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LETTER OF TRANSMITTAL

In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Deputy Prime Minister and Minister for Finance, the Annual Report of the Central Bank of Kenya for the Fiscal Year 2010/11. The Annual report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Fiscal Year ended June 30, 2011.

Njuguna Ndung'u

Governor

PREFACE

The world economy rebounded from 0.5 percent decline in 2009 to 5.1 percent growth in 2010. This recovery is largely attributed to accommodative economic policies pursued by countries in response to the 2007/08 global financial crisis.

The Kenyan economy performed well in 2010 and realized growth in gross domestic product (GDP) of 5.6 percent compared with expansion of 1.5 percent in 2008 and 2.6 percent in 2009. The continued recovery was driven by strong growth in Agriculture and Forestry, Electricity and Water Supply, Mining and Quarrying, Financial Intermediation, Wholesale and Retail Trade, Repairs, and Transport and Communication. The economy continued to perform favourably in the first three months of 2011 and registered real growth of 4.9 percent, or 60 basis points above 4.3 percent growth in the corresponding period in 2010. Real GDP growth is projected to stabilize at 5.3 percent in 2011.

The monetary policy focused on achieving and maintaining low inflation. The twelve month inflation rate rose from 3.5 percent in June 2010 to 14.5 percent in June 2011 on account of adverse supply side shocks, including drought and high oil prices. The annual average inflation rose to 6.9 percent in June 2011 from a low of 3.9 percent in January 2011 and 5.4 percent in June 2010. Monetary conditions were tightened beginning March 2011 to contain domestic inflation. Money supply, M3, grew by 15.1 percent and reserve money grew by 4.3 percent in the year to June 2011 against target growths of 16.8 percent and 2.4 percent, respectively. M3 expansion largely reflected increased bank credit to the private sector.

The Central Bank Rate (CBR) continued to signal the direction of short-term interest rates. Emphasis at the beginning of the fiscal year 2010/11 was on lowering interest rates to allow for credit expansion to support economic growth. This stance was reviewed in the second half of the year to rein in inflationary expectations and stabilize the exchange rate. The CBR was raised by 50 basis points between January 2011 and June 2011. Consistent with the tight stance of monetary policy, the average interbank rate rose from 1.2 percent in March 2011 to 6.4 percent in June 2011. The average 91-day Treasury bill interest rate rose by 732 basis point to 8.9 percent in the year to June 2011, the average deposit rate edged up 27 basis points to 3.9 percent between February and June 2011, while average bank lending rates remained steady at 13.9 percent. The spread on commercial bank lending rates remained above 10 percent throughout the fiscal year reflecting risk perception by banks on the economy.

The Government continued to pursue prudent fiscal policy and realized a reduced budget deficit of 137.6 billion (5.0 percent of GDP) on commitment basis in the fiscal year 2010/11. The deficit was within the target of 6.8 percent of GDP. Government revenues grew by 21.2 percent to Ksh 660.8 billion during the year but fell short of target due to underperformance in Appropriation-in-Aid and non-tax revenue. Government expenditure and net lending increased by 13.7 percent to Ksh 817.1 billion, but fell short of target partly on account of a low absorption rate on development expenditure. However, the share of the development budget increased from 27.7 percent in fiscal year 2009/10 to 28.7 percent in fiscal year 2010/11 in line with fiscal objective of prioritizing infrastructural development to crowd in private investment.

The Kenya shilling weakened by 9.9 percent against the US dollar in fiscal year 2010/11 from Ksh 81.0 in June 2010 to Ksh 89.0 in June 2011. This reflects developments in the international currency market, particularly the Debt Crisis in the Euro zone, and pressure from Kenya's balance of payments. The surplus on the balance of payments narrowed from US$ 592 million in the fiscal year 2009/10 to US 261 million in the twelve months to June 2011 due to stronger growth in the value of merchandise imports as compared with growth in the value of exports of goods and services. The wider current account deficit was financed by private financial inflows. During the year under review, the Central Bank of Kenya increased its holding of foreign exchange reserves from US$ 3,799 million (3.9 months of import cover) as at June 2010 to US$ 4,142 million (3.9 months of import cover) as at June 2011. The build up of official reserves was achieved through domestic interbank purchases by the Bank and program disbursement under the 3 Year Extended Credit Facility (2011-14) negotiated with the International Monetary Fund.

The performance of the Banking Sector improved in the fiscal year 2010/2011. The sector's total assets increased by 21 percent from Ksh 1,548.4 billion in June 2010 to Ksh 1,874.8 billion in June 2011. The major components of the balance sheet were loans and advances, government securities and placements, which accounted for 55.0 percent, 22.0 percent and 6.0 percent of total assets, respectively. Gross loans and advances grew by 30.7 percent to Ksh 1,083.1 billion in June 2011. The stock of gross non-performing loans (NPLs) declined by 5.2 percent to Ksh 58.3 billion in June 2011 thereby lowering the ratio of gross NPLs to gross loans from 7.4 percent to 5.4 percent over the period under review. Deposits from customers, which accounted for 75 percent of total funding liabilities, increased by 15.9 percent to Ksh 1,412.8 billion in June 2011 mainly due to branch expansion, remittances and receipts from exports. Other developments in the banking sector include increased uptake of customer credit history by banks; additional approvals to banks to roll out the agency banking model; and the licensing of a deposit taking microfinance institution.

UTANGULIZI

Uchumi wa dunia uliimarika kutoka kushuka kwa asilimia 0.5 mwaka 2009 hadi kukua kwa asilimia 5.1 mwaka 2010. Kuimarika huku hasa ni kutokana na sera nzuri za kiuchumi zilizoanzishwa na nchi mbali mbali kwa nia ya kukabiliana na matatizo ya kiuchumi duniani ya mwaka 2007/08.

Uchumi wa Kenya uliimarika mwaka 2010 na kupata ukuaji katika jumla ya pato la taifa (GDP) kwa asilimia 5.6 ikilinganishwa na ukuaji wa asilimia 1.5 mwaka 2008 na asilimia 2.6 mwaka 2009. Upanuzi huu ulitokana hasa na ukuaji mkubwa katika sekta muhimu nchini zikiwemo kilimo na misitu, usambazaji wa uhakika wa umeme na maji, uchimbaji wa madini, usawazishaji wa sekta ya fedha, biashara ya jumla na rejareja, na uchukuzi na mawasiliano. Uchumi uliimarika vyema katika miezi mitatu ya kwanza ya mwaka 2011 na kukua kwa asilimia 4.9, au alama 60 juu ya ukuaji wa asilimia 4.3 kwa wakati kama huo mwaka uliopita. Pato halisi la taifa linatarajiwa kukua kwa asilimia 5.3 mwaka 2011.

