 litres)	239,705	281,336	349,759	398,261
Output Growth %	34.12%	17.37%	24.33%	13.87%
Beer				
Output ('000 litres)	211,038	257,124	278,905	328,345
Output Growth %	9.35%	21.84%	8.47%	17.73%
Cigarettes				
Output (Number of sticks)	8,590,015	10,052,423	12,048,634	13,280,558
Output Growth %	20.34%	17.02%	19.86%	10.22%

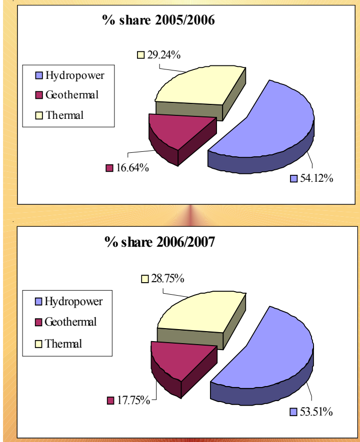
Sources: Kenya National Bureau of Statistics, Sugar Board, Dairy Board, Kenya Revenue Authority and Magadi Soda

Sugar production, however, declined by 6.3 percent during the year 2006/07. The decline was attributed to high production costs which undermined the competitiveness especially with imports.

To promote industrial growth, the Government has progressively introduced tax incentives and duty waivers on capital goods, plant and equipment. The Government also eliminated numerous licenses and fees.

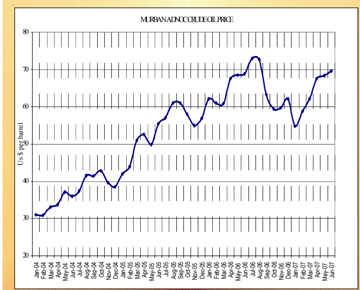
As in the year 2005/06, growth in the manufacturing sector, however, continues to be hampered by high cost of operations due to infrastructural constraints, high and volatile crude oil prices in international markets among other constraints.

CHART 1B: PERCENTAGE SHARE OF ELECTRICITY SOURCES



Source: Kenya Power & Lighting Co.

CHART 1C: SAUDI ARABIAN CRUDE OIL



Source: Ministry of Energy

Energy Sector Developments

Domestic supply of electricity expanded by 7.9 percent from 5,604 million Kilowatt Hours (KWH) in the previous fiscal year, to 6,097 million KWH. The growth in power generation over the last two years is attributed to increased water supply to hydroelectric dams and increased exploitation of thermal and geothermal power sources.

In the petroleum sub-sector, crude oil prices showed signs of stabilization after rapid increases in the past three years. The average price of Murban Adnoc crude oil from Saudi Arabia increased from US $ 68.9 per barrel in June 2006 to US $ 69.7 per barrel in June 2007. At the domestic level, the high international prices led to volatile domestic fuel prices.

Building and Construction

Building and construction grew by 6.3 percent in 2006. Cement consumption, a major input in the construction industry, went up by 8.9 percent from 1,249,392 tonnes in the three quarters of 2005/06 to 1,360,542 tonnes in the same period in 2006/07. In 2007/08, the Government increased its budgetary allocation for road construction, maintenance and rehabilitation activities. This will go a long way in unlocking the potential for growth through improved road network.

Transport

There was a marked improvement in the transport sector as shown in Table 1.4 of the leading indicators in the transport industry.

New registration of motor vehicles grew by 9.8 percent in the first ten months of 2006/07 from 40,171 units in 2005/06 to 53,594 units. Expansion was also achieved in air transport with the incoming passengers through the Jomo Kenyatta International Airport (JKIA) increasing by 7.7 percent in 2006/07 to 1,509,378, while outgoing passengers expanded by 7.1 percent to 1,501,246. The continued improvement in the telecommunications sector manifested itself in 35.25 percent growth in excise duty collection from airtime to reach Ksh 5,360 million in 2006/07. Similarly, the vibrant tourism sector effects are spilling over to the transport sector from a broad perspective, in terms of revenues to consumption of, for instance, more fuels and other factors.

TABLE 1.4: PERFORMANCE OF MAJOR SUB-SECTORS

Activity	Jun 2003/04	Jun 2004/05	Jun 2005/06	Jun 2006/07
Cargo by KPA				
Output (MT)	12,505,385	13,284,921	13,524,051	15,218,665
Output Growth %	9.09%	6.23%	1.28%	12.53%
Passengers through JKIA				
Number of incoming passengers	1,097,084	1,297,660	1,401,225	1,509,378
Growth %	11.00%	18.29%	7.98%	7.72%
Number of outgoing passengers	1,111,067.00	1,327,742.00	1,401,482.00	1,501,246.00
Growth %	10.70%	19.50%	5.55%	7.12%
Cargo by Kenya Railways				
Output (MT)	1,995,059	1,790,225	1,958,138	
Output Growth %	-7.86%	-10.27%	9.40%	
Throughput by Kenya Pipeline				
Output ('000 litres Equivalent)	3,093,366	3,459,298	3,627,232	3,963,076
Output Growth %	9.69%	11.83%	4.90%	9.26%
Excise duty on Airtime				
Output (Ksh Million)	2,068	2,982	3,963	5,360
Growth %	205.47%	44.20%	32.90%	35.25%

Sources: Kenya Ports Authority, Kenya Railways, Kenya Pipeline and Kenya National Bureau of Statistics

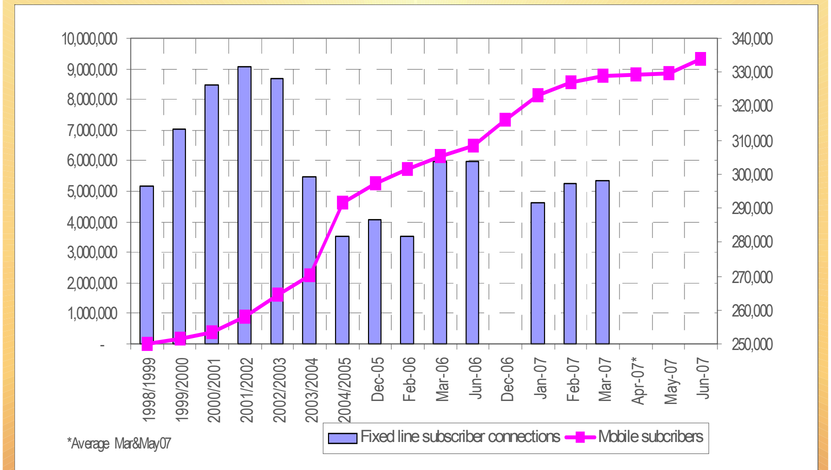
As shown in Table 1.4, pipeline and cargo handling also improved during the financial year. Petroleum products transported by the Kenya Pipeline Company (KPC) increased by 9.3 percent from 3,627,232 cubic meters during 2005/06 to 3,963,076 cubic meters in 2006/07, while cargo handled by the Kenya Ports Authority (KPA) increased by 12.5 percent from 13,524,051 metric tonnes to 15,218,665 metric tonnes in 2006/07.

In November 2006, the Kenya Government and Kenya Railways, through a concession agreement, handed over the railways system to Rift Valley Railways. The concession, as part of a wider infrastructural reform, is expected to lead to cheaper, faster rail transport and movement of goods through the Port of Mombasa.

Telecommunications

Activity in the telecommunications sector continued to improve in 2006/07. Mobile telephone subscribers increased by 43.5 percent from 6,484,791 in June 2006 to 9,304,818 in June 2007. The growth was supported by increased network roll out by the operators as they improved access to rural areas. As a result, excise duty on airtime services rose by 35.3 percent from Ksh 4.0 billion in the fiscal year 2005/06 to Ksh 5.4 billion .

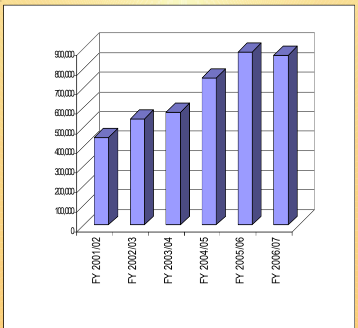
CHART 1D: COMPARATIVE GROWTH OF FIXED AND MOBILE NETWORKS



Source: Communication Commission of Kenya

Tourism

CHART 1E: TOURIST ARRIVALS



Source: Kenya Tourist Board

The tourism sector grew by 14.3 percent in the fiscal year 2006/07, as shown in Table 1.5. A break-down by point of entry indicates that arrivals through Jomo Kenyatta International Airport and Moi International Airport, Mombasa, increased by 14.7 percent and 12.5 percent, respectively, compared with 15.2 percent and 25.1 percent in 2005/06. The good performance followed strategic marketing by the Kenya Tourist Board (KTB), especially in non-traditional markets, improved markets and product diversification. Arrivals by cruise ships in 2006/07 declined by 5.1 percent from 9.7 percent in 2005/06.

TABLE 1.5: TOURIST ARRIVALS BY POINT OF ENTRY

	FY 2004/05	FY 2005/06	FY 2006/07
Cruise ships	5,615	6,161	5,849
Output Growth %	172.18%	9.72%	-5.06%
JKIA	553,437	637,545	731,252
Output Growth %	33.98%	15.20%	14.70%
MIAM	194,572	243,425	273,877
Output Growth %	20.62%	25.11%	12.50%
Total	**753,624**	**884,728**	**1,010,978**
Output Growth %	30.74%	17.40%	14.28%

FY - Fiscal year
Source: Kenya Tourist Board

Uses of Available Resources

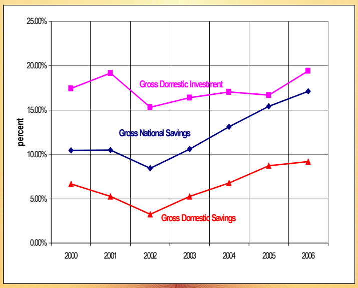
Resources available in the economy measured as gross national disposable income amounted to 107.9 percent of GDP at current prices in 2006 compared with 106.7 percent of GDP in 2005 (Table 1.6). The increase partly resulted from an increase in net current transfers from 6.7 percent of GDP in 2005 to 7.9 percent of GDP. Total output by all sectors also grew by 6.1 percent compared with 5.7 percent in 2005.

TABLE 1.6: USE OF RESOURCES (KSH MILLION)

	2002	2003	2004	2005	2006
Gross national disposable income	1,077,425	1,198,942	1,357,301	1,533,151	1,766,998
Net current transfers	53,325	67,609	80,856	95,868	129,646
Gross national income	1,024,099	1,131,333	1,276,445	1,437,283	1,637,352
Net factor income payments (Y(f))	-11,275	-6,728	-10,017	-8,194	-5053
Gross domestic product (at market price	1,024,099	1,138,061	1,276,445	1,437,283	1,637,352
Total Consumption (C)	990,774	1,078,028	1,189,979	1,311,878	1,486,743
Government consumption - C(g)	176,821	205,207	228,044	247,263	267,068
Private consumption - C(p)	813,953	872,821	961,935	1,064,615	1,219,675
Gross domestic investment (I)	156,737	186,542	217,742	239,630	317,830
Gross fixed capital formation	178,466	179,254	207,196	264,912	309,402
Increase/Decrease in stocks	-21,729	7,288	10,546	-25,282	8,428
Exports of goods and nfs (X)	244,468	270,118	336,360	395,787	412,416
Imports of goods and nfs (M)	-314,884	-339,301	-435,844	-523,970	-615,283
GDP deflator (2001=100)	101.0	108.0	116.0	123.0	131.98
Real GDP	1,025,584	1,055,658	1,109,338	1,172,784	1,244,445
Real GDP growth (annual in %)	0.03%	2.90%	5.10%	5.70%	6.10%
Gross National savings	86,650	120,914	167,322	221,273	280,255
Gross Domestic Savings	33,325	60,033	86,466	125,405	150,609
Total National Balance(S-I)	-70,087	-65,628	-50,420	-18,357	-37,575
CAB (X-M+Y(f)+TR(f))	-28,366	-8,302	-28,645	-40,509	-78,274
Discrepancy	-41,721	-57,326	-21,775	22,152	40,699
CAB + DISCREPANCY	-70,087	-65,628	-50,420	-18,357	-37,575
Kenya - National Accounts					
In shares of GDP	2002	2003	2004	2005	2006
Gross national disposable income	105.21%	105.35%	106.33%	106.67%	107.92%
Net current transfers (TR(f))	5.21%	5.94%	6.33%	6.67%	7.92%
Gross national income	100.00%	99.41%	100.00%	100.00%	100.00%
Net factor income payments (Y(f))	-1.10%	-0.59%	-0.78%	-0.57%	-0.31%
Gross domestic product (GDP)					
Gross Domestic Product (expend)					
Total Consumption ©	96.75%	94.72%	93.23%	91.27%	90.80%
Government consumption - C(g)	17.27%	18.03%	17.87%	17.20%	16.31%
Private consumption - C(p)	79.48%	76.69%	75.36%	74.07%	74.49%
Gross domestic investment (I)	15.30%	16.39%	17.06%	16.67%	19.41%
Gross fixed capital formation	17.43%	15.75%	16.23%	18.43%	18.90%
Increase/Decrease in stocks	-2.12%	0.64%	0.83%	-1.76%	0.51%
Exports of goods and services (X)	23.87%	23.73%	26.35%	27.54%	25.19%
Imports of Goods and services (M)	-30.75%	-29.81%	-34.15%	-36.46%	-37.58%
Gross National savings	8.46%	10.62%	13.11%	15.40%	17.12%
Gross Domestic Savings	3.25%	5.28%	6.77%	8.73%	9.20%

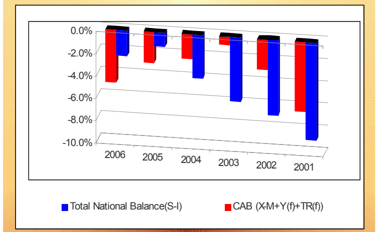
Source: Economic Survey, 2007

CHART 1F: SAVINGS AND INVESTMENT (% OF GDP)



Source: Economic Survey, 2007

CHART 1G: CAB/TOTAL NATIONAL BALANCE GDP RATIO



Source: Central Bank of Kenya

The resources were allocated to consumption, investment and savings. Gross domestic investment increased from 16.7 percent of GDP in 2005 to 19.4 percent of GDP in 2006. The increase in gross domestic investment in 2006 was largely in gross fixed capital formation, which increased from 18.4 percent of GDP in 2005 to 18.9 percent of GDP in 2006. Investment or gross national savings, defined as gross national disposable income less total consumption, increased from 15.4 percent of GDP in 2005 to 17.1 percent of GDP in 2006. Gross domestic savings, that is, gross domestic product less domestic consumption, went up from 8.7 percent of GDP in 2005 to 9.2 percent of GDP in 2006.

The increase in availability of resources in 2006 led to a pick up in aggregate demand, reflected in the increase in total consumption in 2006. Government consumption accounted for 16.3 percent of GDP, down from 17.2 percent of GDP in 2005.

More resources were used for private sector consumption than for consumption by Government in 2006. Private sector consumption accounted for 74.5 percent of GDP in 2006 compared to 74.1 percent of GDP in 2005.

2. CAPITAL FLOWS

Official Development Assistance to Developing Countries

Net disbursements of Official Development Assistance (ODA) by the Development Assistance Committee (DCA) of the OECD declined from US$ 107 billion in 2005 to US$ 104 billion in 2006 (Table 2.1). This decline reflects a return of debt relief to normal levels following Paris Club agreements with Iraq and Nigeria in 2005 and 2006 (Global Development Finance, 2007). However, ODA to Sub-Saharan African countries has risen since 2000 from US$ 12.5 billion to US$ 32 billion in 2006. This increase was largely in the form of debt relief.

TABLE 2.1: NET DISBURSEMENTS OF OFFICIAL DEVELOPMENT ASSISTANCE: 2000-2006 (US$ BILLIONS)

	2000	2001	2002	2003	2004	2005	2006*
All Donors	54.9	53.6	61.5	72.5	83.2	120.4	...
DAC Donors	53.7	52.4	58.3	69.1	79.4	106.8	103.9
Non-DAC Donors	1.1	1.2	3.2	3.4	3.8	4.2	...

Sources: Global Development Finance (2007)

Net Private Capital Flows to Developing Countries

The decline in ODA to developing countries coincided with increased private capital flows to these countries. Net private capital flows to developing countries increased from US$ 204 billion in 2005 to US$ 228 billion in 2006 (Table 2.2), largely reflecting increased bank credit by US$ 26 billion to US$ 112 billion, which was mainly to the banking, oil and gas, and mining sectors. Bank loan commitments were mostly concentrated in Europe and Central Asia, and Latin America and the Caribbean. Private bond flows to developing countries, however, declined in 2006 due mainly to sovereign debt buybacks in Latin America. Most of the private bond flows went to Europe and Central Asia. Net short term private debt flows to developing countries rose to US$ 72 billion and was concentrated in East Asia and Pacific countries, Europe and Central Asia.

TABLE 2.2: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES: 2000-2006 (US$ Billion)

	2000	2001	2002	2003	2004	2005	2006*
1. Net private capital flows (1.1 + 1.2)	**7.1**	**-12.1**	**6.3**	**89.8**	**154.8**	**203.9**	**228.0**
1.1 Private medium and long term debt flows	13.4	11.6	5.8	34.8	86.4	136.2	156.0
of which: bonds	20.9	10.3	10.4	24.7	39.8	55.1	49.3
banks	-3.8	7.8	2.3	14.5	50.6	86.0	112.2
others	-3.7	-6.5	-6.9	-4.4	-4.0	-4.9	-5.5
1.2 Net short term debt flows	-6.3	-23.7	0.5	55.0	68.4	67.7	72.0

* Estimate

Sources: Global Development Finance (2007)

Net Foreign Direct Investment (FDI) Flows to Developing Countries

Net Foreign Direct Investment (FDI) flows to developing countries rose from US$ 281 billion in 2005 to US$ 325 billion in 2006, owing to favorable global economic conditions, and improved policy environment in developing countries, which was characterized by reduced restrictions on foreign ownership and privatization in the banking and telecommunication sectors.

Net FDI flows to Europe and Central Asia accounted for 36 percent of net FDI flows to developing countries in 2006 and amounted to US$ 116 billion. Twenty seven percent (27) of net FDI flows or US$ 88 billion went to East Asia and Pacific countries, while 21 percent or US$ 69 billion went to Latin America and the Caribbean. South Asia, Middle Eastern and North African countries collectively absorbed 10 percent of net FDI flows to developing countries, while Sub-Saharan Africa absorbed 4 percent.

TABLE 2.3: NET FDI INFLOWS TO DEVELOPING COUNTRIES: 2000 - 2006

	2000	2001	2002	2003	2004	2005	2006*
East Asia & Pacific	45.1	47.7	57.0	53.5	65.8	96.4	88.3
Europe & Central Asia	25.2	25.4	26.4	34.2	62.7	73.2	116.4
Latin America & the Caribbean	79.8	70.6	51.0	43.0	62.5	70.0	69.4
South Asia	4.4	6.1	6.7	5.6	7.3	9.9	12.9
Middle East & North Africa	4.8	4.1	4.9	8.1	6.8	13.8	19.2
Sub-Saharan Africa	***3.5***	***12.1***	***5.3***	***9.1***	***7.1***	***13.8***	***12.5***
Kenya	***0.11***	***0.01***	***0.02***	***0.08***	***0.04***	***0.01***	***0.03***
Total	**166.5**	**171.0**	**157.0**	**160.0**	**217.8**	**280.8**	**324.7**

* Estimate

Sources: Global Development Finance (2007) & Economic Survey 2007

Net Portfolio (Equity) Flows to Developing Countries

Net portfolio (equity) flows to developing countries increased from US$ 67 billion in 2005 to US$ 94 billion in 2006 supported by growing demand from institutional investors. The biggest share of these flows went to East Asia and Pacific, Latin America and the Caribbean countries. Net portfolio flows to East Asia and Pacific countries rose to US$ 48 billion in 2006 as net flows to Latin America and the Caribbean decreased to US$ 11 billion (Table 2.4). Net portfolio flows to Sub-Saharan Africa increased from US$ 7 billion in 2005 to US$ 13 billion in 2006. Net portfolio flows to Kenya also improved from a net outflow of US$ 0.03 billion in 2005 to a net outflow of US$ 0.02 billion in 2006.