Sera ya fedha ililenga kufikia na kudumisha mfumuko wa bei ya chini. Katika muda wa miezi kumi na mbili mfumuko wa bei uliongezeka kutoka asilimia 3.5 mwezi Juni 2010 hadi asilimia 14.5 mwezi Juni 2011 kutokana na ukame na kupanda kwa bei ya mafuta. Wastani wa mwaka wa mfumuko wa bei uliongezeka hadi asilimia 6.9 mwezi Juni 2011 kutoka asilimia 3.9 mwezi Januari 2011 na asilimia 5.4 mwezi Juni 2010. Kuliwekwa masharti magumu kwa suala zima la fedha kuanzia mwezi Machi 2011 ili kukabiliana na mfumuko wa bei nchini. Usambazaji wa pesa, M3, ulikua kwa asilimia 15.1 na pesa za akiba zikakua kwa asilimia 4.3 mwaka huu hadi Juni 2011. Lengo lilikuwa ni ukuaji wa asilimia 16.8 na asilimia 2.4, mtawalia. Upanuzi wa M3 hasa ulionekana wakati mabenki yalipozidisha kutoa mikopo kwa sekta ya binafsi.

Kiwango cha riba cha Benki Kuu ya Kenya (CBR) kiliendelea kuonyesha mwelekeo wa viwango vya riba vya muda mfupi. Mwanzoni mwa mwaka wa fedha 2010/11 msisitizo ulikuwa katika kupunguza viwango vya riba ili kutoa nafasi kwa sekta ya binafsi kukopa na kuchochea ukuaji wa uchumi. Msimamo huu ulibadilishwa katika nusu ya pili ya mwaka ili kukabiliana na tatizo la mfumuko wa bei na kuleta utulivu wa kiwango cha ubadilishanaji wa pesa za kigeni. Kiwango cha riba cha Benki Kuu kiliongezeka kwa alama 50 kati ya Januari 2011 na Juni 2011. Kutokana na masharti makali ya sera nzima ya pesa, kiwango cha riba kati ya mabenki kilipanda kutoka asilimia 1.2 mwezi Machi 2011 hadi asilimia 6.4 mwezi Juni 2011. Kiwango cha riba katika siku 91 kwa hawala za serikali kiliongezeka kwa alama 732 hadi asilimia 8.9 kufikia mwezi Juni 2011, na kiwango cha pesa zilowekwa kikaongezeka kwa alama 27 hadi asilimia 3.9 kati ya mwezi Februari na Juni 2011, wakati viwango vya kukopa kwa benki vikawa katika asilimia 13.9. Hivyo basi, tofauti kati ya kiwango cha riba ya mikopo na amana ilibakia kuwa juu ya asilimia 10 katika mwaka mzima wa fedha na kuonyesha hali ya mtazamo wa mabenki kuhusu uchumi.

Serikali iliendeleza sera makini za fedha na kuafikia kiwango kidogo cha nakisi ya bajeti la shilingi bilioni 137.6 (asilimia 5.0 ya pato la taifa) katika mwaka wa fedha 2010/11 ikilinganishwa na asilimia 6.8 ya pato la taifa kwenye bajeti. Mapato ya serikali yaliongezeka kwa asilimia 21.2 hadi shilingi bilioni 660.8 mwaka huu lakini haikutimiza lengo. Matumizi ya serikali yaliongezeka kwa asilimia 13.7 hadi shilingi bilioni 817.1, lakini lengo halikutimia kutokana na kiwango kidogo cha matumizi ya ustawishaji. Hata hivyo , kiwango cha bajeti ya ustawishaji kiliongezeka kutoka asilimia 27.7 mwaka wa fedha 2009/10 hadi asilimia 28.7 mwaka wa fedha 2010/11 ikiwa katika kuendeleza sera ya kutoa kipaumbele kwa ustawishaji wa miundo msingi.

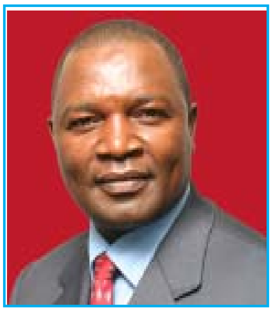
Shilingi ya Kenya ilishuka thamani kwa asilimia 9.9 dhidi ya dola ya Marekani mwaka wa fedha 2010/11 kuanzia shilingi shilingi 81.0 mwezi Juni 2010 hadi shilingi 89.0 mwezi Juni 2011. Hii inaoyesha maendeleo katika soko la fedha la kimataifa, hasa tatizo la deni katika eneo la Ulaya, na shinikizo katika ulipaji wa Kenya. Ziada katika ulipaji ilipungua kutoka dola za kimarekani milioni $ 592 kwa mwaka wa fedha 2009/10 hadi dola za kimarekani milioni 261 katika muda wa miezi kumi na mbili hadi Juni 2011 kutokana na ukuaji mkubwa wa thamani ya bidhaa zinazoingia nchini ikilinganishwa na thamani ya bidhaa na huduma zinazouzwa nje ya nchi. Mwaka huo, Benki Kuu ya Kenya iliongeza akiba yake ya pesa za kigeni kutoka dola za kimarekani milioni 3,799 million (sawa na malipo ya miezi 3.9 ya bidhaa zinazoingia nchini) kufikia mwezi Juni 2010 hadi dola za kimarekani $ 4,142 million (sawa na malipo ya miezi 3.9 ya bidhaa zinazoingia nchini) kufikia mwezi Juni 2011. Kuimarika kwa akiba rasmi kulitokana na ununuzi wa fedha za kigeni na Benki Kuu ya Kenya kutoka kwa mabenki ya humu nchini na mgawo wa pesa chini ya mpango wa mkopo wa miaka 3 (2011-14) kati ya Serikali na shirika la fedha duniani (IMF).

Sekta ya benki iliimarika katika mwaka wa fedha 2010/2011. Raslimali za sekta hiyo ziliongezeka kwa asilimia 21 kutoka shilingi bilioni 1,548.4 mwezi Juni 2010 hadi shilingi bilioni 1,874.8 mwezi Juni 2011. Daftari la hesabu lilionyesha mikopo na amana za serikali, ambazo zilikuwa asilimia 55.0 na asilimia 22.0 ya idadi kamili ya amana, mtawalia. Mikopo kwa jumla na chambele (advances) iliongezeka kwa asilimia 30.7 percent hadi shilingi bilioni 1,083.1 mwezi Juni 2011.

Kiwango cha mikopo ambayo hayalipwi (NPLs) kilipungua kwa asilimia 5.2 hadi bilioni 58.3 mwezi Juni 2011 na kupunguza uwiano wa mikopo hiyo kutoka asilimia 7.4 hadi asilimia 5.4 katika muda ambao ukaguzi ulifanywa. Pesa kutoka kwa wateja, ikiwa ni asilimia 75 ya dhima, iliongezeka kwa asilimia 15.9 hadi shilingi bilioni 1,412.8 mwezi Juni 2011 hasa kutokana na kuongezeka kwa matawi katika sehemu mbali mbali, fedha kutoka kwa Wakenya walioko ugenini na mapato kutoka kwa bidhaa zinazouzwa nje ya nchi.

Mambo mengine yaliyochangia katika kuimarika kwa sekta ya benki ni mabenki kukusanya taarifa muhimu za wateja katika ulipaji mikopo; mabenki kupata idhini ya kuanzisha mfumo wa benki za mawakala; na kutoa leseni kwa taasisi za kutoa mikopo midogo midogo kuweka pesa za wateja.

BOARD OF DIRECTORS



PROF. NJUGUNA NDUNG'U
Governor and Chairman
Central Bank of Kenya

MR. JOSEPH M. KINYUA
Permanent Secretary,
Ministry of Finance

DR. HEZRON NYANGITO
Deputy Governor
Central Bank of Kenya

DR. WILLIAM O. OGARA

MR. NICHOLAS A. NESBITT

MS. AGNES WANJIRU KAMIRI

MS. WANZA KIOKO

MR. JOSEPH K. WAIGURU

SENIOR MANAGEMENT

MR. PETER K. ROTICH
Director, Human Resources Department

PROF.. KINANDU MURAGU
Executive Director, Kenya School of Monetary Studies

MR. JONATHAN A. BETT
Director, Finance and Information Management Services

MR. KENNEDY ABUGA
Director, Governor's Office

MR. CASSIAN J. NYANJWA
Director, Department of Estates, Supplies and Transport

MR. FREDRICK P.K. PERE
Director, Bank Supervision Department

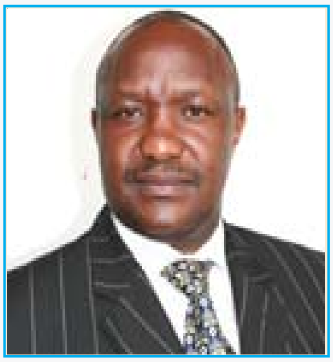
SENIOR MANAGEMENT

MR. GERALD A. NYAOMA
Director, Financial Markets Department

MR. JACKSON M. KITILI
Director, Banking & Risk Management Department

MR. CHARLES G. KOORI
Director, Research and Policy Analysis Department

MR. JAMES T. LOPOYETUM
Director, Currency Operations and Branch Administration



MR. WILLIAM NYAGAKA
Director, Internal Audit & Risk Management

MEMBERS OF THE MONETARY POLICY COMMITTEE

Prof. Njuguna Ndung'u
Governor, Chairman

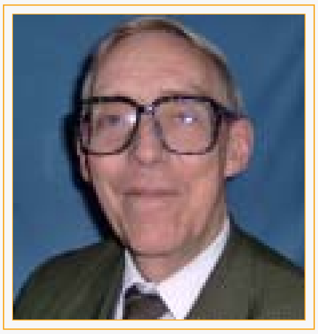
Dr. Hezron O. Nyangito
Deputy Governor, Vice-Chairman

Mr. Joseph K. Kinyua
PS, Treasury
Treasury Representative

Mrs. Sheila S.M.R. M'Mbijjewe
Member

Mr. Charles Koori
Member

Dr. Rose W. Ngugi
Member



Prof. Terry C. I. Ryan
Member

Mr. Wycliffe Mukulu
Member

Mr. John Birech
Member

BANK REORGANISATION

Re-Appointment of the Governor

The Governor, Prof. Njuguna Ndung'u was re-appointed by His Excellency President Mwai Kibaki vide Gazette Notice No. 2055 dated February 25, 2011 to serve as the Governor of the Central Bank of Kenya for a further term of four (4) years with effect from March 4, 2011.

Appointment of Members of Central Bank of Kenya Board and Monetary Policy Committee (MPC)

H.E. the President appointed four (4) new members to the Central Bank of Kenya Board of Directors and re-appointed one of the outgoing directors for a further term of four (4) years with effect from March 14, 2011 and June 1, 2011, respectively.

The Minister for Finance appointed two (2) new members to the Monetary Policy Committee of the Bank and re-appointed two (2) in the previous committee for a further term of three (3) years with effect from May 1, 2011.

CBK Participation in Nairobi International Trade Fair

The Central Bank of Kenya jointly with the three other financial sector regulators (The Capital Markets Authority (CMA), The Retirement Benefits Authority (RBA) and The Insurance Regulatory Authority (IRA) participated in the Nairobi International Trade Fair and Mombasa ASK Show, which were held from September 27 to October 3, 2010 and from August 4 to August 8, 2010, respectively.

Establishment of Currency Centres

The Central Bank of Kenya partnered with the Kenya Bankers Association (KBA) to establish Currency Centres in Nakuru and Meru on November 18, 2010 and February 22, 2011, respectively to facilitate smooth currency services (withdrawals and deposits) for commercial banks within a designated region.

Restructuring of Departments

On December 3, 2010, the Central Bank of Kenya restructured some of the departments to align itself with the on-going economic reforms and the Government's national economic aspirations focusing on attainment of Vision 2030.

The following Departments were restructured:-

1. Financial Markets Department
2. Banking Services and Risk Management Department
3. Bank Supervision Department
4. Human Resources and Administration Department
5. Currency Operations and Branch Administration
6. Finance, Planning and IMS Department
7. Governors' Office Department

Launch of Project SIMBA Change Management Initiatives

On July 5, 2010 the Central Bank of Kenya appointed a change management team to spearhead Project SIMBA.

In order to modernize and upgrade its operations, the Central Bank of Kenya launched the Oracle system which is an Enterprise Resource Planning (ERP) information system used to plan and administer human, financial and material resources. The system went live on December 14, 2010.

Appointment of PMAS Moderation and Appeals Committees

Further to the launch of the new Performance Management and Appraisal System (PMAS) in July 2009, the Central Bank of Kenya appointed PMAS Moderation and Appeals Committees on December 3, 2010 in a bid to enhance positive staff performance and transform the Bank into a high performing institution.

1. WORLD ECONOMY

The June 2011 update of the World Economic Outlook by the International Monetary Fund indicates that the world economy grew by 5.1 percent in 2010 compared with a decline of 0.5 percent in 2009. Reduction in excess capacity, accommodative policies, improvements in business confidence, financial conditions and consumption accounted for the economic recovery in 2010. However, global recovery remains unbalanced with weak recovery in advanced economies and robust growth in emerging and developing economies (Table 1.1).

Advanced economies grew by 3 percent in 2010 compared with a decline of 3.4 percent in 2009. Fiscal stimulus coupled with accommodative monetary policy stance were instrumental in boosting real GDP growth in 2010. However, substantial slack, subdued private demand, high indebtedness and high unemployment remain a challenge to rapid economic recovery in these economies.

Emerging and developing economies grew by 7.4 percent in 2010 compared with 2.8 percent in 2009. Some Asian countries continue leading in the recovery process followed by Sub-Saharan Africa, Eastern Europe and Latin America. China and India grew by 10.3 percent and 10.4 percent in 2010, respectively. GDP growth in Sub-Saharan Africa accelerated to 5.0 percent in 2010 from 2.8 percent in 2009. Much of this growth was attributed to higher commodity prices, accommodative policy measures, increased exports, tourism and capital inflows.