TABLE 2.4: NET PORTFOLIO EQUITY FLOWS TO DEVELOPING COUNTRIES: 2000-2006 (US$ BILLION)

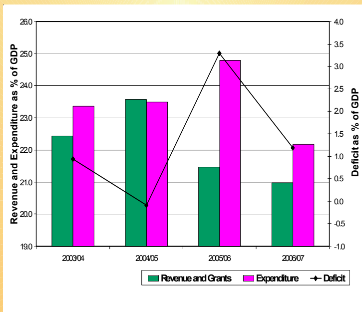
	2000	2001	2002	2003	2004	2005	2006*
East Asia & Pacific	6.6	1.8	3.8	12.5	19.0	26.1	48.4
Europe & Central Asia	0.6	-0.4	0.1	-0.6	5.3	6.3	10.5
Latin America & the Caribbean	-0.6	2.5	1.4	3.4	-0.6	12.4	11.1
South Asia	2.4	2.7	1.0	8.0	8.8	12.2	10.0
Middle East & North Africa	0.2	-0.1	-0.3	0.3	0.7	2.3	1.6
Sub-Saharan Africa	**4.2**	**-0.9**	**-0.4**	**0.7**	**6.7**	**7.4**	**12.5**
Kenya	**-0.01**	**0.00**	**0.00**	**-0.04**	**-0.07**	**-0.03**	**-0.02**
Total net Flows	**13.4**	**5.6**	**5.8**	**24.3**	**39.9**	**66.7**	**94.1**

* Estimate

Source: Global Development Finance (2007) & Economic Survey 2007

3. FINANCING OF THE GOVERNMENT

CHART3A: GOVERNMENT BUDGET PERFORMANCE



Sources: Central Bank of Kenya and Treasury

Due to significant growth in tax revenue and lower than budgeted Government expenditure, Government budgetary operations in the fiscal year 2006/07 resulted in a lower overall budget deficit (including grants) of Ksh 21.6 billion or 1.2 percent of GDP on commitment basis, compared with Ksh 51.5 billion or 3.3 percent of GDP in the fiscal year 2005/06. As shown in Table 3.1 and Chart 3A, the deficit was also lower than the revised budget target for the fiscal year of Ksh 67.2 billion or 3.7 percent of GDP. During the fiscal year, the Government increased its expenditure on development projects resulting in a decline in the proportion of recurrent expenditure and a sustained increase in the proportion of development expenditure.

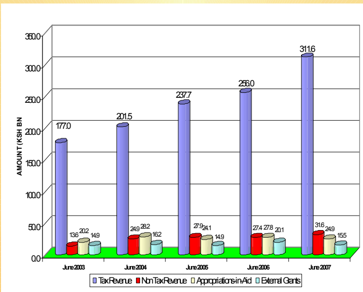
TABLE 3.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS

	FY 2003/2004	FY 2004/2005	FY 2005/2006	FY 2006/2006		
	Actual	Actual	Actual	Prov.	Rev. Target	Over(+) / Below (-)
1. REVENUE	**270.9**	**304.6**	**331.3**	**383.6**	**415.5**	**-31.9**
Revenue	254.7	289.7	311.3	368.1	381.0	-12.9
Tax Revenue	201.5	237.7	256.0	311.6	308.6	3.0
Non Tax Revenue	24.9	27.9	27.4	31.6	37.1	-5.5
Appropriations-in-Aid	28.2	24.1	27.8	24.9	35.3	-10.4
External Grants	16.2	14.9	20.1	15.5	34.5	-19.0
2. EXPENSES	**282.2**	**303.4**	**382.8**	**405.2**	**483.4**	**-78.2**
Recurrent Expenditure	244.5	257.7	315.2	324.1	359.1	-35.0
Development Expenditure	37.7	45.6	67.7	81.1	124.3	-43.2
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-11.3**	**1.2**	**-51.5**	**-21.6**	**-67.9**	**46.3**
Deficit on a commitment basis as a % of GDP	-0.9	0.1	-3.3	-1.2	-3.7	
4. ADJUSTMENT TO CASH BASIS	**11.4**	6.1	15.0	-16.9	**0.7**	**-17.6**
5. DEFICIT ON A CASH BASIS	**0.1**	**7.3**	**-36.5**	**-38.5**	**-67.2**	**28.7**
Deficit on a cash basis as a % of GDP	0.0	0.6	-2.4	-2.1	-3.7	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**0.0**	**0.0**	**0.0**	**-1.6**	**0.0**	
7. FINANCING	**-0.1**	**-7.3**	**36.5**	**37.0**	**67.2**	**-30.3**
Domestic (Net)	8.8	-6.7	28.3	34.7	32.8	1.9
External (Net)	-8.9	-0.6	1.3	-1.7	16.2	-17.9
Capital Receipts (privatisation)	0.0	0.0	7.0	4.0	18.2	-14.2
Others	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Central Bank of Kenya and Treasury

Revenue

CHART 3B: COMPOSITION OF REVENUE



Sources: Central Bank of Kenya and Treasury

Due to improved economic performance, implementation of tax administration reforms and modernisation programs at the Kenya Revenue Authority (KRA), the robust growth in Government revenue witnessed since the fiscal year 2003/2004 was sustained in the fiscal year 2006/2007. Consequently, Government revenue and grants grew by 15.8 percent from Ksh 331.3 billion in the fiscal year 2005/06 to Ksh 383.6 billion in the fiscal year 2006/07 (Chart 3B). However, expressed as a proportion of GDP, Government revenue and grants declined from 21.5 percent to 21.0 percent during the period following a decline in grants and appropriations-in-aid received compared with the previous year.

Tax revenue increased from Ksh 256.0 billion in the fiscal year 2005/06 to Ksh 311.6 billion in the fiscal year 2006/07. This represented an increase of Ksh 55.6 billion or growth of 21.7 percent during the period. Similarly, non-tax revenue grew by 15.2 percent from Ksh 27.4 billion to Ksh 31.6 billion during the period. However, appropriations-in-aid (AIA), otherwise known as user fees and charges, declined from Ksh 27.8 billion in the fiscal year 2005/06 to Ksh 24.9 billion in the fiscal year 2006/07. This result was below expectation as the targeted AIA was Ksh 35.3 billion in the fiscal year 2006/07.

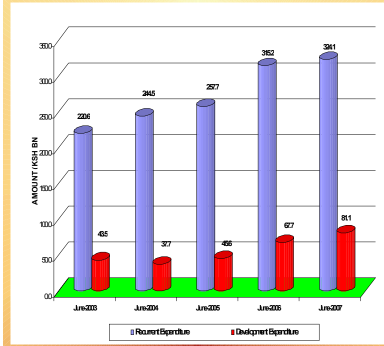
Government receipts of external grants decreased from Ksh 20.1 billion in the fiscal year 2005/06 to Ksh 15.5 billion in the fiscal year 2006/07. The reduced inflow of external grants during the year could be attributed largely to low absorption capacity of external resources which has in turn decreased utilisation of the donor commitments by the Government. Consequently, the disbursement of the grants was 44.9 percent of the expected Ksh 34.5 billion in the fiscal year 2006/07. The Government is in the process of developing an External Aid Policy which will address among other things, the low absorption of external loans and grants.

Following these developments, the proportion of tax revenue in total revenue and grants increased from 77.3 percent in the fiscal year 2005/06 to 81.2 percent in the fiscal year 2006/07. However, the proportions of non-tax revenue, AIA and external grants in total revenue and grants dropped from 8.3 percent, 8.4 percent and 6.1 percent to 8.2 percent, 6.5 percent and 4.0 percent, respectively, during the period.

Expenditure and Net Lending

Government expenditure and net lending increased from Ksh 382.8 billion in the fiscal year 2005/06 to Ksh 405.2 billion in the fiscal year 2006/07. This represented a rise of Ksh 22.4 billion or growth of 5.8 percent in Government expenditure during the period. As shown in Table 3.1 and Chart 3C, the increase in overall expenditure during the period was attributed to increases of Ksh 13.4 billion and Ksh 9.0 billion in development and recurrent expenditures respectively. Recurrent expenditure increased mainly due to increased outlays for improvement of terms of service for civil servants, and to meet expenses on interest

CHART 3C: GOVERNMENT EXPENDITURE



Sources: Central Bank of Kenya and Treasury payments on domestic debt. Overall Government expenditure has increased over the last three fiscal years partly to finance free primary education in public schools and infrastructure rehabilitation.

Despite the rise in Government expenditure, total expenditure and net lending declined from 24.8 percent of GDP in the fiscal year 2005/06 to 22.2 percent of GDP in the fiscal year 2006/07. This was attributed mainly to a faster growth in GDP compared with the growth in expenditure during the period. During the period, recurrent expenditure dropped from 20.4 percent of GDP to 17.7 percent while development expenditure remained unchanged at 4.4 percent of GDP.

Following these developments, the proportion of development expenditure in total expenditure increased from 17.7 percent in the fiscal year 2005/06 to 20.0 percent in the fiscal year in 2006/07. However, the proportion of recurrent expenditure in total expenditure dropped from 82.3 percent to 80.0 percent during the period.

The increase in development expenditure during the fiscal year 2006/07 was attributed largely to increased expenditure towards improvement of roads, access to water, energy, and telecommunications. This is consistent with the Government fiscal policy objective of shifting resources towards development outlays in order to promote public investment to sustain economic recovery.

Financing

Government budgetary operations during the fiscal year 2006/07 resulted in a financing requirement of Ksh 44.3 billion which is lower compared with a requirement of Ksh 57.5 billion in the fiscal year 2005/06. As shown in Table 3.2, the Ksh 44.3 billion financing requirement was to finance a budget deficit of Ksh 37.0 billion, make external debt repayments of Ksh 1.7 billion, and repay domestic debt amounting to Ksh 5.6 billion owed to the Central Bank of Kenya. The Ksh 44.3 billion financing requirement was sourced through net domestic borrowing of Ksh 7.3 billion from commercial banks; Ksh 14.9 billion from non-banks, Ksh 18.1 billion through draw down of Government deposits at the Central Bank of Kenya, and Ksh 4.0 billion from privatisation proceeds from sale of Government shares in the

Mumias Sugar Company. The Government had anticipated a total of Ksh 18.2 billion from privatization but only Ksh 4 billion was realised due to suspension of further divestiture in KenGen and delay in privatising Kenya Reinsurance Corporation.

TABLE 3.2: GOVERNMENT OVERALL BORROWING REQUIREMENTS AND ITS SOURCES (KSH BN)

I. FINANCING REQUIREMENTS	2003/04	2004/05	2005/06	2006/07
1. Budget deficit	-	-	36.5	37.0
2. External debt reduction	8.9	0.6	-	1.7
3. Domestic debt reduction	3.2	19.6	5.6	5.6
3.1 Central Bank (incl. items in transit)	-	4.3	5.6	5.6
3.2 Commercial banks (net of deposits)	-	15.3	-	-
3.3 Non-bank sources	3.2	-	-	-
4. Increase in GoK deposits at CBK	4.7	6.1	15.4	-
TOTAL	**16.7**	**26.4**	**57.5**	**44.3**
II. FINANCING SOURCES	**2003/04**	**2004/05**	**2005/06**	**2006/07**
1. Budget surplus	0.1	7.3	-	-
2. External debt increase	-	-	1.3	-
3. Increase in domestic debt	16.7	19.1	49.3	22.2
3.1 Central Bank	5.7	-	-	-
3.2 Commercial banks	10.9	-	27.1	7.3
3.3 Non-bank sources	-	19.1	22.1	14.9
4. Reduction in GoK deposits at CBK	-	-	-	18.1
5. Privatisation proceeds	-	-	7.0	4.0
TOTAL	**16.7**	**26.4**	**57.5**	**44.3**

Source: Treasury and Central Bank of Kenya

Outlook for the Fiscal Year 2007/08

Boosted by the expected good performance of the economy and continued implementation of tax administration reforms, Government revenue is projected to grow to Ksh 428.9 billion or 20.8 percent of GDP during the fiscal year 2007/08. Similarly, external grants are projected at Ksh 40.3 billion or 2.0 percent of GDP during the fiscal year. Government expenditure is projected at Ksh 580.4 billion or 28.2 percent of GDP during the fiscal year and will comprise Ksh 411.2 billion or 20.0 percent of GDP in recurrent expenditure and Ksh 169.2 billion or 8.2 percent of GDP in development expenditure.

Consequently, overall budget deficit including grants is projected at Ksh 109.8 billion or 5.3 percent of GDP in the fiscal year. The higher deficit compared with that in the previous fiscal year largely reflects the substantial rise in development expenditure. The deficit will be financed through net external borrowing of Ksh 39.8 billion, net domestic borrowing totaling Ksh 33.9 billion and net privatization receipts amounting to Ksh 36.0 billion. The net domestic borrowing requirement of 1.6 percent of GDP in the fiscal year 2007/08 is lower than the 1.9 percent of GDP in the fiscal year 2006/07 and is consistent with the medium-term target of 1.5 percent of GDP.

4 PUBLIC DEBT

Kenya's public and publicly guaranteed debt increased from Ksh 789.1 billion at the end of June 2006 to Ksh 801.3 billion at the end of June 2007 (Table 4.1). This represented an increase of Ksh 12.2 billion or growth of 1.5 percent during the fiscal year 2006/07. The increase in the stock of debt during the fiscal year was attributed to an increase of Ksh 46.9 billion in domestic debt, which was partly offset by a decrease of Ksh 34.7 billion in external debt. Domestic debt increased during the fiscal year mainly due to planned domestic borrowing to finance the budget deficit while the decrease in external debt was attributed largely to strengthening of the Kenya shilling.

TABLE 4.1: PUBLIC DEBT (KSH BN)

	June 2004		June 2005		June 2006*		June 2007**	
	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT								
Securitised debt	**289.6**	**94.6**	**302.3**	**95.8**	**349.7**	**97.7**	**402.9**	**99.6**
Treasury Bills	99.8	32.6	107.8	34.2	130.3	36.4	130.0	32.1
Of which Repo Treasury bil	36.9	12.0	35.9	11.4	35.5	9.9	35.5	8.8
Treasury Bonds	188.6	61.6	193.4	61.3	218.4	61.0	272.2	67.3
Government Stocks	1.1	0.4	1.1	0.3	1.1	0.3	0.8	0.2
Non Securitised debt	**16.7**	**5.4**	**13.3**	**4.2**	**8.1**	**2.3**	**1.8**	**0.4**
Overdraft/Advances	16.7	5.4	13.3	4.2	8.1	2.3	1.8	0.4
others	0.02	0.01	0.02	0.01	0.02	0.00	0.00	0.00
TOTAL DOMESTIC DEBT	**306.2**	**100.0**	**315.6**	**100.0**	**357.8**	**100.0**	**404.7**	**100.0**
(as a % of Total Debt	40.9		42.1		45.3		50.5	
EXTERNAL DEBT**								
Bilateral	162.9	36.8	157.7	36.3	154.9	35.9	137.9	34.8
Multilateral	260.7	58.8	255.8	58.9	255.5	59.3	240.3	60.6
Comm. Banks	2.9	0.7	1.8	0.4	1.3	0.3	0.3	0.1
Export Credit	16.7	3.8	19.2	4.4	19.5	4.5	18.0	4.5
TOTAL EXTERNAL DEBT	**443.2**	**100.0**	**434.5**	**100.0**	**431.2**	**100.0**	**396.6**	**100.0**
(as a % of Total Debt	59.1		57.9		54.7		49.5	
TOTAL PUBLIC DEBT	**749.4**		**750.0**		**789.1**		**801.3**	
(as a % of GDP)	62.0		58.0		51.1		43.8	

* External debt stock Revised
** Provisional

Sources: Central Bank of Kenya and Treasury

There was a shift in the composition of the overall debt at the end of the fiscal year 2006/07, with domestic debt accounting for the larger proportion. As a proportion of total debt, domestic debt increased from 40.9 percent at the end of June 2004 to 45.3 percent at the end of June 2006, and further to 50.5 percent at the end of June 2007. External debt, on the other hand, dropped from 59.1 percent of total debt in June 2004 to 49.5 percent in June 2007. This was partly due to lower external financing and partly due to the strengthening of the Kenya Shilling resulting in a reduction in external debt in Kenya shilling terms.

Despite the growth in the stock of debt during the fiscal year 2006/07, the ratio of the overall debt stock to GDP declined from 51.1 percent at the end of June 2006 to 43.8 percent at

Table 4.2: Public Debt to GDP Ratios

	June 2004	June 2005	June 2006*	June 2007**
	Ksh bn	Ksh bn	Ksh bn	Ksh bn
DOMESTIC DEBT	**306.2**	**315.6**	**357.8**	**404.7**
(as a % of GDP	25.4	24.4	23.2	22.1
EXTERNAL DEBT	**443.2**	**434.0**	**431.2**	**396.6**
(as a % of GDP	36.7	33.6	27.9	21.7
TOTAL PUBLIC DEBT	**749.4**	**749.5**	**789.1**	**801.3**
(as a % of GDP)	62.0	58.0	51.1	43.8

* External debt stock Revised

** Provisional

Sources: Central Bank of Kenya and Treasury

the end of June 2007. External debt to GDP ratio declined from 27.9 percent to 21.7 percent while domestic debt to GDP ratio fell from 23.2 percent to 22.1 percent during the period. Both domestic and external debt, therefore, declined as a proportion of GDP, resulting in an overall decline in debt to GDP ratio. The drop in the debt to GDP ratio during the period was attributed mainly to a faster growth in GDP. This development is consistent with the Government debt management objective of ensuring a stable or declining debt to GDP ratio in order to achieve and maintain sustainable public debt.

To ensure effective debt management, the Government in collaboration with Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI) and Debt Relief International (DRI), organised the National Debt Sustainability Analysis workshop which was held in Nairobi in May 2007.

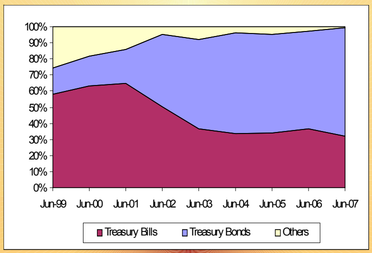
The workshop provided comprehensive training to Government officials in the analysis of debt as well as drafting of the first national debt strategy. The results of the Debt Sustainability Analysis indicated that Kenya's debt is sustainable in the medium to long term. However, to ensure that the debt remains sustainable, the Government should strive to contract most of its new debt from external sources on concessional terms, and also devise a framework for recording and monitoring contingent liabilities due to the high risk they pose on the sustainability of domestic debt. A recent survey by the Ministry of Finance revealed that domestic contingent liabilities stood at 7.0 percent of GDP at the end of June 2006. Since some of the contingent liabilities are normally settled through issuance of domestic debt instruments, they pose a risk to domestic debt sustainability.

Public Domestic Debt

Public domestic debt increased by 13.1 percent from Ksh 357.8 billion at the end of June 2006 to Ksh 404.7 billion at the end of June 2007. The rise in domestic debt during the period was attributed to the success of the Government domestic borrowing programme. The Treasury bills and bonds auctions realized average oversubscriptions of 39.5 percent and 77.6 percent respectively compared with 36.8 percent and 41.6 percent respectively in the fiscal year 2005/06.

The success of the domestic borrowing programme was attributed mainly to the stability of interest rates on Government securities during the fiscal year coupled with improved liquidity following increased participation by institutional investors such as pension funds and insurance firms in the Government securities market.

CHART 4A:COMPOSITION OF GOVERNMENT DOMESTIC DEBT



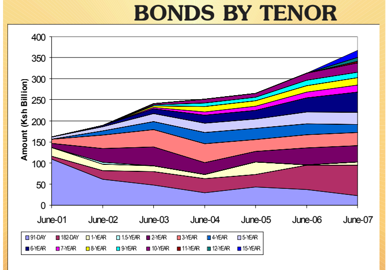
Sources: Central Bank of Kenya and Treasury

The proportion of Treasury bonds in total domestic debt increased from 61.0 percent at the end of June 2006 to 67.3 percent at the end of June 2007 (Chart 4A). Furthermore, outstanding Treasury bonds increased from Ksh 218.4 billion at the end of June 2006 to Ksh 272.2 billion at the end of June 2007. The rise in the stock of Treasury bonds during the period followed emphasis in the use of Treasury bonds for new domestic borrowing and the issuance of Treasury bonds totalling Ksh 20.0 billion in June 2007 to the National Bank of Kenya. Consequently, Treasury bills (including Repos) decreased from Ksh 130.3 billion to Ksh 130.0 billion, and the proportion of Treasury bills in total domestic debt dropped from 36.4 percent to 32.1 percent during the period.

Due to the rise in the stock of Treasury bonds, the average maturity of domestic debt increased from 2 years and 2 months at the end of June 2006 to 3 years and 1 month at the end of June 2007. This is consistent with the Government debt management strategy of restructuring domestic debt from the short-dated Treasury bills to the longer-dated Treasury bonds in order to reduce the risks associated with short term borrowing.

The rise in the average debt maturity in the fiscal year 2006/07 followed successful issuance of longer dated Treasury bonds with tenors of up to 15 years. The Government issued 12-year and 15-year Treasury bonds during the fiscal year, both of which were oversubscribed. The success of the 15-year bond reflects increased appetite for longer dated Treasury bonds by institutional investors comprising pension funds and insurance companies as they seek to match their long term liabilities with long term assets.

CHART 4B: OUTSTANDING TREASURY BILLS & BONDS BY TENOR



Sources: Central Bank of Kenya

The Government made significant progress towards deepening the bond market during the fiscal year 2006/07 (Chart 4B). Consequently, the proportion of Treasury bonds with tenors of

10-years and above increased from 7.8 percent at the end of June 2006 to 19.0 percent at the end of June 2007. Furthermore, 2-year Treasury bonds, which had accounted for the largest proportion of Treasury bonds at the end of June 2006, dropped from 18.2 percent of outstanding Treasury bonds at the end of June 2006 to 13.8 percent at the end of June 2007. The largest proportion of outstanding Treasury bonds at the end of June 2007 was held in 6-year bonds which accounted for 17.8 percent, up from 15.2 percent at the end of June 2006.

Tables 4.3 and 4.4 gives trends in holdings of Treasury bills and Treasury bonds by key categories. It is important to note that Treasury bills holdings by commercial banks dropped from 36.1 percent in June 2006 to 34.7 percent in June 2007, while their holdings of Treasury bonds increased from 45.9 percent to 51.7 percent during the period. These developments imply that the Government has substantially reduced the rollover and interest rate risks on domestic debt. As part of the process of deepening the Government securities market, the Master

TABLE 4.3: OUTSTANDING STOCK OF TREASURY BILLS BY HOLDER (KSH BN)

Holders		Jun-05		Jun-06		Jun-07	
		Ksh	%	Ksh	%	Ksh	%
Banking Institutions		68.7	63.7	83.3	63.9	80.8	62.2
	Central Bank*	35.9	33.3	35.7	27.4	35.6	27.4
	Comm. Banks	31.9	29.5	47.0	36.1	45.1	34.7
	NBFIs	0.9	0.8	0.5	0.4	0.2	0.2
Insurance Companies		7.7	7.1	11.0	8.5	13.5	10.4
Parastatals		6.9	6.4	11.2	8.6	9.0	6.9
of which NSSF		0.1	0.1	0.6	0.5	0.2	0.1
Building Societies		0.2	0.2	0.5	0.4	0.6	0.5
Others		24.4	22.6	24.2	18.6	26.0	20.0
Total		**107.8**	**100.0**	**130.3**	**100.0**	**130.0**	**100.0**

* Includes Repo Treasury bills

Source: Central Bank of Kenya

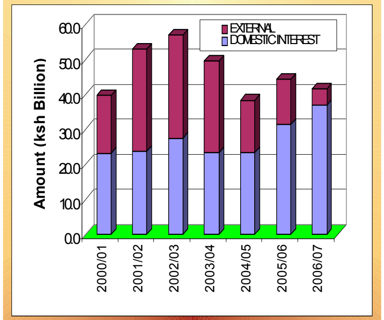
TABLE 4.4: OUTSTANDING STOCK OF TREASURY BONDS BY HOLDER (KSH BN)

Holders		Jun-05		Jun-06		Jun-07	
		Ksh	%	Ksh	%	Ksh	%
Banking Institutions		86.5	44.7	101.0	46.3	141.5	52.0
	Central Bank	0.0	0.0	0.0	0.0	0.0	0.0
	Comm. Banks	84.4	43.6	100.1	45.9	140.7	51.7
	NBFIs	2.1	1.1	0.9	0.4	0.9	0.3
Insurance Companies		26.1	13.5	26.4	12.1	27.5	10.1
Parastatals		16.6	8.6	23.2	10.6	27.3	10.0
of which NSSF		2.8	1.4	4.9	2.2	6.8	2.5
Building Societies		2.7	1.4	1.8	0.8	1.3	0.5
Others		61.5	31.8	65.9	30.2	74.6	27.4
Total		**193.4**	**100.0**	**218.4**	**100.0**	**272.2**	**100.0**

Source: Central Bank of Kenya

Repurchase Agreement (MRA) among commercial banks was operationalised.

CHART 4C: INTEREST PAYMENTS ON PUBLIC DEBT



Sources: Central Bank of Kenya and Treasury

Domestic Debt Service

Reflecting the rise in domestic debt, Government expenditure on interest and other charges on domestic debt increased from Ksh 31.4 billion in the fiscal year 2005/06 to Ksh 36.9 billion in the fiscal year 2006/07 (Chart 4C). As a ratio of ordinary Government revenue, domestic interest payments increased from 8.6 percent to 11.9 percent during the period. Domestic interest payments on new domestic borrowing increased from Ksh 10.4 billion in the fiscal year 2005/06 to Ksh 13.3 billion in the fiscal year 2006/07.

Public and Publicly Guaranteed External Debt

Kenya's external debt has been on a downward trend since June 2004, reflecting reduced access to external financing and strengthening of the Kenya shilling (Table 4.5). This trend continued in the fiscal year 2006/07 with external debt falling by 8.0 percent from Ksh 431.2 billion at the end of June 2006 to Ksh 396.6 billion at the end of June 2007. The decrease in the debt during the fiscal year 2006/07 reflected principal repayments amounting to Ksh 14.6 billion and revaluation gains of Ksh 32.9 billion, which more than offset the Ksh 12.9 billion external loans disbursements. The disbursements during

CHART 4D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2007

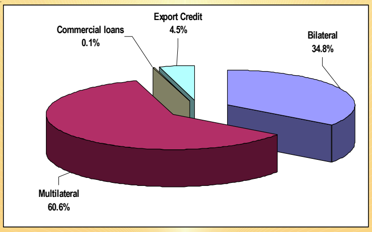
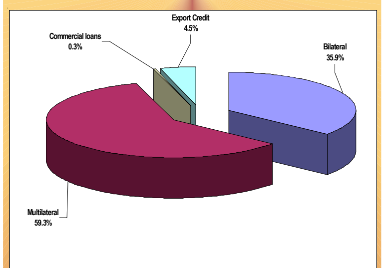


TABLE 4.5: DISTRIBUTION OF EXTERNAL PUBLIC DEBT

	Jun-03	%	Jun-04	%	Jun-05	%	Jun-06	%	Jun-07	%
Bilateral	142.6	35.0	162.9	36.8	157.7	36.3	154.9	35.9	137.9	34.8
Multilateral	233.8	57.4	260.7	58.8	255.3	58.8	255.5	59.3	240.3	60.6
Commercial loans	3.6	0.9	2.9	0.7	1.8	0.4	1.3	0.3	0.3	0.1
Export Credit	27.0	6.6	16.7	3.8	19.2	4.4	19.5	4.5	18.0	4.5
Total	**407.1**	**100.0**	**443.2**	**100.0**	**434.0**	**100.0**	**431.2**	**100.0**	**396.6**	**100.0**

Sources: Central Bank of Kenya and Treasury

CHART 4E: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2006



Sources: Central Bank of Kenya and Treasury

the fiscal year comprised of Ksh 9.0 billion in project loans and Ksh 32.9 billion programme loan from the IMF which was disbursed in April 2007.

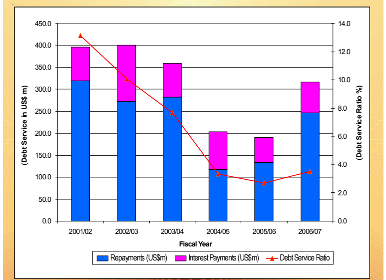
The proportion of external debt owed to multilateral creditors increased from 59.3 percent in June 2006 to 60.6 percent in June 2007, while export credits remained unchanged at 4.5 percent of total external debt. The proportion of the debt owed to bilateral creditors and commercial banks, however, dropped from 35.9 percent and 0.3 percent respectively to 34.8 percent and 0.1 percent respectively during the period (Charts 4D and 4E).

The share of external debt held in US dollars and Sterling pounds at the end of June 2007 remained unchanged at 32.0 percent and 6.0 percent, respectively, as at the end of June 2006. However, the proportion of external debt held in Euros and Japanese Yen decreased from 34.0 percent and 27.0 percent to 33.8 percent and 25.5 percent respectively during the period. The share of external debt held in other currencies including SDRs increased from 1.0 percent to 2.8 percent during the period following receipt of the Ksh 3.9 billion programme loan disbursement from the IMF in April 2007.

External Debt Service

External debt service (including IMF loan repayments) increased from Ksh 12.8 billion or 4.1 percent of ordinary revenue in the fiscal year 2005/06 to Ksh 19.2 billion or 5.2 percent of ordinary revenue in the fiscal year 2006/07. The decrease in external debt service during the period was attributed mainly to the end of the consolidation period in December 2006 for the Paris Club debt re-scheduling under the 2004 agreement. This resulted in an increase in external debt service in the second half of the fiscal year 2006/07. Under the agreement, a total of external debt repayments totalling Ksh 26.0 billion were re-scheduled from January 2004 and December 2006 out of which only Ksh 3.3 billion was re-scheduled in the fiscal year 2006/2007. The external debt service during the fiscal year 2006/07 comprised Ksh 14.6 billion in principal repayments and Ksh 4.6 billion in interest.

CHART4F: EXTERNAL DEBT SERVICE AND DEBT SERVICE RATIO



Sources: Central Bank of Kenya and Treasury

As shown in Chart 4F, external debt service ratio has generally declined since the fiscal year 2001/02 mainly due to faster growth in export earnings compared with debt service payments. However, the debt service ratio increased from 2.7 percent in the fiscal year 2005/06 to 3.5 percent in the fiscal year 2006/

07. As noted earlier, this was attributed to increased debt service following the end of re-scheduling Paris Club debt in December 2006.

Prospects for FY 2007/08

Government domestic and external borrowing during the fiscal year 2007/08 are projected at Ksh 34.0 billion and Ksh 39.8 billion respectively. However, as indicated in the Budget Strategy Paper for 2007/08 to 2009/10, gross domestic debt to GDP ratio at the end of June 2008, is projected to remain unchanged from the end of June 2007 position of 22.4 percent, as GDP is projected to grow at a faster rate than the growth in domestic debt. External debt, on the other hand, is projected to rise slightly from 21.9 percent of GDP at the end of June 2007 to 22.0 percent at the end of June 2008.

The Government will develop a comprehensive debt management strategy by the end of the fiscal year 2007/08 for effective and strategic management of the country's public debt. The strategy is designed to achieve and maintain public debt at sustainable levels while ensuring that the overall borrowing requirements are met at minimum cost, and consistent with a prudent degree of risk.

5. BANKING SECTOR DEVELOPMENTS

Overview

The banking sector remained stable in the period to June 2007. One bank was put under statutory management in June 2006.

Total deposits and assets held by financial institutions grew by 18.9 percent and 19.9 percent respectively. Pre-tax profits also grew by an impressive 30 percent. The stability in the sector was attributed to the favourable macroeconomic environment and stringent supervisory oversight. The introduction of Risk Management Programmes improved standards of credit appraisal and administration of loans and advances. This contributed to the overall decline in the non-performing loans portfolio.

Structure of the Banking Sector

Financial institutions remained at 45, comprising 42 commercial banks, 2 mortgage finance companies and one non-bank financial institution. Family Finance Building Society, the only remaining Building Society converted its operations to a Commercial Bank with effect from April 30, 2007. The period was also characterised by rapid expansion of branch network of banking institutions. During the year, 83 branches for banks were approved. The opening of new branches in rural areas is a manifestation that the banks are now moving downstream. This move coupled with the new products that the banks have been launching are expected to improve access to financial services. Furthermore, the number of forex bureaus increased from 89 to 95 over the same period. The increase in the number of forex bureaus was due to licensing of new forex bureaus in the period under review.

Structure of the Balance Sheet

The balance sheet structure for the banking sector is shown in Table 5.1 below. The banking sector's total assets expanded by 19.9 percent in response to the favourable macroeconomic environment. The growth in assets was funded by an increase in deposits, fresh capital injection and retained profits.

The major components of the asset portfolio were loans and Government securities. Loans and advances constituted 50 percent of total assets in June 2007, while Government securities comprised 22 percent of total assets. Loans were mainly disbursed to private households, transport and communications, building and construction and manufacturing sectors. On the other hand, Treasury Bonds accounted for 71.9 percent of Government securities.

TABLE 5.1: BALANCE SHEET (KSH MILLION)

	June 2007	June 2006	% Change
Assets			
Cash	13,744	11,346	21.1
Balances from CBK	57,890	56,147	3.1
Placements	80,249	50,361	59.3
Govt. securities	184,522	146,309	26.1
Other Investments	6,868	7,697	-10.7
Loans & advances	417,498	362,031	15.3
Foreign Assets	4,484	4,437	1.1
Other assets	68,193	56,815	20
Total Assets	**833,448**	**695,142**	**19.9**
Deposits	682,147	573,459	18.9
Foreign Liabilities	4,753	2,542	86.9
Other liabilities	42,102	32,216	30.7
Capital & Reserves	104,445	86,925	20.2
Total Liabilities and shareholders funds	**833,447**	**695,142**	**19.9**

Source: Published Financial Statements and Disclosures

Non – Performing Loans

Gross non-performing loans declined by 31 percent from Ksh 102.0 billion in June 2006 to Ksh 70.7 billion in June 2007. As a result, asset quality, measured by the ratio of net non-performing loans to gross loans, improved from 5.3 percent in June 2006 to 4.8 percent in June 2007. The decline in the level of non-performing loans was mainly attributed to the repayment by the Government of its guaranteed debts amounting to Ksh 20 billion to the National Bank of Kenya. Enhanced corporate governance and risk management, as well as enforcement of strict provisioning policy by the Central Bank, has also contributed to the reduced level of non-performing loans. The estimated value of securities, at Ksh 22.2 billion, together with provisions amounting to Ksh 27 billion in June 2007, resulted in reduction of the net exposure of the sector to only Ksh 0.5 billion. Non-performing loans therefore, do not pose any significant credit risk exposure to the sector.

Deposit Liabilities

Deposit liabilities in the banking system, including accrued interest increased by 18.9 percent from Ksh 573.5 billion at the end of June 2006 to Ksh 682.1 billion in June 2007. The increase in the deposit base was attributed to branch expansion and aggressive marketing campaigns by some institutions, external donor inflows to various government agencies and non-governmental organizations, and the increase in earnings from tourism and exports. As shown in Table 5.2, demand deposits accounted for 57 percent of total deposits followed by Time and Savings deposits at 29.7 percent and 13.3 percent, respectively.

TABLE 5.2: COMPOSITION OF DEPOSITS (KSH MILLION)

Type of Deposits	Jun-07	Jun-06	Share in 2007	% Change
Demand deposits	**388,403**	**296,385**	**57.0**	**31.0**
Kenya shillings	310,771	236,943	45.6	31.2
Foreign currency	77,632	59,442	11.4	31.0
Time deposits	**202,771**	**170,540**	**29.7**	**18.9**
Kenya Shillings	172,890	169,417	25.3	2.0
Foreign currency	29,881	1,123	4.4	256.0
Savings deposits	**90,973**	**106,534**	**13.3**	**-14.6**
Kenya shillings	90,054	105,860	13.2	-14.9
Foreign currency	919	674	0.1	36.4
Total	**682,147**	**573,459**	**100.0**	**18.9**

Source: Central Bank Returns

Capital and Reserves

During the period under review, the banking sector remained well capitalised, with capital and reserves increasing by 20.2 percent from Ksh 86.9 billion in June 2006 to Ksh 104.4 billion in June 2007. The increase in capital and reserves in the sector was as a result of fresh capital injection and retention of profits. The sector's core and supplementary capital (total capital) increased by 18.8 percent from Kshs. 76.8 billion in June 2006 to Ksh 91.3 billion in 2007. Total Risk weighted assets increased by 13.1 percent from Ksh 488.1 billion to Ksh 551.9 billion over the same period. Consequently, the sector's capital adequacy index, as measured by the ratio of total capital to total risk weighted assets ratio, increased from 16.7 percent in June 2006 to 17.3 percent in June 2007, well above the minimum 12 percent requirement.

Profitability

As shown in Table 5.3 below, the banking sector's pre-tax profits grew by 30 percent from Ksh 12.6 billion in June 2006 to Ksh 16.3 billion in June 2007. The improvement in profitability was therefore attributed to an increase in interest income from loans and advances, increased volume of transactions based and related fees and commission charges coupled with reduction in bad debt charges. The sector continued to derive a greater proportion of its income from loans and advances which constituted 49 percent of total income. Interest income from loans and advances increased by 13 percent from Ksh 22.2 billion in 2006 to Ksh 25.2 billion in 2007. Non-funded income including fees and commission charges constituted 25 percent of total income.

TABLE 5.3: BANKING INDUSTRY PROFITS (KSH MILLION)

Item	Jun-07	Jun-06	% Change
Total income	51,164	44,983	13.70%
Expenses before provisions	32,055	28,698	11.70%
Profit before provisions	19,109	16,285	17.30%
Provisions for bad debts	2,760	3,715	-25.70%
Profit before tax	**16,349**	**12,570**	**30.00%**

Source: Published Financial Statements and Disclosures

Outlook for the Banking Sector

The banking industry is expected to sustain the strong performance throughout the year 2007, benefiting mainly from an improved domestic economy, expanding business opportunities and a robust monetary policy stance. Institutions are expected to continue rolling out new products as they expand their branch and ATM network.

Competition is likely to increase with the planned entry of fully–fledged Islamic banks after the Minister for Finance opened a window for Sharia-compliant products in the budget speech for year 2007/08.

It is also anticipated that further consolidation will take place in the industry through mergers and acquisitions as institutions seek to achieve economies of scale required to effectively compete and expand into the increasingly lucrative mass market, as well as meet the new requirements of attaining the minimum capital requirements of Ksh 1 billion by the end of 2010 as proposed in the year 2007/08 budget speech.

6. MICRO FINANCE SECTOR DEVELOPMENTS

Microfinance institutions are now recognized as legitimate providers of financial services and as the key to unlocking economic growth for entrepreneurs and poor families, especially in rural areas. Most innovative and promising initiatives for increasing access to financial services for impoverished and ordinary Kenyans are provided by microfinance institutions. The Central Bank anticipates this trend to continue as institutions are licensed to intermediate deposits into new financial products.

A significant step in the development of the microfinance industry in Kenya is the enactment of the Microfinance Act in December 2006. It was introduced to enhance the performance of this sector by putting in place the necessary laws and regulatory framework for the establishment, licensing and supervision of deposit-taking microfinance institutions, focused on providing services and products to low income households and enterprises. The overriding rationale for microfinance regulation and supervision is to create an enabling environment that will promote the performance and sustainability of deposit-taking microfinance institutions, while at the same time protecting depositors' interests. The Act envisages two tiers of microfinance institutions, i.e. nationwide microfinance institutions whose minimum core capital is prescribed at Ksh 60 million, and community microfinance institutions with a minimum core capital of Ksh 20 million.