TABLE 1.1: ACTUAL, AND PROJECTED OUTPUT OF SELECTED COUNTRIES/REGIONS 2009 - 2012

Country/Region	2009	2010	2011	2012
Global Output	-0.5	5.1	4.3	4.5
Advanced Economies	-3.4	3.0	2.2	2.6
USA	-2.6	2.9	2.5	2.7
Euro Zone	-4.1	1.8	2.0	1.7
UK	-4.9	1.3	1.5	2.3
Emerging and Developing Economies	2.8	7.4	6.6	6.4
Developing Asia	7.2	9.6	8.4	8.4
China	9.2	10.3	9.6	9.5
India	6.8	10.4	8.2	7.8
Brazil	-0.6	7.5	4.1	3.6
SSA	2.8	5.0	5.5	5.9

Source: IMF, Update World Economic Outlook June 2011

Capital Flows

Net capital flows to developing countries declined by 20 percent in 2009 to US$ 598 billion from US$ 744 billion in 2008. International capital flows to Europe and Central Asia and Latin America and the Caribbean declined by 66 percent and 6 percent in 2009, respectively. Net capital flows to the Middle East and North Africa (MENA), and South Asia rose by 32 percent and 26 percent, respectively. The increase in capital flows to MENA was due largely in lending by official creditors and inflow of short-term debt (Table 1.2).

TABLE 1.2: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES 2005-2009

(US $ Billion)	2005	2006	2007	2008	2009*
Total	465	610	1111	744	598
By region:					
East Asia and Pacific	171	192	282	183	191
Europe and Central Asia	128	218	411	262	90
Latin America and the Caribbean	85	66	217	177	167
Middle East and North Africa	19	14	30	21	28
South Asia	29	77	118	62	77
Sub-Saharan Africa	33	43	53	39	45

* Estimate

Source: Global Development Finance (2010)

Net private capital flows comprises foreign direct investment and portfolio investment. Net Foreign Direct Investment (FDI) flows to developing countries declined by 40 percent in 2009 to US$ 354 billion from US$ 587 billion in 2008 (Table 1.3).

TABLE 1.3: NET FDI INFLOWS TO DEVELOPING COUNTRIES 2006 TO 2010 (US$ Billion)

	2005	2006	2007	2008	2009*
Net private and official flows	**465**	**610**	**1111**	**744**	**598**
of which:					
Net equity flows	341	451	643	534	462
FDI flows	274	343	508	587	354
Portfolio flows	68	108	135	-53	108
Net debt flows	124	159	467	210	136
Official	-64	-70	0	28	76
Private	188	229	467	182	59

* Estimate

Source: Global Development Finance (2010)

In contrast, there was a reversal in net portfolio equity flows to developing countries from an outflow of US$ 53 billion in 2008 to a US$ 108 billion inflow in 2009. This reflected divestiture by international investors from riskier assets to securities perceived to be safer. The recovery in portfolio flows was associated with the rebound in world trade.

Remittances to Developing Countries

Remittances to developing countries increased by 6.5 percent to US$ 326 billion in 2010 from US$ 306 billion in 2009 (Table 1.4). Remittance flows proved to be resilient during the global financial crisis and had become even more important as a source of external financing in many developing countries. The global economic recovery experienced in 2010, led to an increase in remittance flows to all six developing regions. Remittance flows to South Asia and East Asia and Pacific increased by 8.0 percent and 9.4 percent, respectively in 2010. However, remittance flows to Latin America and the Caribbean and Eastern Europe and Central Asia regions remained almost flat in 2010 because of economic weakness in the United States and Western Europe (Table 1.4). Sub-Saharan Africa registered a 4.8 percent growth in remittance flows in 2010.

TABLE 1.4: REMITTANCE FLOWS TO DEVELOPING COUNTRIES: 2006-2010 (US$ billion)

	2006	2007	2008	2009	2010*
East Asia & Pacific	57	71	86	85	93
Europe & Central Asia	28	39	46	36	36
Latin America & the Caribbean	59	63	65	57	58
Middle East & North Africa	25	31	35	32	36
South Asia	43	54	72	75	81
Sub-Saharan Africa	***13***	***19***	***21***	***21***	***22***
Total	**225**	**277**	**324**	**306**	**326**

* Estimate

Source: World Bank

Outlook for 2011 and 2012

Global recovery in the second quarter of 2011 has slowed down slightly due to greater than expected slowdown in US economic activity, the impact of the earthquake and Tsunami that hit Japan in March 2011, renewed financial volatility and fiscal imbalances in the US and euro area, and economic slowdown in some emerging market economies.

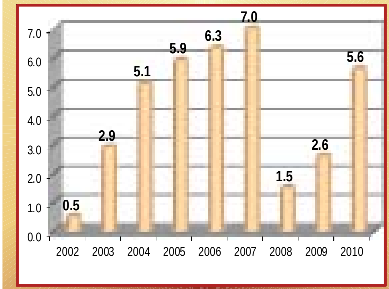
Global output is, therefore, projected to expand in 2011 and 2012 by 4.3 percent and 4.5 percent, respectively. Advanced economies are projected to slow down to 2.2 percent in 2011 before picking up to 2.6 percent in 2012. Low capacity utilization, high unemployment and fiscal and financial imbalances continue to pose a challenge to economic recovery in these economies. Output growth in emerging and developing economies is projected at 6.6 percent in 2011 and 6.4 percent in 2012. Overheating in some of the emerging economies, rising food and fuel prices and sluggish recovery in advanced economies remain downside risks for these economies. Sub-Saharan Africa is expected to grow by 5.5 percent and 5.9 percent in 2011 and 2012, respectively. This growth is anchored on regional and global trade, tourism and continued sound economic policies

DOMESTIC ECONOMY - OVERVIEW

Real GDP amounted to Ksh 1.47 trillion in 2010, an increase of 5.6 percent from Ksh 1.39 trillion in 2009. All sectors of the economy registered positive growth rates led by Electricity and Water Supply, Mining and Quarrying, Financial Intermediation, Wholesale and Retail Trade, Repairs, Agriculture and Forestry, and Transport and Communication. Of the total volume produced in 2010, Agriculture and Forestry accounted for 21.7 percent, while Transport and Communication, Wholesale and Retail Trade, and Manufacturing accounted for 12.4 percent, 10.5 percent and 9.7 percent, respectively.

The economy continued to perform favourably in the first three months of 2011 and registered real growth of 4.9 percent despite challenges faced during the quarter. Uneven distribution of rainfall negatively impacted on agricultural production as well as generation of hydro-electric power. Quarterly growth of output from Agriculture and Forestry slowed to 2.2 percent in the first quarter of 2011 from 5.7 percent in a corresponding period of 2010, while the Electricity and Water Supply sector expanded by 3.5 percent compared with a decline of 2.5 percent over the same period. Sectors that performed comparably well in the first quarter of 2011 were Mining and Quarrying which grew by 13.9 percent, Financial Intermediation which grew by 10.9, Construction and Hotels and Restaurants which grew by 10.7 percent and 8.3 percent, respectively, and Transport and Communication which registered growth of 6.5 percent.