In this regard, the Central Bank of Kenya has developed the prudential microfinance regulations that will enhance efficiency and promote a broader and deeper access to financial services and products, while ensuring safety and soundness of the financial system as a whole. In general, it is envisaged that the regulatory requirements and prudential norms that the Central Bank of Kenya has developed for microfinance institutions will be flexible and reflect the specific characteristics and stages of evolution of the industry in Kenya. The Act is expected to be effective during the second half of 2007.

Survey on Access to Financial Services

During the year, the Banking Supervision Department, in collaboration with representatives from the financial sector, commissioned a national survey to measure the demand and access to financial services in Kenya. The survey's objective was to establish the basic aspects of financial behaviour of Kenyan citizens across the financial spectrum - from rich to poor. A total of 4,420 interviews were targeted. Questions covered all providers of financial services including the major financial institutions, banks and finance companies, SACCOs, micro-finance institutions, insurance companies, pension funds together with the more informal and less immediate obvious sources such as Rotating and Accumulating Savings and Credit Associations (ROSCAs and ASCAs), informal money lenders, employers, NGOs, friends and family.

The findings of this survey revealed the following aspects ranging from product usage to challenges in gaining access to financial services:

- Only 19 percent of Kenyans are banked and thus have formal access to financial services through commercial banks, building societies and Post Bank.
- An additional 8 percent are served by SACCOs and MFIs and 35 percent depend primarily on informal financial services such as ROSCAs (Rotating Savings and Credit Associations) and ASCAs (Accumulating Savings and Credit Associations). These constitute the financially included, who have access to formal and informal financial services.
- 38 percent of Kenyans are financially excluded, i.e. they have no access to financial services and are classified as 'unbanked', reporting no usage of either formal or informal products.
- The study also revealed that access to financial services varies across the country and is highest in Nairobi, which has the greatest number of bank branches (194 out of 443).

7. MONEY SUPPLY

Monetary Policy for the Financial Year 2006/07

Monetary policy for the financial year 2006/07 was directed towards achieving and maintaining inflation at 5 percent. Accordingly, the Central Bank of Kenya set the path for expansion of both reserve money and money supply consistent with the achievement of price stability. Money supply, M3, and reserve money were targeted to grow by 14.0 percent by June 2007.

TABLE 7.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2006/07 MONETARY PROGRAMME

	Jun'06	Dec'06	Jun'07	Sep'07
Reserve money (Ksh million)	107.7	124.2	123.1	125.3
NFA of CBK (Ksh million)	159.5	160.4	175.7	182.9
Memo:				
Annual change in reserve money	14	12.5	13.1	12.0
Annual change in extended broad money	15.6	13.8	14.3	12.0
Real GDP growth				6.4
Overall inflation	5.0		7.0	5.0

Source: Central Bank of Kenya

The Bank used the liquidity forecasting framework to monitor the daily reserve money vis-à-vis the targets. Open market operations (OMO) was the main monetary policy instrument, complemented by cash ratio requirement which was maintained at 6 percent throughout the year. In addition, CBK used the Central Bank Rate (CBR) to signal the direction and stance of monetary policy. The monetary policy stance supported macroeconomic developments in the first quarter of 2007 resulting in a stable rate of underlying inflation.

Money Supply

The growth of M3, accelerated from 16.0 percent in the twelve months to June 2006 to 18.8 percent in the year to June 2007 as shown in Table 7.2. This was above the 13.1 percent target set for the year to June 2007.

TABLE 7.2: PERFORMANCE OF MONETARY AGGREGATES JULY 2006 - JUNE 2007 (Percent)

	RM		M3X	
	Act.	Targ.	Act.	Targ.
2006				
Jun	14.0	7.6	16.0	10.0
Jul	13.6	11.5	17.2	12.1
Aug	16.6	11.5	15.8	12.1
Sep	16.8	11.5	17.4	12.1
Oct	13.6	10.1	17.0	11.0
Nov	12.8	10.1	17.9	11.0
Dec	16.9	12.5	17.9	13.8
2007				
Jan	17.1	12.4	17.8	12.5
Feb	18.4	12.4	16.8	12.5
Mar	19.1	12.4	17.8	12.5
Apr	17.8	14.3	15.0	13.1
May	21.6	14.3	17.3	13.1
Jun	17.5	14.3	18.8	13.1

Source: Central Bank of Kenya

The increase in M3 resulted from the expansion in net foreign assets (NFA) of the banking system and net domestic assets (NDA) as shown in Table 7.3. NFA expanded by 25.2 percent compared with 24.1 percent a year earlier, on account of a surplus in the capital and financial account of the balance of payments. The NDA of the banking system increased by 15.9 percent compared with 12.8 percent in the previous year, following increased credit to Government in the year to June 2007.

TABLE 7.3: MONEY SUPPLY AND ITS SOURCES (KSH BN)

	Jun-05 Act	Jun-06 Act	Jun-07 Act	Annual % Change 2005/06	Annual % Change 2006/07
1.0 Liability					
Money Supply					
Money supply, M2 1/	442.4	522.0	605.3		
Money supply, M3 2/	526.8	611.2	719.5	16.1	18.8
Money supply, M3X 3/	663.8	771.1	894.6		
2.0 Assets (2.1+2.2)	532.7	605.5	719.5		
2.1 Net foreign assets 4/	154.4	191.6	239.8	24.1	25.2
Central Bank	95.7	159.5	174.2	51.9	9.2
Banking Institutions	52.8	32.1	65.6	-35.0	104.4
2.2 Net domestic assets (2.21+2.22)	378.3	413.9	479.7	12.8	15.9
2.21 Domestic Credit (2.210+2.211)	466.3	521.7	606.8	12.6	16.3
2.210 Government (net)	112.3	117.9	157.2	12.6	33.3
2.211 Private sector and other public sector	354.0	403.8	449.6	15.1	11.3
2.22 Other assets net	-87.9	-107.8	-127.0	11.9	17.9
Memorandum Item:					
Reserve Money 5/	94.4	107.7	126.5	14.0	17.5

1/ Broad money, M2, comprises M1 and call, 7-days, savings & time deposits as well as certificates of deposits held by the private sector & parastatals with NBFIs. M2 excludes deposits of both the central & local Government with NBFIs, and all cross deposits of both commercial banks and NBFIs.

2/ Broad money, M3, comprises M2 plus foreign currency deposits held by residents with banking institutions.

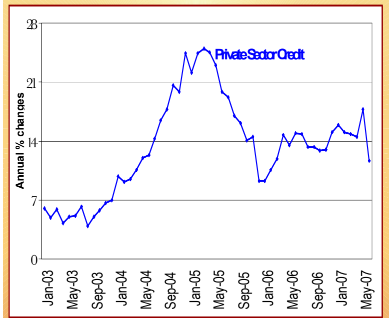
3/ Overall liquidity L, comprises M3 plus non-bank holdings of government securities.

4/ NFA valued at constant exchange rate of Ksh 78.95 to the US $ (September 30th, 2001)

5/ Reserve money comprises currency in circulation & commercial banks balances held with the Central Bank.

Source: Central Bank of Kenya

CHART 7A: ANNUAL PERCENTAGE CHANGES IN PRIVATE SECTOR CREDIT



Source: Central Bank of Kenya

Domestic Credit

The banking system credit to the domestic economy grew by 16.3 percent in the year to June 2007 compared with 12.6 percent a year earlier. Credit to Government also increased by 33.3 percent in the year to June 2007 compared with 12.6 percent last year. Over the same period, credit to the private sector grew by 11.3 percent compared with 15.1 percent as shown in Chart 7A and Table 7.3.

Most of the credit expansion to the private sector was to manufacturing sector (13.8 percent), private households (13.5 percent), trade (12.6 percent) and business services (10.4 percent) as shown in Table 7.4. These sectors together accounted for 50.3 percent of the credit extended during the year.

TABLE 7.4: CREDIT TO PRIVATE AND OTHER PUBLIC SECTORS (KSH BN)

	2006 Jun		2007 Jun		Annual Change		Jun '06 - Jun '07
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)	% dist. of ann. change in credit to private sector and other public sectors
1. Credit to other public sector	**11.8**	**2.9**	**11.5**	**2.6**	**-0.3**	**-2.2**	
Local government	-1.8	-0.4	-1.4	-0.3	0.4	-21.1	
Parastatals	13.6	3.4	13.0	2.9	-0.6	-4.7	
2. Credit to private sector	**391.6**	**97.1**	**437.1**	**97.4**	**45.5**	**11.6**	**100.0**
Agriculture	34.7	8.6	28.7	6.4	-6.0	-17.3	6.6
Manufacturing	71.1	17.6	60.5	13.5	-10.5	-14.8	13.8
Trade	57.7	14.3	55.1	12.3	-2.6	-4.5	12.6
Building and construction	31.1	7.7	37.0	8.2	5.8	18.8	8.5
Transport & communications	35.6	8.8	37.3	8.3	1.7	4.9	8.5
Finance & insurance	29.7	7.4	27.5	6.1	-2.2	-7.5	6.3
Real estate	25.7	6.4	25.3	5.6	-0.4	-1.7	5.8
Mining and quarrying	3.1	0.8	4.1	0.9	1.0	32.2	0.9
Private households	45.4	11.2	58.9	13.1	13.6	30.0	13.5
Consumer durables	11.8	2.9	17.4	3.9	5.6	47.1	4.0
Business services	41.7	10.3	45.4	10.1	3.6	8.7	10.4
Other activities	4.1	1.0	40.1	8.9	35.9	870.4	9.2
3. TOTAL (1+2) *	**403.4**	**100.0**	**448.7**	**100.0**	**45.2**	**9.4**	

*Absolute and percentage changes may not necessarily add-up due to rounding

Source: Central Bank of Kenya

Reserve money increased by 17.5 percent in the year to June 2007, compared with 14.0 percent in a similar period in 2006 as shown in Table 7.5. Reserve money growth exceeded the 13.1 percent target for the period, and was Ksh 3.4 billion above the Ksh 123.1 billion target. The reserve money mainly composed of cash outside banks of Ksh 79.3 billion, and bank reserves of Ksh 47.2 billion. The increase in reserve money in the year to June 2007 was mainly due to increased net foreign assets (NFA). Net domestic assets (NDA) of the Bank, however, declined but remained above target.

NFA of the CBK grew by 9.2 percent following foreign exchange interbank purchases by the Bank to meet the statutory requirement of 4.0 months of imports.

NDA of the Central Bank declined by Ksh 4.8 billion from Ksh -51.8 billion in June 2006 to Ksh -47.0 billion in June 2007 (Table 7.5). The decline in NDA followed decline in net Government borrowing from Ksh -15.8 billion in June 2006 to Ksh -3.5 billion by the end of June 2007. Net indebtedness of the Central bank to commercial banks also declined by KSh 7.7 billion to KSh -15.6 billion. Other domestic assets net of liabilities of the Central Bank, similarly, declined from Ksh -12.7 billion in June 2006 to Ksh -27.9 billion in the year to June 2007.

TABLE 7.5: RESERVE MONEY & ITS SOURCES (KSH BN)

		2006 Jun	2007 Jun	Change Absolute	Target Jun-07	Deviation
1	Net Foreign Assets	159.5	174.1	14.6	175.7	-1.6
2	Net Domestic Assets	-51.8	-47.0	4.8	-52.6	5.6
	2 Government Borrowing (net)	-15.8	-3.5	12.3	-10.3	6.8
	2 Advances & Discounts	-23.3	-15.6	7.7	-27.9	12.3
	2 Other Domestic Assets (net)	-12.7	-27.9	-15.2	-14.4	-13.5
3	Reserve Money	107.7	126.5	18.8	123.1	3.4
	3 Bank Reserves	40.8	47.2	6.4	46.5	0.7
	3 Cash Outside Banks	66.8	79.3	12.4	76.6	2.7

Source: Central Bank of Kenya

Outlook

In the year to June 2008, the Bank targets 12.7 percent growth for both money supply and reserve money as shown in Table 7.6. In implementing monetary policy through the reserve money targets, the Bank will continue to use open market operations to manage reserve money which is the basis for money supply expansion.

While the pass-through of high international oil prices has so far been minimal, further increases in oil prices remain a great threat to price stability. The Bank will, however, continue to monitor developments and guard against possible risks to price stability in 2008.

TABLE 7.6: MONETARY PROGRAMME FOR 2007/08

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Reserve money (Ksh million)	123.1	125.3	139.1	134.0	138.8
NFA of CBK (Ksh million)	175.7	182.9	189.4	196.4	220.1
Memo:					
Annual change in reserve money	14.0	12.0	10.0	11.1	12.7
Annual change in extended broad money (M3)	14.0	12.0	11.0	11.1	12.7
Real GDP growth	5.0				6.4
Overall inflation	7.0				5.0

Source: Central Bank of Kenya

Monetary Policy Advisory Committee (MPAC) Activities

During the year, the MPAC held six formal meetings and attended a workshop at which the role of the Central Bank in economic transformation was discussed. The workshop shared experiences of countries such as Israel, Malaysia, Korea and Mauritius. The MPAC undertook studies to enable a better understanding of issues such as exchange rate, relationship between money and inflation, and currency outside banks. Preliminary results of these studies and their policy implications were discussed at the MPAC meetings.

While noting that the monetary aggregates remained above targets during the fiscal year, the Committee recognised challenges in the open markets operations arising from the ineffectiveness of the monetary policy instruments particularly with respect to currency outside banks. The MPAC debated alternative solutions to these challenges and advised the Central Bank accordingly.

8. INFLATION

During the year to June 2007, month-on-month overall inflation increased from 10.9 percent in June 2006 to 11.1 percent in June 2007. This was mainly on account of supply shocks. Meanwhile, average annual overall inflation declined from 11.1 percent in the year to June 2006 to 10.4 percent in the year ending June 2007.

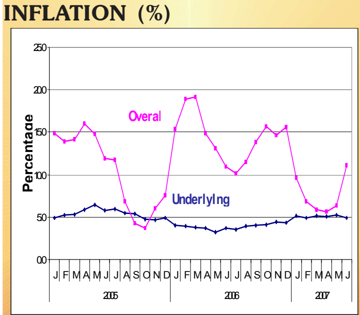
The month-on-month underlying measure of inflation which excludes volatile item's prices increased from 3.7 percent in June 2006 to 4.9 percent in June 2007. Similarly, the average annual underlying inflation increased from 4.4 percent in the year to June 2006 to 4.6 percent in the year to June 2007. During the year to June 2007, the average annual underlying inflation fluctuated between 3.7 percent and 4.9 percent and fell within the 5 percent inflation objective.

TABLE 8.1: MONTH-ON-MONTH OVERALL & UNDERLYING INFLATION (%)

	2006					2007					
	Jun	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Overall	10.9	13.85	15.69	14.64	15.59	9.67	6.81	5.87	5.66	6.33	11.1
Underlying	3.68	4.02	4.11	4.39	4.32	5.15	4.92	5.13	5.03	5.22	4.9

Sources: Kenya National Bureau of Statistics and Central Bank of Kenya

CHART 8A:12-MONTH INFLATION (%)



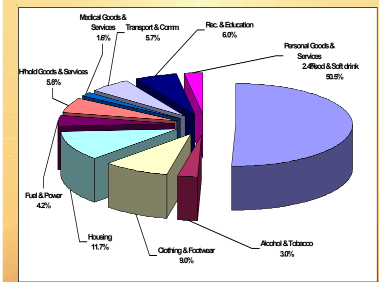
Source: Kenya National Bureau of Statistics

Chart 8A and Table 8.1 show trends in both overall and underlying inflation rates based on the month-on-month measure of inflation.

Inflation by Category of Goods and Services

The categories of goods and services and their respective weights in the basket are presented in Chart 8B.

CHART 8B: GOODS AND SERVICES CATEGORY WEIGHTS



Source: Kenya National Bureau of Statistics

Month-on-month inflation was higher in June 2007 than in June 2006 with eight of the ten categories of goods and services surveyed by the Kenya National Bureau of Statistics (KNBS) having higher inflation. Only two categories had lower inflation. Fuel and power inflation decreased from 11.4 percent in June 2006 to 8.5 percent in June 2007, while Transport and Communication inflation decreased from 8.3 percent to 3.1 percent during the same period. The decline in fuel and power inflation is an indication of stabilizing oil prices.

The consumer sub-indices with higher inflation in June 2007 compared with June 2006 were food and drink, moving from 14.9 percent to 15.0 percent, alcohol and tobacco, climbing from 6.5 percent to 8.0 percent, a change pointing to increased taxes, housing costs increased from 4.8 percent in June 2006, to 5.8 percent in June 2007. Household goods and services inflation increased from 3.1 percent to 5.9 percent, Medical goods and services inflation increased from 3.8 percent to 4.7 percent , while personal goods and services inflation increased from 2.5 percent to 3.6 percent.

Inflation among Income Groups and Areas

All the four income groups and areas surveyed by the Kenya National Bureau of Statistics experienced higher inflation in the year to June 2007 than in the year to June 2006. The "Nairobi lower income" group experienced an average of 11.4 percent in the year to June 2007, compared with 14.15 percent in the year to June 2006. The high inflation in this income category is explained by the group's higher income expenditure share on food and drinks whose inflation is usually high and volatile. In contrast, the "Nairobi upper income" group spends a smaller share of income on food items and experienced lower inflation. In the year to June 2007, average annual inflation in this income category averaged 5.13 percent which was a reduction from 7.73 percent in the year to June 2006.

Inflation for the "Nairobi income" group which combines the incomes of "Nairobi lower" and "Nairobi upper" income groups declined to 10.35 percent in the year to June 2007, from 13.0 percent in the year to June 2006. The "Rest of Kenya" income group inflation averaged 10.34 percent in the year to June 2007, edging up from an average of 9.88 percent in year to June 2006.

Inflation Outlook

Inflation in the future will continue to hinge on movements and developments in, among other factors, international oil prices, the shilling exchange rate, and impact of money supply.

9. INTEREST RATES

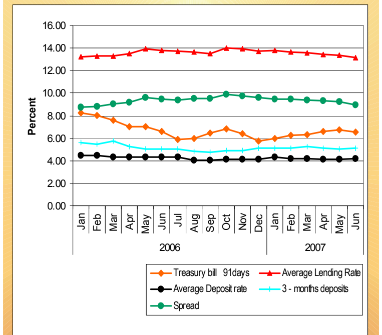
The Central Bank Rate

The Central Bank Rate (CBR) that became effective on 2nd June 2006, was initially set at 9.75 percent and reviewed upwards by 25 basis points to 10 percent effective August 2, 2006. The CBR remained unchanged at 10 percent until June 2007 when the Monetary Policy Advisory Committee (MPAC) advised that it be adjusted downwards to 8.5 percent to bring it in line with other short term interest rates.

Short Term Interest Rates

As a result of the upward review of the CBR in August 2006, short term interest rates rose during the period January to June 2007, with the 91 – day Treasury bill rate increasing from an average of 5.73 percent in December 2006 to 6.53 percent in June 2007. The average interbank rate increased from an average of 6.34 percent in December 2006 to 6.98 percent in June 2007, while the Repo rate increased from 6.34 percent in December to 7.08 percent in June 2007. The average 182-day Treasury bill rate, however, declined over the same period from 7.32 percent to 7.19 percent in June 2007.