CHART 2A: REAL GDP GROWTH RATES, 2002 - 2010 (%)



Sources: Economic Survey & Central Bank of Kenya

Measured by the value of total production of goods and services, the economy grew by 5.6 percent in 2010 sustaining the momentum of recovery from 2.6 percent in 2009 (Table 2.1 and Chart 2A). In total, real output at market prices amounted to Ksh 1.47 trillion in 2010 compared with Ksh 1.39 trillion in 2009. Of the total production in 2010, Agriculture and Forestry contributed 21.7 percent. Medium-sized sectors including Transport and Communication, Wholesale and Retail Trade, and Manufacturing contributed 12.4 percent, 10.5 percent and 9.7 percent to total output in 2010, respectively. Favourable weather conditions accounted for the sterling performance in Agriculture, while growth in Transport and Communication reflects increased use of mobile telephone services, road transport services (both passenger and freight) and air transport services. Growth in Manufacturing derived from increased processing of agricultural produce, cement, timber and galvanized iron. The financial sector facilitated production during the year under review through extension of additional credit especially to manufacturing, agriculture, domestic trade, private households, real estate and business services. All other sectors of the economy registered positive growth rates in 2010.

TABLE 2.1: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES

MAIN SECTORS	Share in 2010 Nominal GDP (%)	Share in 2010 Real GDP (%)	2005	2006	2007	2008	2009	2010*
Agriculture and Forestry	***21.5***	***21.7***	299,749	312,926	320,423	307,354	299,431	318,382
Fishing	***0.6***	***0.4***	5,751	6,249	6,181	5,363	5,564	5,713
Mining and Quarrying	***0.7***	***0.5***	5,334	5,554	6,272	6,453	6,163	6,770
Manufacturing	***10.0***	***9.7***	115,699	122,953	130,673	135,291	136,992	143,028
Electricity and Water Supply	***2.4***	***2.3***	27,898	27,288	29,771	31,345	30,390	33,404
Construction	***4.3***	***3.5***	35,446	37,649	40,405	43,735	49,141	51,351
Wholesale and Retail Trade, Repairs	***10.3***	***10.5***	106,009	118,361	131,754	138,053	143,388	154,558
Hotels and Restaurants	***1.7***	***1.3***	15,572	17,894	20,814	13,298	18,993	19,796
Transport and Communication	***9.8***	***12.4***	122,243	136,306	156,845	161,616	171,976	182,051
Financial Intermediation	***5.6***	***4.0***	43,869	47,170	50,306	51,659	54,043	58,797
Real estate, Renting and Business Services	***4.8***	***5.3***	65,882	68,446	70,860	73,503	75,674	78,089
Public Administration and Defence	***4.7***	***3.2***	46,461	45,974	45,031	45,317	46,029	47,035
Education	***5.7***	***5.9***	72,908	73,188	76,257	80,771	82,952	86,851
Health and Social Work	***2.6***	***2.2***	27,249	28,075	28,983	30,035	31,352	31,785
Other Community, Social and Personal Servic	***3.3***	***3.7***	45,876	47,814	49,420	50,829	52,219	53,729
Private Households with Employed Persons	***0.4***	***0.3***	4,011	4,091	4,173	4,256	4,342	4,428
less: Financial Services Indirectly Measured	***(0.8)***	***(0.7)***	(11,261)	(11,835)	(12,174)	(10,484)	(12,762)	(10,189)
All Industries at Basic Prices	***87.5***	***86.1***	1,028,696	1,088,103	1,155,993	1,168,395	1,195,888	1,265,579
Taxes less Subsidies on Products	***12.5***	***13.9***	144,088	161,367	180,855	188,882	197,286	204,938
Real GDP at market prices	***100.0***	***100.0***	1,172,784	1,249,470	1,336,848	1,357,277	1,393,174	1,470,517
GDP Deflator (2001 =100)			121	130	137	156	170	173

Growth Rates in percent

	Share in 2010 Nominal GDP (%)	Share in Real GDP in 2010 (%)	2005	2006	2007	2008	2009	2010*
Agriculture and Forestry	21.50	21.65	6.9	4.4	2.4	(4.1)	(2.6)	6.3
Fishing	0.60	0.39	9.6	8.7	-1.1	(13.2)	3.7	2.7
Mining and Quarrying	0.70	0.46	2.7	4.1	12.9	2.9	(4.5)	9.8
Manufacturing	10.00	9.73	4.7	6.3	6.3	3.5	1.3	4.4
Electricity and Water Supply	2.40	2.27	0.1	-2.2	9.1	5.3	(3.0)	9.9
Construction	4.30	3.49	7.6	6.2	7.3	8.2	12.4	4.5
Wholesale and Retail Trade, Repairs	10.30	10.51	5.5	11.7	11.3	4.8	3.9	7.8
Hotels and Restaurants	1.70	1.35	13.3	14.9	16.3	(36.1)	42.8	4.2
Transport and Communication	9.80	12.38	8.9	11.5	15.1	3.0	6.4	5.9
Financial Intermediation	5.60	4.00	2.8	7.5	6.6	2.7	4.6	8.8
Real estate, Renting and Business Services	4.80	5.31	3.4	3.9	3.5	3.7	3.0	3.2
Public Administration and Defence	4.70	3.20	-1.3	-1.0	-2.1	0.6	1.6	2.2
Education	5.70	5.91	0.9	0.4	4.2	5.9	2.7	4.7
Health and Social Work	2.60	2.16	3.2	3.0	3.2	3.6	4.4	1.4
Other Community, Social and Personal Servic	3.30	3.65	3.1	4.2	3.4	2.9	2.7	2.9
Private Households with Employed Persons	0.40	0.30	2.0	2.0	2.0	2.0	2.0	2.0
less: Financial Services Indirectly Measured	-0.80	-0.69	4.3	5.1	2.9	(13.9)	21.7	(20.2)
All Industries at Basic Prices	87.50	86.06	5.1	5.8	6.2	1.1	2.4	5.8
Taxes less Subsidies on Products	12.50	13.94	10.2	12.0	12.1	4.4	4.4	3.9
Real GDP at market prices	100.00	100.00	5.7	6.5	7.0	1.5	2.6	5.6

* Provisional

Sources: Economic Survey 2010

Economic Performance in 2011

The economy continued to perform favourably in the first three months of 2011 and registered real growth of 4.9 percent despite challenges faced during the quarter (Table 2.2). Inadequate and delayed rainfall negatively impacted on agricultural production as well as generation of hydro-electric power. Quarterly growth of output from Agriculture and Forestry slowed to 2.2 percent in the first quarter of 2011 from 5.7 percent in the same period of 2010, while the Electricity and Water Supply sector declined to 3.5 percent from a decline of 2.5 percent in the first quarter of 2010.