CHART 9A: INTEREST RATES



Source: Central Bank of Kenya

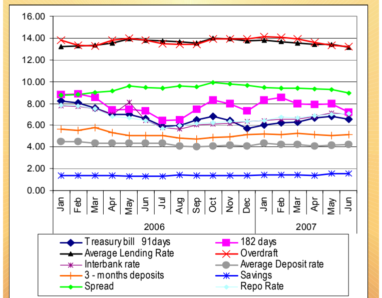
TABLE 9.1: INTEREST RATES (%)

	2006												2007					
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91days	8.23	8.02	7.60	7.02	7.01	6.60	5.89	5.96	6.45	6.83	6.41	5.73	6.00	6.22	6.32	6.65	6.77	6.53
182 days	8.84	8.85	8.52	7.36	7.48	7.32	6.42	6.47	7.45	8.31	7.99	7.32	8.28	8.56	7.97	7.93	7.98	7.19
Average Lending Rate	13.20	13.27	13.33	13.51	13.95	13.79	13.72	13.64	13.54	14.01	13.93	13.74	13.78	13.64	13.56	13.44	13.38	13.14
Overdraft	13.81	13.34	13.26	13.81	14.02	13.78	13.48	13.43	13.42	13.94	13.96	13.91	14.11	14.05	13.95	13.58	13.35	13.20
Interbank rate	7.78	7.73	7.52	6.97	8.12	6.41	5.74	5.66	6.02	6.08	6.18	6.34	6.43	6.52	6.55	6.81	7.11	6.98
Average Deposit rate	4.48	4.48	4.33	4.35	4.36	4.35	4.31	4.08	4.04	4.11	4.15	4.11	4.35	4.21	4.19	4.11	4.14	4.18
3 - months deposits	5.61	5.49	5.74	5.28	5.04	5.05	5.06	4.80	4.75	4.88	4.93	5.13	5.15	5.09	5.23	5.14	5.06	5.10
Savings	1.33	1.36	1.34	1.33	1.31	1.27	1.32	1.41	1.36	1.35	1.37	1.35	1.42	1.41	1.43	1.35	1.57	1.54
Spread	8.72	8.79	9.00	9.16	9.59	9.44	9.40	9.56	9.50	9.90	9.77	9.63	9.43	9.42	9.37	9.32	9.23	8.96

Source: Central Bank of Kenya

On an annual basis, short term interest rates were lower in June 2007 than in June 2006. The average interest rate on the 91-day Treasury bill declined from 6.60 percent in June 2006 to 6.53 percent in June 2007. Similarly, the average interest rate on the 182-day Treasury bill declined from 7.32 percent in June 2006 to 7.19 percent in June 2007. The decline in short term interest rates during the year reflected increased liquidity in the money market that manifested itself in the frequent over subscriptions for Government securities. Over the same period, the average interbank rate increased from 6.41 percent in June

CHART 9B: TRENDS IN INTEREST RATES (%)



Source: Central Bank of Kenya

2006 to 6.98 percent in June 2007. The Repo rate also increased from 6.39 percent to 7.08 percent in June 2007.

Lending Rates

Average lending and deposit interest rates were lower in June 2007 than those in June 2006. The commercial banks' overall weighted average lending rate declined from 13.8 percent in June 2006 to 13.1 percent in June 2007. The decline in the overall lending rate reflected the decline in lending rates for the "1 to 5 year" loans category that declined by 1.36 percent, mainly owing to the 1-5 year corporate lending rate that fell by 2.01 percent. Lending rates for virtually all categories of loans declined except the over 5 year loans category that increased by 18 basis points for both the corporate and business categories, while the personal over 5 year lending rate declined. The decline in lending rates is, among other factors, attributed to increased liquidity in the financial system due to decline in government borrowing.

Deposit Rates

The overall weighted average deposit rate declined from 4.35 percent in June 2006 to 4.18 percent in June 2007. The decline was in interest rates on the "over three months" category that declined by 80 basis points, which was much higher than the increase in the other deposit interest rates. The interest rate on demand deposit increased from 1.3 percent in June 2006 to 1.5 percent in June 2007, while the savings deposit interest rate increased from 1.27 percent to 1.54 percent in June 2007.

The decline in the overall lending interest rate in June 2007 was much higher than the decline in the overall deposit rate, consequently, the interest rate spread declined from 9.44 percent in June 2006 to 8.96 percent in June 2007. Chart 9B and Table 9.1 show data on selected interest rates and the interest rate spread.

Interest Rates Outlook

Interest rates are expected to remain stable, consistent with expected stability in most of the macroeconomic fundamentals. They are expected to remain stable in the medium term as they tend towards the CBR which is expected to signal the monetary conditions in the economy. The stable interest rate would be supported by the continued implementation of prudent monetary policy by the Bank. The improved revenue collection by KRA, leading to stable Government domestic borrowing, will foster stability in interest rates.

10. BALANCE OF PAYMENTS

Overview

Kenya's overall balance of payments surplus declined from US$ 847 million in the 2005/06 fiscal year to US$ 372 million in the fiscal year 2006/07. This development reflects the value of merchandise imports, which remained well above the value of merchandise and services exports owing mainly to increased demand for production inputs necessitated by higher domestic and external demand. The resultant deficit in the current account was financed by short term financial inflows.

The current account deficit widened to US$ 786 million, reflecting the wider trade deficit of US$ 4,323 million. The value of merchandise imports grew by US$ 1,750 million against an increase in the value of merchandise exports of US$ 534 million. The increase in imports reflected an increase in imports of machinery and transport equipment, implying productive capacity expansion during the year. Net receipts from services exports (excluding current transfers) improved by US$ 478 million. The capital and financial account, where private financial flows are reflected, recorded a surplus of US$ 1,158 million.

TABLE 10.1: BALANCE OF PAYMENTS (US $ M)

ITEM	Year to Jun 2006	Year to June 2007*				Year to Jun 2007*	Absolute Change
		Q1 Jul-Sep	Q2 Oct-Dec	Q3 Jan-Mar	Q4 Apr-Jun		
1. OVERALL BALANCE	**847**	**63**	**28**	**189**	**92**	**372**	**-475**
2. CURRENT ACCOUNT	**-320**	**-106**	**-211**	**-320**	**-149**	**-786**	**-466**
2.1 Goods	**-3107**	**-889**	**-1108**	**-1184**	**-1142**	**-4323**	**-1216**
Exports (fob)	**3311**	949	897	986	1014	**3845**	**534**
Coffee	**133**	30	25	32	55	**143**	**9**
Tea	**615**	190	161	200	176	**727**	**113**
Horticulture	**474**	111	139	147	155	**552**	**78**
Oil products	**101**	41	39	41	44	**166**	**65**
Manufactured Goods	**370**	119	113	118	125	**474**	**104**
Raw Materials	**147**	56	54	66	47	**224**	**77**
Re-exports	**448**	79	42	58	38	**218**	**-230**
Other	**1023**	322	324	323	372	**1342**	**319**
Imports (cif)	**6419**	1837	2005	2170	2156	**8168**	**1750**
Oil	**1606**	455	398	384	518	**1755**	**149**
Chemicals	**879**	260	282	268	293	**1102**	**223**
Manufactured Goods	**854**	284	284	301	366	**1234**	**380**
Machinery & Transport Equipment	**1806**	529	720	816	597	**2662**	**855**
Other	**1272**	310	321	402	382	**1416**	**143**
2.2 Services	**2787**	**783**	**897**	**864**	**993**	**3537**	**750**
Non-factor services (net)	**1333**	387	455	414	463	**1719**	**386**
of which tourism	**671**	160	171	234	240	**805**	**134**
Income (net)	**-135**	-9	-3	-6	-25	**-43**	**93**
of which official interest	**-166**	-22	-18	-21	-17	**-78**	**88**
Current Transfers	**1589**	405	444	456	556	**1861**	**272**
Private (net)	**1435**	410	450	456	556	**1872**	**437**
Public (net)	**154**	-6	-6	0	0	**-11**	**-165**
3. CAPITAL & FINANCIAL ACCOUNT	**1167**	**170**	**239**	**508**	**241**	**1158**	**-10**
3.1 Capital Tranfers (net)	**194**	**30**	**54**	**33**	**88**	**204**	**10**
3.2 Financial Account	**973**	**140**	**185**	**476**	**153**	**953**	**-20**
Official, medium & long-term	**-278**	-48	-2	-50	-6	**-106**	**172**
Inflows	**127**	19	48	14	47	**128**	**2**
Outflows	**-405**	-67	-51	-64	-53	**-235**	**171**
Private, medium & long-term (net)	**443**	-182	-241	172	-97	**-348**	**-790**
Commercial Banks (net)	**233**	-145	-203	-36	-62	**-446**	**-679**
Other private medium & long-term	**209**	-38	-38	208	-35	**98**	**-111**
Short-term (net) incl. errors & omission	**809**	370	428	354	255	**1407**	**598**

* Provisional

**Based on curreny year's imports of goods and non-factor services

***Based on 36 months average of imports of goods and non-factor services

Source: Central Bank of Kenya

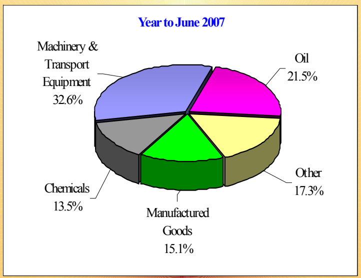
Merchandise Account

Merchandise imports grew by 27.3 percent largely reflecting increased imports of capital and intermediate goods, while merchandise exports grew by 16.1 percent due mainly to increased exports of agricultural commodities and manufactured goods.

Imports

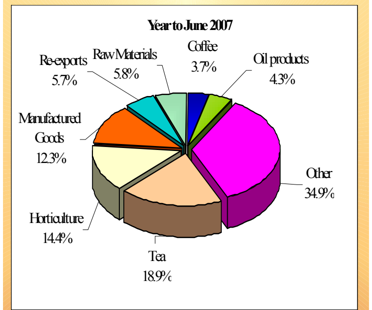
The value of Kenya's merchandise imports rose from US$ 6,419 million in the 2005/06 fiscal year to US$ 8,168 million during the 2006/07 fiscal year. Increases were recorded in all import categories, namely machinery and transport equipment, manufactured goods, chemicals and oil. These items, respectively, accounted for 32.6 percent, 15.1 percent, 13.5 percent and 21.5 percent of the total value of imports during the period in review (Chart 10A).

CHART 10A : COMPOSITION OF KENYA'S IMPORTS



Sources: Central Bank of Kenya

CHART 10B : COMPOSITION OF KENYA'S EXPORTS



Sources: Central Bank of Kenya

Machinery and transport equipment particularly recorded the highest increase of US$ 855 million or 47.3 percent compared with the previous fiscal year. The value of other imports used in production like chemicals and oil also increased by 25.4 percent and 9.3 percent, respectively. The increase in imports was therefore, beneficial to the economy.

Exports

The value of merchandise exports which mainly comprise tea, horticulture, manufactured goods, re-exports (mainly oil), raw materials, coffee and other miscellaneous items, rose from US$ 3,311 million in the previous fiscal year to US$ 3,845 million in the 2006/07 fiscal year. Chart 10B shows that the composition of Kenya's exports remained more or less unchanged in the 2006/2007 fiscal year as compared with the previous fiscal year, with coffee, tea and horticulture collectively accounting for 37.0 percent of the total value of exports, while manufactured goods contributed 12.3 percent to the total value of exports.

The value of tea exports rose during the review period following an increase in export price to an average of US$ 1,971 per tonne and an increase in export volume to 371,635 tonnes. The higher value of horticulture exports reflected increased export volume of vegetables and cut flowers. The export prices of vegetables and fruits, however, declined. Coffee exports also rose due to improved export price to an average of US$ 2,769 per tonne which offset the reduced quantity of coffee exported of 50,796 tonnes.

Services Account

The services account recorded a higher surplus of US$ 3,537 million during the 2006/07 fiscal year. This followed increased receipts from non-factor services, reduced outflows from the income account and increased current transfers.

Total receipts from non-factor services rose by US$ 432 million to US$ 2,595 million during the 2006/07 fiscal year, reflecting improvement in transportation and travel services, and other Government services. Inflows related to transportation services and foreign travel rose by US$ 70 million and US$ 134 million, respectively. Total non-factor service payments rose to US$ 876 million, reflecting mainly increased outflows related to foreign travel and freight services.

Net outflows from the income account reduced from US$ 135 million in the 2005/06 fiscal year to US$ 43 million in the 2006/07 fiscal year owing to increased interest earnings on official foreign exchange reserves which grew by US$ 48 million to US$ 119 million, and reduced interest payments on official foreign debt by US$ 88 million to US$ 78 million. Interest earnings by the private sector declined to US$ 11 million as private interest rose by US$ 39 million to US$ 91 million.

Net current transfers receipts rose by US$ 272 million to US$ 1,861 million in the 2006/07 fiscal year, reflecting in part increased external remittance receipts.

Capital and Financial Flows

The surplus in the capital and financial account reduced to US$ 1,158 million in the 2006/07 fiscal year compared with US$ 1,167 million a year earlier, largely reflecting increased net foreign assets of commercial banks.

Private medium and long-term financial flows worsened to a net outflow of US$ 348 million in the 2006/07 fiscal year due mainly to increased net foreign assets of commercial banks by

US$ 446 million. Other private financial flows also worsened to a net inflow of US$ 98 million, reflecting reduced receipts of foreign loans. Foreign direct investment inflows, however, increased to US$ 66 million. Short term capital inflows rose by US$ 598 million to US$ 1,407 million. The increased short term flows may pose a danger if the short term flows are used to finance long term investments. The extent of the increase in short term flows may, however, have been exaggerated by the inclusion of remittances which should be part of current account.

Official capital and financial flows improved by US$ 172 million during the fiscal year 2006/07, mainly due to reduced foreign debt repayments by US$ 171 million to US$ 235 million. Official loan receipts also increased, albeit marginally, to US$ 128 million while project grants to the Government also increased by US$ 10 million to US$ 204 million.

Direction of Trade

As shown in Table 10.2, the main destination countries for Kenya's merchandise exports were Uganda (11.3 percent), United Kingdom (10.3 percent), the Netherlands (7.8 percent), United States of America (7.6 percent), Tanzania (7.6 percent), Pakistan (5.8 percent), Sudan (4.3 percent), Egypt (3.9 percent), and Democratic Republic of Congo (3.0 percent).

TABLE 10.2: KENYA'S EXPORTS: MAIN DESTINATION COUNTRIES (US$ M)

Destination Country	Fiscal Years		
	2004/05	2005/06	2006/07
Uganda	535	434	435
Tanzania	234	259	291
Sudan	86	110	166
Egypt	82	140	151
DRC	132	101	116
Somalia	53	75	115
Others	350	339	432
Total Africa	**1,473**	**1,459**	**1,705**
United Kingdom	306	332	396
Netherlands	234	249	299
USA	60	121	294
Pakistan	162	199	223
United Arab Emirates	42	57	85
Germany	64	67	69
India	54	51	65
France	61	55	50
Switzerland	19	31	43
Others	727	690	615
Total Exports	**3,200**	**3,311**	**3,845**

Source: Central Bank of Kenya

On the other hand, Kenya sourced most of her imports from United Arab Emirates (14.6 percent), India (8.6 percent), United States of America (7.9 percent), China (6.6 percent), Japan (6.2 percent), South Africa (5.6 percent), United Kingdom (5.3 percent), Saudi Arabia (3.9 percent), Germany (3.7 percent) and Singapore (3.1 percent) (Table 10.3).

TABLE 10.3: KENYA'S IMPORTS: MAIN SOURCE COUNTRIES (US$ M)

Source Country	Fiscal Years 2004/05	2005/06	2006/07
South Africa	487	561	454
Egypt	77	99	148
Tanzania	32	44	81
Mauritania	0	0	76
Swaziland	32	51	56
Uganda	24	6	41
Others	80	63	110
Total Africa	**733**	**825**	**967**
United Arab Emirates	650	940	1,194
India	290	382	703
USA	579	256	643
China	203	302	540
Japan	319	324	503
United Kingdom	536	684	432
Saudi Arabia	467	302	316
Germany	175	232	304
Singapore	56	223	249
Others	1,460	1,948	2,317
Total Imports	**5,468**	**6,419**	**8,168**

Source: Central Bank of Kenya

Kenya's Trade Structure

Trade with Asian and European countries, respectively, rose to 42.0 percent and 26.8 percent of Kenya's total trade in 2006, while the proportion of trade with African countries and America declined to 22.2 percent and 7.0 percent, respectively (Table 10.4).

Increased trade with Asian countries reflected in part higher imports of motor vehicles and oil. Much of the trade between Kenya and European countries was with the European Union, which rose following increased imports of telecommunication equipment and television receivers from Italy, and fertilizers from Romania. The decline in trade with African countries reflected reduced import of helicopters from South Africa and tobacco from Uganda. The increase in trade with Australia reflected imports of drilling equipment for purposes of oil exploration.

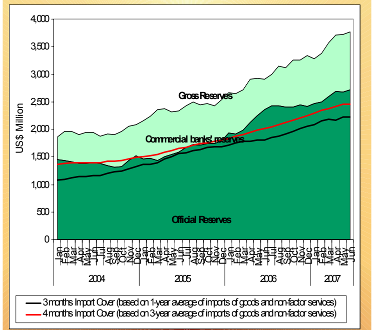
TABLE 10.4: KENYA'S TRADE STRUCTURE

	Total Trade in Billions of Kenya Shillings 2000	2001	2002	2003	2004	2005	2006*	Proportion (%) 2002	2003	2004	2005	2006*
Europe	126.1	122.1	138.3	134.2	159.5	172.5	206.9	32.4	28.9	27.5	24.5	26.8
Western Europe	120.4	119.0	135.3	127.0	151.9	165.8	194.5	31.7	27.3	26.2	23.6	25.2
European Union	115.7	112.0	128.9	119.0	143.9	155.7	180.2	30.2	25.6	24.8	22.1	23.3
Others	4.7	7.0	6.4	8.0	7.9	10.1	14.3	1.5	1.7	1.4	1.4	1.8
Eastern Europe	5.7	3.0	3.0	7.2	7.6	6.7	12.4	0.7	1.5	1.3	1.0	1.6
America	18.4	49.8	23.3	22.1	30.5	65.1	53.8	5.4	4.7	5.3	9.3	7.0
U.S.A	12.9	42.4	18.0	17.2	18.9	54.6	45.1	4.2	3.7	3.3	7.8	5.8
Others	5.5	7.4	5.2	4.9	11.6	10.5	8.8	1.2	1.0	2.0	1.5	1.1
Africa	84.7	104.3	112.0	122.0	154.2	183.5	171.7	26.2	26.2	26.6	26.1	22.2
E.A.Community	36.7	44.8	46.9	47.7	58.0	67.1	51.6	11.0	10.2	10.0	9.5	6.7
Tanzania	12.0	14.1	15.0	16.0	19.9	23.1	22.8	3.5	3.4	3.4	3.3	3.0
Comesa	49.9	65.6	36.8	41.9	51.3	61.4	64.0	8.6	9.0	8.9	8.7	8.3
Other Countries	22.8	24.5	60.2	64.1	83.0	99.0	84.9	14.1	13.8	14.3	14.1	11.0
Asia	144.9	146.2	143.9	174.4	219.1	257.6	324.4	33.7	37.5	37.8	36.6	42.0
Middle East	80.1	77.8	58.4	82.0	107.7	116.8	129.7	13.7	17.6	18.6	16.6	16.8
Far East	64.8	77.4	85.5	92.3	111.4	140.8	194.7	20.0	19.9	19.2	20.0	25.2
Australia & Oceanic	3.3	4.3	2.6	2.5	2.1	2.5	3.8	0.6	0.5	0.4	0.4	0.5
All other Countries N.E.S	5.0	11.2	7.0	9.9	13.9	22.3	11.8	1.6	2.1	2.4	3.2	1.5
Grand Total	**382.3**	**437.7**	**427.0**	**465.0**	**579.4**	**703.5**	**772.5**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

*Provisional

Source: Economic Survey, 2004, 2005, 2006 and 2007

CHART 10C: FOREIGN EXCHANGE RESERVES



Source: Central Bank of Kenya

Foreign Exchange Reserves

Following the favorable outturn in the balance of payments, gross foreign assets of the banking system rose from US$ 2,909 million at the end of June 2006 to US$ 3,767 million at end of June 2007 (Chart 10C).