TABLE 2.2: QUARTERLY GROWTN RATES IN REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES (%)

	2009				2010				2011
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Agriculture and Forestry	-1.5	-4.2	-3.3	-1.5	5.7	3.0	8.6	7.4	2.2
Fishing	29.9	33.5	26.5	-56.1	3.8	2.5	1.9	2.3	1.2
Mining and Quarrying	-12.0	-4.6	-6.2	4.6	20.8	1.4	1.1	18.3	13.9
Manufacturing	4.8	-0.9	-1.3	2.7	6.0	4.9	5.7	1.2	3.2
Electricity and Water Supply	2.3	2.3	-4.2	-12.4	-2.5	5.8	17.1	21.2	3.5
Construction	24.5	10.8	0.7	17.2	0.3	3.6	5.8	7.9	10.7
Wholesale and Retail Trade, Repairs	-0.7	-1.1	3.4	13.8	4.5	5.0	4.7	16.1	3.6
Hotels and Restaurants	159.2	48.7	1.5	-2.7	-2.7	-1.1	10.8	16.2	8.3
Transport and Communication	15.2	-3.2	10.4	3.5	6.0	5.3	4.3	7.9	6.5
Financial Intermediation	3.4	2.6	7.1	5.4	5.0	7.4	10.6	12.1	10.9
Real Estate	8.2	11.7	-6.5	-2.0	4.2	1.3	3.9	3.8	3.8
Public Administration	1.2	0.6	1.7	2.8	1.6	2.3	2.5	2.4	1.8
Education	3.9	1.6	1.6	3.8	3.8	5.3	5.5	4.3	3.3
Other Services	3.3	3.4	3.3	3.2	2.9	2.6	2.1	1.6	0.9
Financial Services Indirectly Measured	15.3	25.6	31.5	15.5	-8.9	-21.0	-25.7	-24.3	-14.6
Taxes less Subsidies on Products	5.0	5.6	-0.1	7.7	2.8	7.0	2.9	3.1	9.0
GDP at constant market prices	5.7	1.1	0.7	3.2	4.3	4.6	5.9	7.2	4.9

Sources: Kenya National Bureau of Statistics

AGRICULTURE

Total production from Agriculture and Forestry increased by 6.3 percent in 2010 compared with 2.6 percent decline in 2009. The sector's contribution to GDP increased from 21.5 percent in 2009 to 21.7 percent in 2010 (Table 2.1). The improved performance that emanated from favourable weather conditions reflected increased production of maize, wheat, rice, tea, sugar cane and milk. While coffee, tea, sugar cane and horticulture fetched better prices in both local and export markets, the average price of maize, wheat and milk declined due to increased supply.

Inadequate and delayed rainfall, however, negatively impacted on agricultural production with coffee and tea production declining by 11.8 percent and 3.6 percent, respectively, in the fiscal year 2010/11. Some activities like horticulture exports and milk production recorded improvement (Table 2.3). Horticulture exports increased by 3.9 percent compared with 1.6 percent growth in the fiscal year 2009/10. Raw milk deliveries increased by 1.8 percent, while sugar cane delivered to factories increased by 8.0 percent in the fiscal year 2010/11.

TABLE 2.3: OUTPUT GROWTH IN KEY CROPS

PRODUCT	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11
Tea							
Production (Tonnes)	321,440	295,791	375,226	328,216	327,713	377,927	364,456
Annual Growth, %	0.19%	-8.07%	25.24%	-11.89%	*-0.15%*	*15.32%*	*-3.56%*
Coffee							
Sales (Tonnes)	51,136	47,995	50,899	39,842	53,701	34,651	30,570
Annual Growth, %	-9.77%	-7.14%	12.58%	-30.82%	*34.78%*	*-35.47%*	*-11.78%*
Horticulture							
Exports (Tonnes)	167,371	186,356	218,848	281,039	245,618	248,664	258,388
Annual Growth, %	-1.28%	11.34%	17.44%	28.42%	*-12.60%*	*1.61%*	*3.91%*
Sugar Cane							
Deliveries (Tonnes)	4,751,432	4,953,329	4,953,167	5,228,645	5,355,771	5,432,517	5,864,460
Annual Growth, %	3.73%	8.52%	0.88%	2.83%	*2.43%*	*0.73%*	*7.95%*
Milk							
Intake (Million Litres)	4,751,432	4,953,329	4,953,167	5,228,645	5,355,771	495	504
Annual Growth, %	3.73%	8.52%	0.88%	2.83%	2.43%	26.60%	*1.82%*

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

MANUFACTURING

Output from the manufacturing sector recovered to 4.4 percent growth in 2010 from 1.3 percent increase in 2009. The contribution of manufacturing sector to GDP stabilized at 9.7 percent in 2010 compared with 9.8 percent in 2009. On an annual basis, production of selected manufactured goods was higher in the year 2010/11 compared with production in the year 2009/10 (Table 2.4). For instance, production of cement continued on an upward trend and amounted to 3,873.9 thousand tonnes in the year to June 2011, or 11.1 percent above 3,485.6 thousand tonnes in the year to June 2010. Production of galvanized sheets also rose from 196.2 thousand tonnes in the fiscal year 2009/10 to 236.2 thousand tonnes in the fiscal year 2010/11, while the amount of sugar processed rose from 507.2 thousand tonnes to 568.2 thousand tonnes in the period under review. The number of motor vehicles assembled locally increased from 5,286 units in the fiscal year 2009/10 to 5,432 units in the fiscal year 2010/11. The amount of soft drinks produced also increased from 363.5 million litres in the fiscal year 2009/10 to 368.7 million litres in the fiscal year 2010/11.

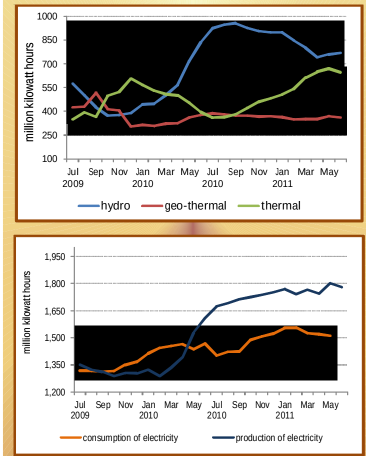
TABLE 2.4: PRODUCTION OF SELECTED MANUFACTURED GOODS

PRODUCT	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11
Processed Sugar							
Production (Tonnes)	507,306	504,589	474,944	530,129	536,893	507,217	568,158
Annual Growth, %	*-3.4%*	*-0.5%*	*-5.9%*	*11.6%*	*1.3%*	*-5.5%*	*12.0%*
Soft Drinks							
Production ('000 Litres)	212,388	279,234	285,993	319,850	368,957	363,501	368,665
Annual Growth, %	*34.5%*	*31.5%*	*2.4%*	*11.8%*	*15.4%*	*-1.5%*	*1.4%*
Galvanised Sheets							
Production (Tonnes)	163,303	171,687	179,176	191,939	183,769	196,193	236,239
Annual Growth, %	*3.3%*	*5.1%*	*4.4%*	*7.1%*	*-4.3%*	*6.8%*	*20.4%*
Cement*							
Production (Tonnes)	1,975,464	2,104,918	2,370,982	2,633,494	3,123,473	3,485,639	3,873,947
Annual Growth, %	*22.9%*	*6.6%*	*12.6%*	*11.1%*	*18.6%*	*11.6%*	*11.1%*
Assembled Vehicles							
Production (Units)	6,200	4,920	5,945	6,535	5,249	5,286	5,432
Annual Growth, %	*12.6%*	*-20.6%*	*20.8%*	*9.9%*	*-19.7%*	*0.7%*	*2.8%*

*Data are for the 12-month period to May 2011

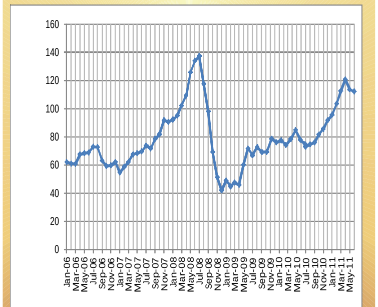
Sources: Kenya National Bureau of Statistics, Kenya Sugar Board, Kenya Dairy Board, Kenya Revenue Authority and Magadi Soda

CHART 2B: PERCENTAGE SHARE OF ELECTRICITY SOURCES



Source: Kenya Power & Lighting Co.

CHART 2C: SAUDI ARABIAN CRUDE OIL



Source: Ministry of Energy

ENERGY SECTOR DEVELOPMENTS

Quarterly production of hydro-electricity had been on a decline since August 2010 but stabilized above 700 million kilowatt hours in the second quarter of 2011. The implicit shortfall relative to supply of the amount of electricity required was largely met by increased production of the more expensive thermal power (Chart 2C shows rising prices for crude oil). Generation of thermal power therefore rose to 2,125 million kilowatt hours in the fiscal year 2010/11 compared with 1,877 million kilowatt hours in the fiscal year 2009/10, while generation of geo-thermal power declined from 1,524 million kilowatt hours in the fiscal year 2009/10 to 1,454 million kilowatt hours in the fiscal year 2010/11. Total production of electricity of 7,006 million kilowatt hours exceeded demand of 5,500 million kilowatt hours, thus reducing the country's reliance on electricity imports from Uganda and Tanzania (Table 2.5 and Chart 2B).

TABLE 2.5: PERFORMANCE OF ENERGY SUB-SECTORS

	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011
Electricity Generation							
Output (Million KWH)	*5,246*	*5,654*	*6,097*	*6,067*	*5,544*	*5,557*	*7,006*
Annual Growth, %	*7.9%*	*7.8%*	*7.9%*	*-0.5%*	*-8.6%*	*0.2%*	*26.1%*
Of which:							
Hydro-power Generation (Million KWH)	*2,868*	*3,025*	*3,300*	*3,488*	*2,849*	*2,155*	*3,427*
Annual Growth, %	*-12.0%*	*5.5%*	*9.1%*	*5.7%*	*-18.3%*	*-24.4%*	*59.0%*
Geo-Thermal Generation (Million KWH	*1,034*	*1,003*	*1,015*	*1,021*	*1,179*	*1,524*	*1,454*
Annual Growth, %	*31.3%*	*-3.0%*	*1.1%*	*0.6%*	*15.5%*	*29.3%*	*-4.6%*
Thermal (Million KWH)	*1,344*	*1,625*	*1,783*	*1,558*	*1,516*	*1,877*	*2,125*
Annual Growth, %	*64.5%*	*20.9%*	*9.7%*	*-12.6%*	*-2.7%*	*23.8%*	*13.2%*
Consumption of Electricity (Million KWH)	*4,351*	*4,606*	*4,966*	*5,243*	*5,328*	*5,602*	*5,500*
Annual Growth, %	*7.0%*	*5.8%*	*7.8%*	*5.6%*	*1.6%*	*5.1%*	*-1.8%*

Sources: Kenya National Bureau of Statistics

BUILDING AND CONSTRUCTION

Key indicators in the building and construction industry recorded improved performance in July-June 2010/11 compared with the same period in 2009/10. Consumption of cement increased from 2,815,580 metric tonnes in the year to May 2010 to 3,331,055 metric tonnes in the year to May 2011, an increase of 18.3 percent.

TRANSPORT AND COMMUNICATION

Transport

Performance in the transport sector declined in July-June 2010/11 compared with performance recorded in the same period 2008/09. Cargo handled through the port of Mombasa decreased by 24.8 percent from 19,064,078 metric tonnes in July-June 2009/10 to 14,335,552 metric tonnes in July-June 2010/11, while Kenya Pipeline throughput declined by 3.8 percent during the same period (Table 2.6).

Telecommunications

In the telecommunications sector, excise duty on airtime declined by 1.3 percent from Ksh 7,893 million in 2009/10 to Ksh 7,796 million in 2010/11. This decline is attributed to lower calling charges.

TABLE 2.6: PERFORMANCE OF TRANSPORT AND COMMUNICATION SUB-SECTORS

Activity	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11
Cargo by KPA*							
Output (MT)	13,284,921	13,524,051	15,198,435	16,290,399	17,534,007	19,064,028	14,335,552
Output Growth %	*6.23%*	*1.28%*	*12.38%*	*7.18%*	*7.64%*	*8.73%*	*-24.8%*
Throughput by Kenya Pipeline							
Output ('000 litres Equivalent)	3,459,298	3,627,232	3,963,076	3,873,855	4,058,727	4,314,488	4,149,607
Output Growth %	*11.83%*	*4.85%*	*9.26%*	*-2.25%*	*4.77%*	*6.30%*	*-3.8%*
Excise duty on Airtime							
Output (Ksh Million)	2,982	3,963	5,360	6,397	6,630	7,893	7,796
Growth %	*32.74%*	*35.41%*	*35.28%*	*16.49%*	*3.64%*	*8.64%*	*-1.23%*

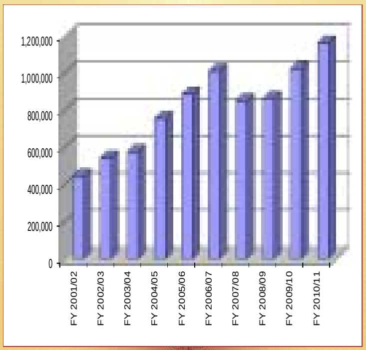
* Provisional

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

TOURISM

The number of tourists arriving in Kenya rose by 13.7 percent in the twelve months to June 2011 compared with 20.1 percent growth in a similar period in 2010. The slowdown was in visitors

CHART 2D: TOURIST ARRIVALS



Source: Kenya Tourist Board

arrivals via Jomo Kenyatta International Airport (JKIA), as those aboard cruise ships and via Moi International Airport, Mombasa (MIAM) increased more rapidly (Table 2.7 and Chart 2D).