Foreign exchange reserves held by the Central Bank of Kenya increased from US$ 2,353 million at the end of June 2006 to US$ 2,723 million (equivalent to 4.4 months of imports) at the end of June 2007. The build up in official reserves during the 2006/2007 fiscal year was mainly achieved through purchases of foreign exchange by the Bank from the domestic inter-bank market in the amount of US$ 412 million, compared with US$ 813 million purchased during the previous fiscal year. These purchases were made to cover the Government's external obligations amounting to US$ 484 million and the Bank's own expenses amounting to US$ 20 million. Forex purchases were also required to maintain official reserve levels above the statutory minimum in view of growing imports. During the year, the Bank also received US$ 376 million as interest earned on foreign exchange reserves and foreign aid to the Government.

Gross foreign assets of commercial banks also rose from US$ 556 million at the end of June 2006 to US$ 1,044 million at the end of June 2007. These assets were largely held as balances with banks abroad in the amount of US$ 834 million in addition to other foreign assets including cash, foreign loans and foreign bills discounted. Besides these holdings, foreign currency deposits held locally by residents increased by US$ 418 million to US$ 1,544 million at the end of June 2007.

11. EXCHANGE RATES

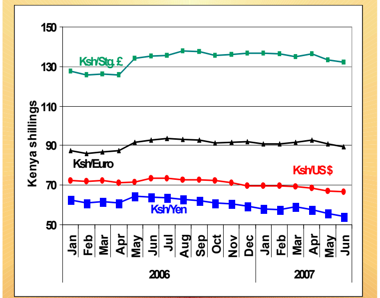
The Kenya Shilling Exchange Rates

The Kenya shilling appreciated against major world currencies in the 2006/07 fiscal year as shown in Table 11.1 and Chart 11A. This was mainly the result of increased foreign exchange inflows into the domestic foreign currency market during the year. The US dollar also weakened against the Sterling Pound and the Euro by 7.7 percent and 6.0 percent, respectively.

The shilling gained against the US dollar by 9.3 percent between June 2006 and June 2007, and averaged Ksh 66.6 per US dollar in June 2007 compared with Ksh 73.4 per US dollar in June 2006. The shilling also gained against the Sterling Pound and the Euro, exchanging at an average of Ksh 132.3 per Sterling Pound and Ksh 89.3 per Euro in June 2007 compared with Ksh 135.4 per Sterling Pound and Ksh 93.0 per Euro in June 2006. The shilling also gained against the Japanese Yen during the period under review, and exchanged at an average of Ksh 54.3 per 100 Yen in June 2007.

Against African currencies, the Kenya shilling gained against the South African Rand by 11.9 percent and the Tanzania shilling by 11.1 percent in the 2006/2007 fiscal year, to exchange at Ksh 9.3 per Rand and Tsh 19.0 per Kenya shilling in June 2007. The Kenya shilling however depreciated against the Uganda shilling from Ush 25.3 per Kenya shilling in June 2006 to exchange at Ush 25.0 per Kenya shilling in June 2007.

CHART 11A: KENYA SHILLING EXCHANGE RATES



Source: Central Bank of Kenya

TABLE 11.1: KENYA SHILLING EXCHANGE RATES

	2005			2006			2007		% Change
	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Jun-06 to Jun-07
Kshs/US$	77.9	76.7	73.1	72.2	73.4	69.6	69.9	66.6	-9.3[a]
Kshs/Stg. £	146.5	139.5	127.6	127.5	135.4	136.8	136.9	132.3	-2.3[a]
Kshs/Euro	102.3	93.2	86.7	87.5	93.0	92.0	90.9	89.3	-3.9[a]
Kshs/Yen	75.5	70.6	61.6	62.6	64.0	59.5	58.1	54.3	-15.2[a]
Kshs/Rand	13.0	11.3	11.4	11.8	10.5	9.9	9.7	9.3	-11.9[a]
Ushs/Kshs*	22.2	22.7	24.8	25.2	25.3	26.1	26.0	25.0	-1.4[b]
Tshs/Kshs*	13.9	14.7	16.0	16.3	17.1	18.6	18.6	19.0	11.1[a]

*Currency per Kenya shilling

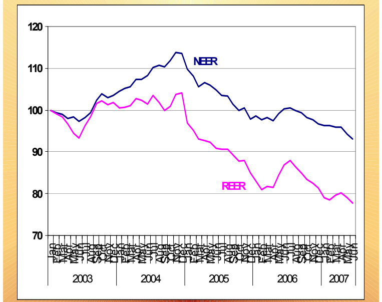
[a] --appreciation

[b] --depreciation

Source: Central Bank of Kenya

International Trade Competitiveness

CHART 11B: KENYA SHILLING REER AND NEER



Source: Central Bank of Kenya

The Kenya shilling appreciated against a basket of currencies of Kenya's major trading partners. The trade-weighted nominal exchange rate index (NEER) declined by 7.2 percent between June 2006 and June 2007 as shown in Chart 11B. The real effective exchange rate index (REER) also appreciated by a larger magnitude of 10.5 percent reflecting higher overall inflation in Kenya relative to inflation in her trading partners. This may be an indication that Kenya lost external competitiveness during the 2006/07 fiscal year.

Outlook for the Kenya Shilling

The Kenya shilling is expected to remain stable, but its level will depend on the extent of increased demand for imports, the volume of inflows of long term capital, remittances and receipts from exports. The continued pursuit of prudent monetary policy by the Central Bank is expected to reduce the negative effect of domestic inflation on the country's external competitiveness.

A. MODE OF PAYMENTS

1. CASH

Currency in circulation remained the most widely used form of payment during the period under review. The amount of currency in circulation as at the end of June 2007 was Ksh 89.94 billion, a growth of Ksh 13.6 billion or 17.8 percent above the previous year's issued currency of Ksh 76.3 billion as indicated in Tables 12.1 and 12.2 below:

TABLE 12.1: CURRENCY IN CIRCULATION BY TYPE

	Jun-05		Jun-06		Jun-07	
Item	Ksh bn.	%	Ksh bn.	%	Kshs bn.	%
Currency in circulation	67.5	100	76.3	100	89.94	100
Bank Notes	64.6	95.7	73.2	95.94	86.45	96.12
Coins	2.9	4.3	3.1	4.06	3.49	3.88

Source: Central Bank of Kenya, Currency Department

The proportion of bank notes and coins as at 30th June 2007 stood at 96.1 percent and 3.9 percent, respectively.

TABLE 12.2: CURRENCY IN CIRCULATION

	Bank notes				Coins		
	2005/2006 Pieces (m)	2006/2007 Pieces (m)	% change		2005/2006 Pieces (m)	2006/2007 Pieces (m)	% change
1000/=	54	65	18.9	40/=	2	2	0
500/=	14	16	17.9	20/=	53	59	12.1
200/=	22	27	20.5	10/=	82	95	15.9
100/=	52	58	11	5/=	114	129	13
50/=	38	42	12.1	1/=	442	469	6.1
20/=	10	10	0	=/50	210	218	3.8
10/=	12	12	0	=/10	360	360	0
5/=	6	6	0	=/05	300	300	0
	209	**236**	**13**		**1,562**	**1,632**	**4.4**

Source: Central Bank of Kenya, Currency Department

Notes in circulation grew by 13.0 percent from 209 million pieces in the year to June 30, 2006 to 236 million pieces in the year to June 30, 2007. The highest increase was in the usage of Ksh 1,000, Ksh 500, and Ksh 200 notes, which increased by 18.9 percent, 17.9 percent, and 20.5 percent, respectively. Coins in circulation also grew by 4.4 percent in the same period from 1,562 million pieces to 1,632 million pieces. The highest increase was in Ksh 20 coin, Ksh 10 coin, and Ksh 5 coin which increased by 12.1 percent, 15.9 percent, and 13.0 percent, respectively. The insignificant rise in the use of coins mainly stems from the public preference for bank notes and their durability compared to bank notes.

Cash Inflows and Outflows

Cash inflows as deposits by banks on a national basis increased from Ksh 196.8 billion as at 30th June, 2006 to Kshs 227.5 billion as at June 2007, an increase of Ksh 31.4 billion or 16.0 percent. Cash outflows also increased from Kshs 205.6 billion in the previous year to Kshs 241.1 billion during the period under review. There was therefore a net currency outflow during the period ending 30th June, 2007 of Ksh 13.6 billion as depicted in Table 12.3 below.

TABLE 12.3: CURRENCY INFLOWS AND OUTFLOWS (KSH M)

Inflow by banks	2005/2006	2006/2007
Bank Notes	196,106.29	226,747.29
Coins	713.07	704.83
Total	196,819.36	227,452.12
Outflows by banks		
Bank Notes	204,715.57	239,983.16
Coins	922.79	1,076.91
Total	**205,638.36**	**241,060.07**
Net Outflows	**-8,818.99**	**-13,607.95**

Source: Central Bank of Kenya, Currency Department

Development in Counterfeiting Practices

Counterfeit notes decreased significantly from 4,787 notes as at 30th June, 2006 to 997 notes as at 30th June, 2007 (Table 12.4). The value of the notes decreased by 83.4 percent, from Ksh 3,387,900 to Ksh 561,800.

It terms of denomination, there were 395 pieces of Ksh 1,000 note making up 40.10 percent, and 184 pieces of the Ksh 500 note or 18.70 per cent of the counterfeit notes. The decrease may be attributed to the Bank's enhanced security measures to counteract counterfeiting of currency notes.

TABLE 12.4: COUNTERFEIT NOTES BY DENOMINATION

Period	No. of pieces 2005/2006	Amount (Kshs)	No. of pieces 2006/2007	Amount (Kshs)
Denomination				
1000/=	2,597	2,597,000	395	395,000
500/=	1,239	619,500	184	92,000
200/=	763	152,600	336	67,200
100/=	188	18,800	70	7,000
50/=	-	-	12	600
20/=	-	-	-	-
10/=	-	-	-	-
5/=	-	-	-	-
Total	**4,787**	**3,387,900**	**997**	**561,800**

Source: Central Bank of Kenya, Currency Department

2. NON-CASH INSTRUMENTS

Cheques continued to dominate the non-cash payment instruments accounting for over 80 percent of total transactions. In the year to June 2007, the average daily volume of cheques settled through the Nairobi Automated Clearing House averaged 46,833 cheques valued at Ksh 8.51 billion, a decrease from 56,000 cheques valued at Ksh 10.0 billion in similar period in 2006.

Electronic Funds Transfer (EFT) transactions or credit based payments increased by 23.6 percent during the year to Ksh 592 million as compared to Ksh 479 million in the previous year.

The Clearing System Operations

The operations of the automated clearing house went on smoothly during the year under review. As at the end of June 2007, the volume of clearing throughput on a national basis stood at Ksh 3,654,599.6 million as indicated in Table 12.5.

TABLE 12.5: CLEARING HOUSE KSH TRANSACTION AS AT JUNE, 2007

Financial Year	Items	Values (Millions)	Volumes (Thousand)
2005	Debit	1,943	11,287
	Credit	355	3,633
	Total	2,298	14,920
2006	Debit	2,642	14,513
	Credit	479	5,032
	Total	3,121	19,945
2007	Debit	3,063	16,859
	Credit	592	5,601
	Total	**3,655**	**22,460**

Source: Central Bank of Kenya, Banking Services Division

During the year to June 2007, there was continued growth in the USD and GBP transaction values processed through the Clearing House domestic foreign currency clearing system of 17.2 percent and 3.4 percent, respectively. The value of Euro transactions processed decreased by 5.4 percent as indicated in Table 12.6.

TABLE 12.6: DOMESTIC FOREIGN CURRENCY CHEQUE CLEARING TRANSACTIONS AS AT JUNE 2007

Currency	USD		GBP		EURO	
	Value (m)	Volume ('000')	Value (m)	Volume ('000')	Value (m)	Volume ('000')
2005	1,202.67	159.4	19.83	2	78.37	5.1
2006	1,812.80	240.8	23.07	2.6	114.3	7.2
2007	2,124.75	272.4	23.86	2.6	108.13	7.5
Growth (percent)	17.2		3.4		-5.4	

Source: Central Bank of Kenya Banking Services Division

Viewed by currency type, the USD dominated the DFCC transactions.

KEPSS Usage as at June 2007

Kenya Electronic Payments and Settlement System (KEPSS) moved a volume of 155,131 transactions worth Ksh 7,929 billion in the year to June 30, 2007, representing a 6.27 percent increase from the year to June 30, 2006. The average amount moved per transaction however, declined from Ksh 61.38 million to Ksh 51.38 million, a decrease of 16.29 percent. The number of transactions moved per day, however, increased by 17.60 percent in the year to June 30, 2007 to 625 compared with 532 in the year to June 30, 2006. This number is expected to increase with the increase in response to the planned awareness campaign by the Bank, and the envisaged connectivity to KEPSS by KRA and Government Ministries. Direct payments through KEPSS decreased marginally from 92.2 percent to 91.2 percent while Clearing House Net Settlement Instructions (NSI) processed through KEPSS increased from 7.8 percent to 8.8 percent in the same period (Tables 12.7 and 12.8) below.

TABLE 12.7: TRENDS IN TOTAL ANNUAL FLOWS

Year to June 30	Total value moved per year (Ksh m)	No. of Transactions	Average value per transaction (Ksh m)	Days worked	Per day	
					Value (Ksh m)	Transactions
2006	7,641,197	120,249	61.38	227	32,919	532
2007	7,929,003	155,131	51.38	247	32,038	625

Source: Central Bank of Kenya, National Payments Systems

TABLE 12.8: DIRECT PAYMENTS VERSUS NET SETTLEMENT INSTRUCTIONS (NSI)

Year to June 30	Total value moved	Settlement proportions			
		Direct (Ksh m)	%	Indirect {NSI (Ksh m)}	%
2006	7,461,197	6,878,229	92.2	582,968	7.8
2007	7,929,003	7,234,837	91.2	694,166	8.8

Source: Central Bank of Kenya, National Payments Systems

Multiple third party Message Type (MT) 102 increased by 31.6 percent from 6,192 messages in the year to June 30, 2006 to 8,147 messages as at June 30, 2007, while single third party Message Type (MT) 103 increased by 86.51 percent in the same period from 24,978 messages to 46,587 messages. Overall, total third party messages processed through KEPSS increased by

75.6 percent from 31,170 messages to 54,734 messages in the year to June 30, 2007 (Table 12.9 below).

TABLE 12.9: THIRD PARTY TRANSACTIONS PROCESSED THROUGH KEPSS BY MESSAGE TYPE

Year to June 30	MT102	MT103	TOTAL
2006	6,192	24,978	31,170
2007	8,147	46,587	54,734

Source: Central Bank of Kenya, National Payments Systems

Mobile Phone Usage for Funds Transfer

In the year to June 30, 2007, the two mobile phone companies, Safaricom and Celtel entered the payment market with innovative m-payments products, M-pesa and Sokotele, respectively.

These innovative products have gained acceptance in the Kenyan market with a strong growth in customer registrations and uptake across the country. The products have also registered an increased volume of small value transfers both into urban areas from rural parts of the country and vice versa.

Plastic Card Usage

The annual demand for plastic cards continued to grow with the number of ATMs increasing by 32.8 percent from 555 ATMs by December 2005 to 737 ATMs by December 2006. Correspondingly, the total number of cards in use rose from 995,377 cards in December 2005 to 1,657,054 cards in December 2006, representing an increase of about 66.5 percent. This expansion may be attributed to the opening of more bank branches and roll out of ATMs across the country by Pesa Point. Tables 12.10 - 12.12 highlight these developments.

TABLE 12.10: NUMBER OF ATMs & USAGE (VOLUMES & VALUE OF TRANSACTION)

	2000	2001	2002	2003	2004	2005	2006
Number of ATM machines	94	107	174	215	324	555	737
Number of transactions '000'	5,297	5,707	6,005	4,637	6,656	9,103	14,222

TABLE 12.11: USAGE OF POS TERMINALS

	2000	2001	2002	2003	2004	2005	2006
Electronic							
Number of transactions	0	0	311	2,318	2,630	3,524	3,607
Value of transactions	1,500	1,600	1,700	8,308	11,306	14,275	13,995
Manual							
Number of transactions	0	0	0	165	557	3,965	3,645
Value of transactions	0	0	0	5,048	6,086	7,973	8,452

TABLE 12.12: NUMBER OF CARDS IN CIRCULATION

	2000	2001	2002	2003	2004	2005	2006
ATM cards	239,000	262,100	248,247	266,811	332,015	426,110	829,962
Debit cards	62,256	159,498	202,018	330,007	356,989	496,647	750,085
Credit cards	16,531	18,522	18,215	57,146	59,164	69,478	73,238
Charge cards	2,784	3,068	3,301	3,693	3,371	3,142	3,769
Total	320,571	443,188	471,781	657,657	751,539	995,377	1,657,054

Source: Central Bank of Kenya, National Payments Systems

B. CURRENT AND FUTURE DEVELOPMENTS

1. Legal Framework

The NPS Bill was forwarded by the Ministry of Finance to the Attorney General's office in preparation for presentation to Parliament. It is envisaged that the enactment of the Bill will facilitate the realization of a safe and efficient payment system in Kenya as it will widen the Bank's oversight function on institutions currently not licensed under the Banking and Micro Finance Acts, but are engaged in Movement of money.

In the year to June 30, 2007, the Bank successfully managed to execute the Vertical Master Repurchase Agreements and Intra-day Liquidity Facility agreements for open market operations intra-day and overnight liquidity provision to KEPSS participants.

2. Mobile Phone Banking and Remittances System

The Bank, in liaison with the Government will continue working towards the realization of an appropriate policy and regulatory framework for electronic money products, mobile phone banking and money remittance systems to ensure their safety, efficiency and reliability while promoting accessibility to banking services by Kenyans, and deepening of the financial sector.

3. Connectivity to KEPSS

The Bank in consultation with KRA and the Ministry of Finance commenced initiatives for KEPSS connectivity. The Government system (G-pay system), is currently being piloted as a precursor to the envisaged connectivity.

KEPSS connectivity will mitigate risk associated with cheques issuance and usage.

4. East African Cross Border Payment System

The Monetary Affairs Committee (MAC) of the East African Central Bank Governors adopted a harmonized East Africa Cross Border Payment System which will involve connectivity of the Real Time Gross Settlement (RTGS) systems in the region. The system is aimed at ensuring efficient and safe settlement of intra-regional financial transactions. Cross border payment system oversight initiatives will be pursued in line with the above developments.

OUTLOOK

Recent data from the Kenya National Bureau of Statistics shows that the real GDP grew by 6.3 percent in the first quarter of 2007, compared with 4.1 percent in the first quarter of 2006. It is expected that the on-going infrastructure projects relating to roads and power generation, will boost economic growth. In addition, Kenya continues to be a popular tourist destination, as exports continue to rise and macroeconomic prices remain stable.

However, the high and volatile crude oil prices remain a threat to macroeconomic stability.

CENTRAL BANK OF KENYA
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2007

TABLE OF CONTENTS **PAGE**

Bank Information	61
Directors' Report	62
Statement of Directors' Responsibilities	63
Statement of Corporate Governance	64-66
Report of the Independent Auditors	67
Financial Statements:	
Income Statement	68
Balance Sheet	69
Statement of Changes in Equity	70
Cash Flow Statement	71
Accounting Policies	72 - 77
Notes to the Financial Statements	78 - 91

CENTRAL BANK OF KENYA
BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2007

DIRECTORS

Prof.Njuguna Ndungu	-	Governor and Chairman (Appointed on 4 March 2007)
Mrs Jacinta W. Mwatela	-	Deputy Governor and Deputy Chairman
Mr Joseph K. Kinyua	-	Permanent Secretary-Treasury, Member
Mr Joseph K. Waiguru	-	Member–Appointed on 28 September 2006
Dr. William O. Ogara	-	Member–Appointed on 28 September 2006
Mr. Nicholas A. Nesbitt	-	Member– Appointed on 28 September 2006
Mr. George Ongaya-Okoth	-	Member– Retired on 15 August 2006
Prof. Henry K. Maritim	-	Member– Retired on 19 August 2006
Mr. Paul A. Spence	-	Member– Retired on 19 August 2006
Mr. Owen N. Koimburi	-	Member– Retired on 19 August 2006
Ms Agnes Wanjiru	-	Member –Appointed on 4 January 2007
Ms Wanza Kioko	-	Member –Appointed on 4 January 2007

SENIOR MANAGEMENT

Prof. Njuguna Ndungu	-	Governor
Mrs Jacinta W. Mwatela	-	Deputy Governor
Mr John M. Gikonyo	-	Director –Governor's office & Board Secretary
Mr Aggrey J.K. Bett	-	Director – Finance, Resource Planning and Strategy Management
Mr Jones M. Nzomo	-	Director – Human Resources and Services Department
Ms Rose Detho	-	Director – Banking Supervision Department
Ms Elizabeth C. A. Omolo	-	Executive Director – Kenya School of Monetary Studies
Mr Nicholas M. Kiritu	-	Director – Internal Audit & Risk Management
Mr Nicholas N. B. T. Korir	-	Director –Research Department
Mr Edwin L. Ogola	-	Director – Currency Operations and Branch Administration
Mr Gerald Nyaoma	-	Director – Banking Department
Mr Jackson M. Kitili	-	Director – Monetary Operations & Debt Management
Mr Charles O. Maranga	-	Director – Human Resources (Performance Management System)

REGISTERED OFFICE

Central Bank of Kenya Building
Haile Selassie Avenue
PO Box 60000
00200 Nairobi, Kenya

BRANCHES

Mombasa
Central Bank of Kenya Building
Nkrumah Road
PO Box 86372
80100 Mombasa, Kenya

Kisumu
Central Bank of Kenya Building
Jomo Kenyatta Highway
PO Box 4
40100 Kisumu, Kenya

Eldoret
Kiptagich House
Uganda Road
PO Box 2710
30100 Eldoret, Kenya

Kenya School of Monetary Studies
Thika Road
PO Box 65041
00200 Nairobi, Kenya

AUDITORS
Ernst & Young
Kenya - Re Towers, Upperhill
Off Ragati Road
PO Box 44286
00100 Nairobi, Kenya

LAWYERS
Oraro and Co Advocates
ACK Garden House
1st Ngong Avenue
PO Box 51236
00200 Nairobi, Kenya

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2007

The directors submit their report together with the audited financial statements for the year ended 30 June 2007, which shows the state of affairs of the Bank.

1. INCORPORATION

The Bank is incorporated under the Central Bank of Kenya Act Cap 491(the Act).

2. PRINCIPAL ACTIVITIES

The Bank is established and administered under the Act with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster the liquidity, solvency and proper functioning of a stable market-based financial system. The Bank acts as banker, advisor and fiscal agent of the Government of Kenya.

3. RESULTS

The results for the year as set out on page 8 show that the Bank recorded a deficit of KShs 386 million after a foreign exchange translation loss of KShs 9,845 million. The foreign exchange loss is attributed to appreciation of the Kenya Shilling during the year against foreign reserve currencies of the Bank namely the USA Dollar, the Sterling Pound and the Euro.

4. DIVIDEND

The Board of Directors do not recommend payment of dividend for the year ended 30 June 2007 (2006: KShs 2 billion).

5. DIRECTORS

The directors who served during the year and up to the date of this report are listed on page 1.

6. AUDITORS

The auditors, Ernst & Young, were appointed during the year in line with the Public Procurement and Disposal Act, 2005 for a period of three years.

By order of the Board

J.M. Gikonyo
BOARD SECRETARY

September 12, 2007

CENTRAL BANK OF KENYA
STATEMENT OF DIRECTORS' RESPONSIBILITIES
ON THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2007

We, the directors, certify that:

1. We are responsible for the preparation of financial statements for each financial year which present a true and fair view of the state of affairs of the Bank and of its operating results for that year. We are also responsible in ensuring that the Bank keeps proper accounting records which disclose with reasonable accuracy, the financial position of the Bank.

2. We accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgement and estimates, in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act.

3. We are responsible for safeguarding the assets of the Bank.

4. We are responsible for establishing and maintaining systems of internal control designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.

5. The directors are of the opinion that the financial statements for the year ended 30 June 2007 fairly present the financial position and operating results of the Bank.

6. Nothing has come to the attention of the directors to indicate that the Bank will not remain a going concern for at least twelve months from the date of this statement.

Signed on behalf of the Board of Directors by:-

Governor **Director**

September 12, 2007

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE

The Central Bank of Kenya is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from CBK Act Cap 491 of the laws of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

Board of Directors

Section 11 of the CBK Act Cap 491 provides that the Board of Directors shall constitute the Governor who is also the Chairman, Deputy Governor, who shall also be the Deputy Chairman, the Permanent Secretary to the Treasury, who is a non-voting member and five Non-Executive Directors. Other than the Permanent Secretary to the Treasury who is ex-officio, all the others are appointed by the President of the Republic of Kenya for terms of four years each and are eligible for reappointment provided that no Governor, Deputy Governor or director shall hold office for more than two terms.

Professor Njuguna Ndungu was appointed Governor on 4th March, 2007 following the expiry of the tenure of Dr. Andrew K. Mullei. Currently there are five Non-Executive Directors namely Messrs Waiguru, Nesbitt, Ogara, Kioko and Wanjiru who are all serving their first term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

Board Meetings

The Board meets once every six weeks and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to maintain full and effective control over strategic, financial and operational issues. The Board is not involved in the conduct of day-to-day business as this is a responsibility given to the Governor by the CBK Act Cap 491. It, however, retains responsibility for determining the policy of the Bank.

Monetary Policy Advisory Committee (MPAC)

Section 4D of the CBK Act establishes the Monetary Policy Advisory Committee. Members were appointed by the Minister for Finance on 29 July 2005 for three years with effect from 1 August 2005. Sections 4D2(d) require that the six independent members shall have knowledge, experience and expertise in matters relating to finance, banking, fiscal and monetary policy. The Secretariat of this Committee is based in the Research Department of the Bank and Members have unlimited access to the Bank for purposes of research in any area which they consider useful. The law requires that the Committee meets at least once every two months.

The main duties of the Committee are to:

(a) Advise the Bank with respect to Monetary Policy and;
(b) Perform such other functions as the Minister for Finance may prescribe by regulations.

The Committee is currently made up of the following:

(1) The Governor who is also the Chairman
(2) The Deputy Governor who is the Deputy Chairman
(3) Permanent Secretary to the Treasury or his alternative
(4) Professor T. C. Ryan
(5) Professor Francis Mwega
(6) Dr. Rose W. Ngugi
(7) Mrs. Sheila S.M.R. M'Mbijjewe
(8) Mr. Wycliffe Mukulu
(9) Mr. John Randa

However, there are proposals in the Finance Bill, which if enacted, will change the MPAC in three main aspects:-

1) The Committee members will no longer be 'advisory' to the Bank. The law proposes to delete the word "Advisory" from MPAC, to have the Committee as Monetary Policy Committee(MPC) as is the case in many other countries.

2) The MPC will be more entrenched with two additional CBK staff, unlike currently where only the Governor and Deputy Governor are official members. One of the additional CBK staff will be required to have knowledge in monetary policy formulation and the other to have knowledge/be responsible for monetary policy operations.

3) The Treasury will no longer be represented in the MPC.

The Board of Directors has two sub committees with specific responsibilities and the chairmen of these sub-committees submit regular reports to the Board through the Secretariats. The committees and their respective responsibilities are as follows:

Audit Committee

The Audit Committee is chaired by Dr. William O. Ogara and has three other members who are Non-Executive Directors having experience in Accounting, Auditing, Banking and Financial Management. The committee currently meets on a monthly basis and as necessary. Its responsibilities are to:-

- Keep under review the efficiency and effectiveness of internal controls in the Bank;
- Keep under review financial information and improves the quality of financial reporting with particular attention to compliance with legal and reporting requirements;
- Receive and consider the Bank's Annual Budget;
- Review the effectiveness of the Internal Audit Function and reports received there-from;
- Review the External Auditors Audit scope timetables and approach; their performance and their findings;
- Recommend on the appointment of the external auditors and their fees;
- Review the Bank's annual financial statements prior to their submission to the Board;
- Review the Banks' Risk Management Policies and Procedures.

Human Resources Committee

The Committee is presently chaired by Ms Agnes Wanjiru and membership includes three other Non-Executive Directors with the Governor and the Deputy Governor in attendance. The Committee meets regularly as and when need arises to review human resource policies and make suitable recommendations to the Board.

Management Structure

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on page 1. The positions of Governor and Deputy Governor are set out by statute in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

There are various other Management Committees, which advise the Governor on specific issues in order to enable him to discharge his responsibilities as the Chief Executive Officer of the Bank.

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial year 2006/2007 is disclosed in note 27 (iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid monthly and are eligible for the staff loans.

Code of Ethics

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests, which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct apply to the entire Bank's staff under the staff rules and regulations.

Internal Controls

The management of the Bank has put in place a series of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2005. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of Bank policies and procedures. There is a budget, which is approved by the Board before commencement of the financial year. The Board receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.

Internal Audit

The internal audit function is performed by Internal Audit and Risk Management department which is also responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit are available to the Audit Committee of the Board.

Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explains current monetary policy and also provides the expected monetary policy stance. In addition, the Bank issues policy briefs to the Treasury on both the monetary and fiscal policies. On an annual basis, the Financial Report is published in the Kenya Gazette.

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF CENTRAL BANK OF KENYA

Report on the Financial Statements

We have audited the financial statements of the Central Bank of Kenya set out on pages 68 to 91 which comprise the balance sheet as at 30 June 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. We have obtained all the information and explanations which to the best of our knowledge and belief, were necessary for the purpose of our audit. The financial statements are in agreement with the books of accounts. The financial statements for the year ended 30 June 2006 were audited by another auditor, whose report dated 17 October 2006 expressed unqualified opinion on the financial statements.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the state of financial affairs of the Bank as at 30 June 2007 and of the loss and cash flows for the year then ended in accordance with the International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

Nairobi

2007

ERNST & YOUNG
Certified Public Accountants

CENTRAL BANK OF KENYA
INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE 2007

	Note	2007 KShs million	2006 KShs million
Interest income	2	9,872	6,943
Interest expense	3	(1,016)	(1,039)
Net interest income		**8,856**	**5,904**
Fee and commission income	4	5,243	4,968
Foreign exchange loss	5	(9,337)	(109)
Other operating income	6	321	255
Operating income		**5,083**	**11,018**
Operating expenses	7	(5,469)	(6,267)
Impairment losses	8	-	(4)
(Loss)/profit for the year		(386)	4,747
Dividends:			
Proposed dividend for the year	9	-	2,000

CENTRAL BANK OF KENYA

BALANCE SHEET

AS AT 30 JUNE 2007

ASSETS	Note	2007 KShs million	2006 KShs million
Balances due from banking institutions and gold holdings	10	180,883	172,997
Items in the course of collection		589	537
Investment in government securities	11	4	1
Loans and advances	12	3,742	9,283
Other assets	13	1,562	6,851
Retirement benefit asset	14	240	394
Property and equipment	15	591	694
Prepaid operating lease rentals	16	282	285
Intangible assets	17	49	12
Due from Government of Kenya	18	35,549	35,549
TOTAL ASSETS		223,491	226,603
LIABILITIES			
Currency in circulation	19	89,799	76,207
Deposits	20	91,345	100,824
International Monetary Fund	21	15,740	13,588
Amounts repayable under repurchase agreements	22	15,626	23,342
Other liabilities	23	1,722	997
TOTAL LIABILITIES		214,232	214,958
EQUITY AND RESERVES			
Share capital	24	1,500	1,500
General reserve fund	25	7,759	8,145
Proposed dividend		-	2,000
TOTAL EQUITY AND RESERVES		9,259	11,645
TOTAL LIABILITIES AND EQUITY		223,491	226,603

The financial statements were approved by the Board of Directors for issue on September 12, 2007 and signed on its behalf by:

Governor

Director

CENTRAL BANK OF KENYA
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30 2007

	Share capital KShs million	General reserve fund KShs million	Proposed dividend KShs million	Total KShs million
Year ended 30 June 2006				
Balance at start of the year	1,500	5,398	-	6,898
Profit for the year	-	4,747	-	4,747
Proposed dividends for 2006/(Note 9)	-	(2,000)	2,000	-
Balance at end of the year	1,500	8,145	2,000	11,645
Year ended 30 June 2007				
Balance at start of the year	1,500	8,145	2,000	11,645
Loss for the year	-	(386)	-	(386)
2006 dividends paid	-	-	(2,000)	(2,000)
Balance at end of the year	1,500	7,759	-	9,259

CENTRAL BANK OF KENYA
CASH FLOW STATEMENT
FOR THE YEAR ENDED JUNE 30 2007

	Note	2007 KShs million	2006 KShs million
Operating activities			
Net cash (absorbed)/generated by operating activities	26 (a)	(2,826)	43,526
Investing activities			
Receipts of government loan		-	368
Purchase of property and equipment		(151)	(227)
Purchase of intangible assets		(55)	(14)
Proceeds from disposal of property and equipment		6	10
Proceeds in International Monetary Fund -SDR accounts		8	37
Net cash (used in)/from investing activities		(192)	174
Financing activities			
Dividends paid		(2,000)	-
Currency in circulation		13,592	8,885
Net cash from financing activities		11,592	8,885
Net increase in cash and cash equivalents		8,574	52,585
Cash and cash equivalents at start of year		166,691	114,106
Cash and cash equivalents at end of year	26 (b)	175,265	166,691

1. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

(a) Basis of preparation and form of presentation

(i) Basis of preparation

The financial statements are prepared in accordance with and comply with International Financial Reporting Standards (IFRS). The financial statements are presented in millions of Kenya Shillings (KShs million) and are prepared under the historical cost convention except for measurement at fair value of certain investments.

(ii) Form of presentation

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the "lender of last resort" to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases, confidence can best be sustained if the Bank's support is disclosed only when the conditions giving rise to potential instability in the economy have improved. Although the financial effects of such operations are included in the financial statements of the Bank, these statements may not explicitly identify such support.

(b) Significant accounting judgement and estimates

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the directors' best knowledge of current events and actions, actual results ultimately may differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. The most significant use of judgement and estimates are as follows:

(i) Impairment losses on loans and advances

The Bank reviews its loans and advances at each reporting date to assess whether an allowance for impairment should be recognised in the income statement. In particular, judgement by the directors is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on the assumptions about a number of factors and actual results may differ, resulting in future changes in the allowance.

In addition to specific allowances against individual significant loans and advances, the Bank makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration such factors as any deterioration in industry, technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

(ii) Pensions

The actuarial valuation cost of the defined benefit pension plan is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long nature of these plans, such estimates are subject to significant uncertainty. See note 14 for assumptions used.

(iii) Property, equipment and intangible assets

Critical estimates are made by the management in determining depreciation and amortisation rates for property, equipment and intangible assets. The rates used are set out in the accounting policy (f) and (g) below.

(c) Revenue recognition

Income is recognised in the period in which it is earned. Income is not accrued if its recoverability is considered doubtful.

Interest income and expenses

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments. When loans and advances become impaired, they are written down to their recoverable amounts.

Fees and Commission income

Fees and commissions are recognised on an accruals basis as the service is provided.

(d) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at rates ruling at the transaction dates. Assets and liabilities at the balance sheet date which are expressed in foreign currencies are translated into Kenya Shillings at rates ruling at that date. The resulting differences from conversion and translation are dealt with in the income statement in the year in which they arise.

(e) Employee benefits

Retirement benefits

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund scheme administered by Trustees and funded by the Bank. Deposit Protection Fund Board, a related party, reimburses the Bank the costs of contributions relating to staff seconded to it by the Bank.

The Bank's net obligation in respect to the plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value and the fair value of any plan assets is deducted. The calculation is performed by a qualified actuary using the Projected Unit Credit Method.

(e) Employee benefits (continued)

Where the calculation results in a benefit to the Bank, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reduction in future contributions to the plan. Actuarial gains and losses are charged to the income statement over the remaining working lives of the employees participating in the scheme.

The Bank also makes contributions to a statutory pension scheme, the National Social Security Fund (NSSF). Contributions to the scheme are determined by local statute and are shared between the employer and employee.

Other employee benefits

The Bank provides free medical treatment to staff and their dependants.

The estimated monetary liability for employees' accrued leave entitlement at the balance sheet date is recognised as an expense accrual.

(f) Property and equipment

Property and equipment are stated at purchase price less accumulated depreciation. Depreciation is computed on the straight line basis over the estimated useful lives of the assets at the following rates:

Building improvements	10%
Motor vehicles, furniture and equipment	50%

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any loss or gain on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in other operating income in the income statement in the year the asset is derecognised

(g) Intangible assets

Intangible assets include the value of computer software. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment loss.

The useful lives of intangible assets are assessed to be finite and are amortised over the useful economic life. The amortisation period with a finite useful life are reviewed at least at each financial year end. The amortisation expense on intangible assets with finite lives is recognised in the income statement
Amortisation is calculated using the straight line method to write down the cost of intangible assets to the residual values over the estimated useful life as follows:

Computer software	50%

(h) Financial assets and liabilities

Classification

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

The Bank classifies its financial assets in the following categories: financial assets at fair value through income statement, loans and advances, investments that are held to maturity, and financial assets that are available for sale. The Bank determines the classification of its investments at initial recognition.

(i) Financial assets at fair value through income statement

A financial asset is classified in this category if it is acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are classified as held at fair value through income statement. The Bank does not currently hold financial assets for trading.

(ii) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to counterparty with no intention of trading the receivable.

(iii) Held to maturity

Investments classified as held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's has the intention and ability to hold to maturity. Were the Bank to sell other than an insignificant amount of such assets, the entire category would be reclassified as available for sale. The Bank currently classifies repurchase and reverse purchase instruments as held to maturity.

(iv) Available for sale

These investments are those intended to be held for an indefinite period of time, which may be sold as part of the Bank's operations or otherwise. The Bank does not currently have any assets classified as available for sale.

Recognition and measurement

Loans are recognized when cash is advanced to the borrowers. Purchases and sales of other financial assets are recognized on trade date, the date on which the Bank commits to purchase or sell the asset. Financial assets are initially recognized at fair value, plus transaction costs for financial assets not carried at fair value through the income statement. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all of the risks and rewards of ownership. Financial assets that are available for sale and financial assets at fair value through income statement are subsequently carried at fair value.

Loans and advances and investments that are held to maturity are carried at amortised cost using the effective interest method, less provision for impairment.

(i) Loans and provisions for loan impairment

Loans are stated at outstanding amount less provision for impairment.

As the lender of last resort, the Bank may grant loans or advances for fixed periods not exceeding six months to commercial banks that pledge Government securities specified by the Bank.

In its capacity as the fiscal agent and banker to the Government, the Bank may make direct advances to the Government for the purpose of offsetting fluctuations between receipts from the budgeted revenue and the payments of the Government. The total amount of advances to the Government outstanding shall not exceed five percent of the gross recurrent revenue of the Government as shown in the Appropriation Accounts for the latest year for which those financial statements have been audited by the Controller and Auditor-General.

The Bank also operates a staff loans scheme for its employees for the provision of facilities such as house and car loans.

The Bank determines the terms and conditions for granting of the above loans with reference to the prevailing market interest rates and may determine different rates for different classes of transactions and maturities.

Specific provisions for loan impairment are made in respect of advances. The provisions are based on periodic evaluations of advances and take account of past loss experience, economic conditions and the estimated value of any underlying collateral, and are charged to the income statement.

When a loan is deemed uncollectable, it is written off against the related provision for impairment. Subsequent recoveries are credited to the income statement if previously written off.

(j) Dividends payable

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity until they are declared.

(k) Provisions

Provisions are recognised when the Bank has a present obligation / (legal or constructive) as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

(l) Offsetting of financial assets and liabilities

Financial assets and liabilities are offset and the net amount reported on the balance sheet when there is a legally enforceable right to set-off the recognised amount and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(m) Impairment

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If such condition exists, the asset's recoverable amount is estimated and an impairment loss recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised through the income statement.

(n) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

(o) Receivables

Amounts due from Government of Kenya and other assets are stated at their cost less impairment losses.

(p) Cash and cash equivalents

Cash and cash equivalents comprises of cash balances, bank deposits, current accounts, gold holding, government securities with maturity of upto 3 months from the date of issue.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

		2007 KShs million	2006 KShs million
2	**INTEREST INCOME**		
	Foreign investments earnings	8,440	5,372
	Local investments earnings	1,363	1,506
	Other interest earnings	69	65
		9,872	6,943
3	**INTEREST EXPENSE**		
	Interest on monetary policy issues	968	991
	Interest paid to IMF	48	48
		1,016	1,039
4	**FEES AND COMMISSION INCOME**		
	Commission on sale of government securities	5,236	4,967
	Special projects agency fees	7	1
		5,243	4,968
5	**FOREIGN EXCHANGE LOSS**		
	Gains on sale of foreign exchange	508	378
	Foreign exchange translation loss	(9,845)	(487)
		(9,337)	(109)
6	**OTHER OPERATING INCOME**		
	Rent received	17	14
	Proceeds from disposal of property and equipment	6	10
	Tuition fees and other charges	43	32
	Hospitality services	156	103
	Miscellaneous income	99	96
		321	255
7	**OPERATING EXPENSES**		
	Currency expenses	1,248	2,027
	Depreciation on property and equipment	254	721
	Property maintenance expenses	388	371
	Auditors' remuneration	4	5
	Banking expenses	4	3
	Operating lease rentals	3	4
	Amortisation on intangible assets	19	7
	Staff costs	2,956	2,654
	Other expenses	593	475
		5,469	6,267

8 IMPAIRMENT LOSSES

	2007 KShs million	2006 KShs million
Losses and write-offs of loans	-	4

9 DIVIDENDS

The directors do not recommend the payment of dividends for the year ended 30 June 2007 (2006: KShs 2 billion).

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2007 KShs million	2006 KShs million
Current accounts	2,333	2,604
Term deposits	171,262	162,674
Domestic forex currency cheque clearing	1,641	1,386
Forex travellers cheques	5	5
Gold holdings	20	21
Cash and cash equivalents	175,261	166,690
Accrued interest on foreign investments	1,132	910
Special Drawing Rights	5	13
Total own resources	176,398	167,613
Special project accounts	4,485	5,384
	180,883	172,997

11 INVESTMENT IN GOVERNMENT SECURITIES

Treasury bills and treasury bonds discounted	4	1

All the government securities held have a maturity date of within 90 days from the date of acquisition.

12 LOANS AND ADVANCES

	2007 KShs million	2006 KShs million
Advances to banks under liquidation	8,259	8,259
Other advances to banks	-	5
Government overdraft account (see below and Note 27)	42	5,202
Advances to employees (Note 27)	2,312	2,150
IMF funds on-lent to the Government (Note 27)	1,410	1,948
	12,023	17,564
Provision for loan impairment	(8,281)	(8,281)
Net advances as at 30 June	3,742	9,283

Movement in the provision for loan impairment is as follows:

At start of the year	(8,281)	(8,289)
Additional provisions made in the year	(2)	(2)
Recoveries in the year	2	10
At end of the year	(8,281)	(8,281)

12 LOANS AND ADVANCES (continued)

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at 5% of the Gross Recurrent Revenue as reported in the latest audited financial statements. The limit stands at KShs 13,268,817,798 based on the Government financial statements for 2004/2005, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 11,323,869,438 based on the Government financial statements for 2003/2004.

13 OTHER ASSETS

	2007 KShs million	2006 KShs million
Impersonal accounts	-	4,545
Sundry debtors	1,562	2,306
	1,562	6,851

14 RETIREMENT BENEFIT ASSET

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund. The defined benefit plan is funded by the Bank and the Deposit Protection Fund Board, a related party. The retirement benefit asset is wholly recognised in the financial statements of the Bank while the Deposit Protection Fund Board recognises contributions to the fund as if it were a defined contribution scheme.

The amounts recognised in the balance sheet are determined on the basis of an actuarial review carried out by Alexander Forbes Financial Services as at 30 June 2007.

	2007 KShs million	2006 KShs million
Present value of funded obligations	9,416	8,126
Fair value of plan assets	(10,774)	(9,260)
Present value of net asset	(1,358)	(1,134)
Unrecognised actuarial gain	1,118	740
Asset in the balance sheet	(240)	(394)

The amounts recognised in the income statement are as follows:

Current service costs	498	418
Interest costs	737	641
Expected return on plan assets	(845)	(725)
Total expenses included in operating expenses	391	334

Movements in the net asset recognised in the balance sheet are as follows:

Net expense recognised in the income statement	391	334
Employer contributions	(237)	(250)
Movement in the asset recognised in the balance sheet	(154)	(84)
Actual return on plan assets	**1,451**	**1,235**

14 RETIREMENT BENEFIT ASSET (continued)

The principal actuarial assumptions at the balance sheet date were:

	2007	**2006**
Discount rate (p.a)	9%	9%
Salary increase (p.a)	7%	7%
Expected return on plan assets (p.a)	9%	9%
Future pension increases	0%	0%

15 PROPERTY AND EQUIPMENT

	Land and buildings KShs million	**Motor vehicles KShs million**	**Furniture and equipment KShs million**	**Total KShs million**
30 JUNE 2007				
Cost				
At start of year	1,004	205	2,824	4,033
Additions	-	-	151	151
Adjustments	-	-	90	90
Disposals	-	(21)	-	(21)
At end of the year	1,004	184	3,065	4,253
Depreciation				
At start of the year	921	141	2,277	3,339
Charge for the year	21	37	196	254
Adjustments	-	-	90	90
Eliminated on disposal	-	(21)	-	(21)
At end of the year	942	157	2,563	3,662
Net book value At 30 June 2007	62	27	502	591
30 JUNE 2006				
Cost				
At start of year	1,004	193	2,474	3,671
Additions	-	45	182	227
Adjustments	-	-	247	247
Disposals	-	(33)	(79)	(112)
At end of the year	1,004	205	2,824	4,033
Depreciation				
At start of the year	835	153	1,495	2,483
Charge for the year	86	21	614	721
Adjustments	-	-	247	247
Eliminated on disposal	-	(33)	(79)	(112)
At end of the year	921	141	2,277	3,339
Net book value At 30 June 2006	83	64	547	694

During the year, the Bank carried out a physical verification of its property and equipment. As a result computer equipment previously written off from the books were reinstated.

16 PREPAID OPERATING LEASE RENTALS

Operating lease rentals are carried at historical cost less amortisation over the period of the lease. The breakdown is as follows:

	2007 KShs million	2006 KShs million
Cost		
At 30 June	300	300
Amortisation		
At 1 July 2006 and 2005	15	11
Amortisation for the year	3	4
At end of the year	18	15
Net carrying value at end of the year	282	285

17 INTANGIBLE ASSETS

	2007 KShs million	2006 KShs million
Cost		
At 1 July 2006 and 2005	125	110
Additions	55	14
At end of the year	180	124
Amortisation		
At 1 July 2006 and 2005	112	105
Amortisation for the year	19	7
At end of the year	131	112
Net carrying value at end of the year	49	12

18 DUE FROM GOVERNMENT OF KENYA

Loans due from the Government

	2007 KShs million	2006 KShs million
At start of the year	35,549	35,917
Receipts during the year	-	(368)
At end of the year	35,549	35,549

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act. The loan stood at KShs 35,549 million as at 30 June 2007.

Subsequent to year end, on 24 July 2007, a deed of guarantee was signed between the Government of Kenya (GoK) and Central Bank of Kenya in which the Government agreed to repay KShs 1.11billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

19 CURRENCY IN CIRCULATION

	2007 KShs million	2006 KShs million
Kenya notes	86,310	73,089
Kenya coins	3,484	3,113
Commemorative coins	5	5
	89,799	76,207

20 DEPOSITS

	2007	2006
Banks -Kenya	39,441	31,661
-External	25	20
Non-bank financial institutions	1,450	1,159
Other public entities and project accounts	119	119
International Monetary Fund	9,244	8,687
Government of Kenya	41,066	59,178
	91,345	100,824

21 INTERNATIONAL MONETARY FUND

Kenya has been a member of the International Monetary Fund (IMF) since 1966. The Bank is the designated depository for the IMF's holdings of Kenya's currency. IMF currency holdings are held in the No. 1 and No 2 Accounts, which are deposit accounts of the IMF with the Bank.

	2007		2006	
	SDR'	KShs	SDR'	KShs
International Monetary Fund Account No. 1	20	2,042	20	2,199
International Monetary Fund Account No. 2	-	1	-	1
International Monetary Fund–PRGF Account	122	12,287	87	9,440
International Monetary Fund On-lent to Government of Kenya	14	1,410	18	1,948
	156	**15,740**	**125**	**13,588**
On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and en cashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository.				
Security at 30 June	**243**	**24,947**	**238**	**24,947**

!22 AMOUNTS REPAYABLE UNDER REPURCHASE AGREEMENTS

These are securities issued and utilised by the Bank for monetary policy purposes and are shown as a liability to the buyers

23	OTHER LIABILITIES	2007 KShs million	2006 KShs million
	Impersonal accounts	985	-
	Sundry creditors	513	542
	Refundable deposits	187	237
	Development deposits	37	186
	Amount pending litigation	-	32
		1,722	**997**

24 SHARE CAPITAL

Authorised share capital	5,000	5,000
Issued and fully paid	1,500	1,500

25 GENERAL RESERVE FUND

The general reserve fund is a reserve fund where at least 10% of the net annual profits of the Bank is transferred at the end of each financial year. This is after allowing for expenses for operation and after provision has been made for bad and doubtful debts, depreciation in assets, contribution to staff benefit fund, and such other contingencies and accounting provisions as the Bank deems appropriate

26 NOTES TO THE CASH FLOW STATEMENT

(a)	Cashflows from operating activities	2007 KShs million	2006 KShs million
	Net (loss)/profit for the year	(386)	4,747
	Adjustments for:		
	Depreciation of property and equipment	254	721
	Amortization of prepaid operating leases	3	4
	Amortization of intangible assets	19	7
	Decrease in defined benefit scheme asset	154	84
	Gain on disposal of property and equipment	(6)	(10)
	Operating profit before working capital changes	**38**	**5,553**
	Net decrease in loans and advances	5,541	131
	(Decrease)/increase in amounts repayable under repurchase agreements	(7,716)	18,008
	(Decrease)/increase in deposits	(9,479)	20,927
	Increase/(decrease) in balance with International Monetary Fund	2,152	(1,285)
	Decrease/(increase) in project accounts	899	(222)
	Increase in accrued interest on balances due from banking institutions	(222)	(464)
	(Increase)/decrease in items in the course of collection	(52)	4,931
	Decrease/(increase) in other assets	5,289	(4,041)
	Increase/(decrease) in other liabilities	724	(12)
	Net cash (absorbed)/generated by operations	**(2,826)**	**43,526**

26 NOTES TO THE CASH FLOW STATEMENT (continued)

(b) Cash and cash equivalents

	2007	2006
	KShs million	KShs million
Cash and cash equivalents included in the cash flow statement comprise the following:		
Term deposits	171,262	162,674
Current accounts	2,333	2,604
Domestic forex cheques clearing	1,641	1,386
Travellers Cheques	5	5
Gold holdings	20	21
	175,261	166,690
Investment in Government securities	4	1
	175,265	**166,691**

27 RELATED PARTY TRANSACTIONS

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya, the ultimate owner of the Bank, and The Deposit Protection Fund Board.

(i) Loans

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 12) include advances to employees that as at 30 June 2007 amounted to KShs 2,312 million (2006: KShs 2,150 million). The advances are at preferential rates of interest determined by the Bank.

(ii) Loans to executive directors	2007 KShs million	2006 KShs million
At start of the year	6	12
Loans advanced during the year	14	-
Loan repayments	(4)	(6)
At end of the year	16	6

(iii) Loans to key management personnel		
At start of the year	32	30
Loans advanced during the year	8	19
Loan repayments	(22)	(17)
At end of the year	18	32

(iv) Directors' emoluments:		
Fees to non executive directors	4	9
Other remuneration to executive directors	26	41
Remuneration to senior management	109	105

(v) Government of Kenya

Transactions entered into with the Government include:

(a) Banking services;
(b) Management of issue and redemption of securities at a commission and
(c) Foreign currency denominated debt settlement and other remittances at a fee.

As at the close of business on 30 June, the following balances, which are included in various balance sheet categories, were outstanding:

	2007 KShs million	2006 KShs million
Due from Government of Kenya (Note 18)	35,549	35,549
Overdraft account (Note 12)	42	5,202
IMF funds on-lent to the Government (Note 12)	1,410	1,948
Government of Kenya deposits (Note 20)	41,066	59,178
Investments in GOK Securities (Note 11)	4	1

(vi) Deposit Protection Fund Board

The Bank has a close working relationship with The Deposit Protection Fund Board, an entity incorporated under the Banking Act, and provides it with staff and office accommodation. Certain costs incurred on behalf of The Deposit Protection Fund Board are fully reimbursed to the Bank.

The balance outstanding from The Deposit Protection Fund Board and included in other assets as at year end was KShs 23 million (2006: KShs18 million).

(vii) Kenya School of Monetary Studies

The Kenya School of Monetary Studies is a registered legal entity wholly owned by the Bank. The School is operated as a department and results of its operations are incorporated in the financial statements of the Bank.

27 LIQUIDITY RISK

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 30 June 2007 to the contractual

ASSETS	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Balances due from banking institutions and gold	9,616	171,262	-	-	5	180,883
Loans and advances	41	118	702	1,772	1,109	3,742
Investments in government securities	-	4	-	-	-	4
Items in the course of collection	589	-	-	-	-	589
Other assets	-	1,562	-	-	-	1,562
Property, plant and equipment	-	148	367	76	-	591
Prepaid leasehold land	-	1	3	14	264	282
Intangible assets	-	8	24	17	-	49
Retirement benefit asset	-	-	-	-	240	240
Due from Government of Kenya	-	-	-	5,550	29,999	35,549
TOTAL ASSETS	10,246	173,103	1,096	7,429	31,617	223,491
LIABILITIES						
Currency in circulation	-	-		-		89,799
Deposits	91,345	-		-		91,345
International Monetary Fund	-	-	413	1,535		15,740
Amounts repayable under repurchase	-	15,626		-		15,626
Other liabilities	-	1,722		-		1,722
Equity and reserves	-	-		-		9,259
TOTAL LIABILITIES AND EQUITY	91,345	17,348	413	1,535		223,491
Liquidity gap 2007	**-81,099**	**155,755**	**683**	**5,894**		**-**
Total assets	16,054	169,822	1,278	7,001		226,603
Total liabilities and equity	100,824	24,339	413	1,535		226,603
Liquidity gap As at 30 June 2006	**-84,770**	**145,483**	**865**	**5,466**		**-**

28 CURRENCY RISK

The various currencies to which the Bank is exposed at 30 June 2007 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	90,458	69,003	21,365	-	-	32	180,858
Special Drawing Rights	-	-	-	5	-	-	5
Gold holdings	-	-	-	-	20	-	20
Total assets	90,458	69,003	21,365	5	20	32	180,883
Liabilities							
Balances due to IMF	-	-	-	15,740	-	-	15,740
Commissions for EEC Development Fund	-	37	-	-	-	-	37
Forex bureaux deposits	1,227	108	290	-	-	-	1,625
Total liabilities	1,227	145	290	15,740	-	-	17,402
Net balance sheet position 2007	**89,231**	**68,858**	**21,075**	**-15,735**	**20**	**32**	**163,481**
As at 30 June 2006							
Total assets	87,890	58,568	26,362	13	21	53	172,907
Total liabilities	973	408	216	13,588	-	-	15,185
Net balance sheet position 2006	**86,917**	**58,160**	**26,146**	**-13,575**	**21**	**53**	**157,812**

29 INTEREST RATE RISK

This table shows the extent to which the Bank's interest rate exposures on assets and liabilities are matched. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and maturity date.

	3 months or less	Between 3-12 months	Over 1 year	Non- interest bearing	Total
	KShs million	KShs million	KShs million	KShs million	KShs million
Assets					
Balances due from banking institutions	176,398	-	-	4,485	180,883
Items in the course of collection	-	-	-	589	589
Investment in government securities	4	-	-	-	4
Loans and advances	74	934	2,734	-	3,742
Other assets	-	-	-	1,562	1,562
Property, plant and equipment	-	-	-	591	591
Prepaid leasehold land	-	-	-	282	282
Intangible assets	-	-	-	49	49
Retirement benefit asset	-	-	-	240	240
Due from Government of Kenya	-	1,110	34,439	-	35,549
Total assets	176,476	2,044	37,173	7,798	223,491
Liabilities and equity					
Currency in circulation	-	-	-	89,799	89,799
Deposits	91,345	-	-	-	91,345
International Monetary Fund	-	-	-	15,740	15,740
Amounts repayable under repurchase	15,626	-	-	-	15,626
Other liabilities	-	-	-	1,722	1,722
Equity and reserves	-	-	-	-	9,260
Total liabilities and equity	106,971	-	-	116,520	223,491
Interest sensitivity gap 2007	**69,505**	**2,044**	**37,173**	**-108,722**	**-**
Total Assets	172,939	1,746	37,761	14,157	226,203
Total liabilities and equity	124,166	-	-	102,437	226,203
Interest sensitivity gap 2006	**48,773**	**1,746**	**37,761**	**-88,280**	**-**

30 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES

In the opinion of the directors, the fair values of the Bank's financial assets and liabiliti approximate their respective carrying amounts. Fair values are based on discounted cash flow using a discount rate based on the borrowing rate that directors expect would be available to th Bank at the balance sheet date.

The effective interest rates for the principal financial assets and liabilities at 30 June 2007 and 200 were in the following ranges:

		2007	2006
Assets			
Government securities		6.64%	6.2'
Deposits with overseas correspondent banks			
	- current accounts	0.0%	0.0'
	- term deposits (USD)	5.29%	5.1'
	- term deposits (Pounds Sterling)	5.65%	4.6'
	- term deposits (Euro)	4.10%	2.9'
Loans and advances	- Commercial banks	8.50%	9.75'
	- Government of Kenya	8.50%	9.75'
	- Employees	3.0%	3.0'
Due from Government of Kenya		3.0%	3.0'
Liabilities	-Customer deposits	0%	0'

31 CONTINGENCIES

Pending legal suits

(i) There are several legal suits pending against the Bank relating to the Grand Regency Hote If the suits are successful, the Bank will be required to pay approximately KShs 8.1 billic excluding any interest awards on the claims. The Bank has however lodged counter-clain amounting to KShs 19.3 billion.
In view of observations by the Bank's advocates and the findings of the Goldenbei Commission of inquiry, the directors are of the opinion that the cases are unlikely to b determined against the Bank.

(ii) The Bank is also party to various legal proceedings with potential liability of KShs 38 million at 30 June 2007. Having regard to the legal advice received, and in all circumstance the directors are of the opinion that these legal proceedings will not give rise to liabilities.

32 COMMITMENTS

	2007 KShs million	2006 KShs million
Contracted for	10	163

Capital commitments contracted for relates to currency disintegration and briquetting system for Kisumu and Eldoret bank notes and sorting system.

32 COMMITMENTS (continued)

OPERATING LEASE COMMITMENTS

AS LESSEE:

The total future minimum lease payments due to third parties under non-cancellable operating leases are as follows:

	2007 KShs million	2006 KShs million
One year	11	9
Between two and five years	7	7
Over five years	140	142
	158	**158**

Lease commitments relate to lease rentals for L.R No. 209/11441.

33 EMPLOYEES

The average number of employees during the year was 1,255 (2006: 1,265).

34 TAXATION

No provision for tax is made as Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

35 COMPARATIVES

Where necessary, comparative figures have been adjusted or excluded to conform to changes in presentation in the current year.