TABLE 2.7: TOURIST ARRIVALS BY POINT OF ENTRY

	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09	FY 2009/10	FY 2010/11
Cruise ships	5,615	6,161	5,849	3,531	15,518	287	586
Output Growth %	*172.18%*	*9.72%*	*-5.06%*	*-39.63%*	*339.48%*	*-91.87%*	*104.18%*
JKIA	553,437	637,545	731,252	667,640	691,244	819,843	913,789
Output Growth %	*33.98%*	*15.20%*	*14.70%*	*-8.70%*	*3.54%*	*22.80%*	*11.46%*
MIAM	194,572	243,425	273,877	179,285	156,991	201,611	247,032
Output Growth %	*20.62%*	*25.11%*	*12.50%*	*-34.54%*	*-12.43%*	*12.45%*	*22.53%*
Total	753,624	884,728	1,010,978	850,456	863,753	1,021,741	1,161,407
Output Growth %	*30.74%*	*17.40%*	*14.28%*	*-19.40%*	*1.56%*	*20.14%*	*13.67%*

FY - Fiscal year
Source: Kenya Tourist Board

USE OF AVAILABLE RESOURCES

Total resources available to the economy measured as gross national disposable income declined from 107.3 percent of GDP in 2009 to 106.6 percent of GDP in 2010 (Table 2.8).

Final consumption accounted for 94.5 percent of GDP in 2010, thereby dominating use of domestic resources. While the share of final consumption stabilised, its composition changed with share of government increasing from 15.8 percent of GDP in 2009 to 16.6 percent of GDP in 2010. The share of private consumption declined from 78.2 percent of GDP in 2009 to 77.8 percent of GDP in 2010. On investment, the share of gross domestic investment in GDP declined marginally from 19.4 percent in 2009 to 19.3 percent in 2010 reflecting a decline in inventories. In the external sector, the share of exports of goods and services in GDP increased from 24.2 percent in 2009 to 27.5 percent in 2010, while the share of imports of goods and services also increased from 36.6 percent to 37.9 percent in the same period. As a result, the current account deficit as a percent of GDP narrowed from 5.2 percent in 2009 to 3.7 percent in 2010. The decline in gross national savings as a percent of GDP from 13.3 percent in 2009 to 12.2 percent in 2010 can be attributed to increased public spending. The Savings-Investment gap, therefore, widened from 6.1 percent of GDP in 2009 to 7.1 percent of GDP in 2010.

TABLE 2.8: USE OF RESOURCES (KSH MILLION)

	2004	2005	2006	2007	2008	2009	2010*
Gross national disposable income	1,345,167	1,503,497	1,747,428	1,966,957	2,269,311	2,537,228	2,719,823
Net current transfers (TR(F))	80,856	95,868	129,916	143,152	161,265	174,702	181,155
Gross national income	1,264,311	1,407,629	1,617,512	1,823,805	2,108,046	2,362,526	2,538,668
Net factor income payments (Y(f))	-10,017	-8,194	-5,053	-9,706	-3,127	-2,927	-12,493
Gross domestic product (at market prices)	1,274,328	1,415,823	1,622,565	1,833,511	2,111,173	2,365,453	2,551,161
Total Consumption (C)	1,190,029	1,313,504	1,507,708	1,711,521	1,931,727	2,223,496	2,409,764
Government consumption - C(g)	227,596	246,056	285,056	327,918	348,076	372,797	424,698
Private consumption - C(p)	962,433	1,067,448	1,222,652	1,383,603	1,583,651	1,850,699	1,985,066
Gross domestic investment (I)	217,742	239,446	291,209	348,850	405,477	458,914	492,322
Gross fixed capital formation	207,196	264,728	309,592	355,090	409,597	452,549	508,453
Increase/Decrease in stocks	10,546	-25,282	-18,383	-6,240	-4,120	6,365	-16,131
Exports of goods and nfs (X)	335,743	395,208	439,906	490,987	581,806	571,305	702,103
Imports of goods and nfs (M)	-435,844	-523,970	-613,856	-691,220	-879,821	-865,997	-966,002
Discrepancy	-33,342	-8,365	-2,401	-26,627	71,984	-22,265	-87,025
GDP deflator (2001=100)	115	120	130	137	156	170	173
Real GDP	1,109,541	1,175,133	1,249,470	1,336,848	1,357,277	1,393,174	1,470,517
Real GDP growth (annual in %)	5.1%	5.9%	6.3%	7.0%	1.5%	2.6%	5.6%
Gross National savings	155,138	189,993	239,720	255,436	337,584	313,732	310,059
Gross Domestic Savings	74,282	94,125	109,804	112,284	176,319	139,030	128,904
Total National Balance(S-I)	-62,604	-49,453	-51,489	-93,414	-67,893	-145,182	-182,263
CAB (X-M+Y(f)+TR(f))	-29,262	-41,088	-49,087	-66,787	-139,877	-122,917	-95,237
Discrepancy	-33,342	-8,365	-2,402	-26,627	71,984	-22,265	-87,026
CAB + DISCREPANCY	-62,604	-49,453	-51,489	-93,414	-67,893	-145,182	-182,263
Kenya - National Accounts							
In shares of GDP	2004	2005	2006	2007	2008	2009	2010
Gross national disposable income	105.6%	106.2%	107.7%	107.3%	107.5%	107.3%	106.6%
Net current transfers (TR(f))	6.3%	6.8%	8.0%	7.8%	7.6%	7.4%	7.1%
Gross national income	99.2%	99.4%	99.7%	99.5%	99.9%	99.9%	99.5%
Net factor income payments (Y(f))	-0.8%	-0.6%	-0.3%	-0.5%	-0.1%	-0.1%	-0.5%
Gross domestic product (GDP)							
Gross Domestic Product (expend)							
Total Consumption (C)	93.4%	92.8%	92.9%	93.3%	91.5%	94.0%	94.5%
Government consumption - C(g)	17.9%	17.4%	17.6%	17.9%	16.5%	15.8%	16.6%
Private consumption - C(p)	75.5%	75.4%	75.4%	75.5%	75.0%	78.2%	77.8%
Gross domestic investment (I)	17.1%	16.9%	17.9%	19.0%	19.2%	19.4%	19.3%
Gross fixed capital formation	16.3%	18.7%	19.1%	19.4%	19.4%	19.1%	19.9%
Increase/Decrease in stocks	0.8%	-1.8%	-1.1%	-0.3%	-0.2%	0.3%	-0.6%
Exports of goods and services (X)	26.3%	27.9%	27.1%	26.8%	27.6%	24.2%	27.5%
Imports of Goods and services (M)	-34.2%	-37.0%	-37.8%	-37.7%	-41.7%	-36.6%	-37.9%
Gross National savings	12.2%	13.4%	14.8%	13.9%	16.0%	13.3%	12.2%
Gross Domestic Savings	5.8%	6.6%	6.8%	6.1%	8.4%	5.9%	5.1%
Total National Balance(S-I)	-4.9%	-3.5%	-3.2%	-5.1%	-3.2%	-6.1%	-7.1%
Trade Balance (TB=X-M)	-7.9%	-9.1%	-10.7%	-10.9%	-14.1%	-12.5%	-10.3%
CAB (X-M+Y(f)+TR(f))	-2.3%	-2.9%	-3.0%	-3.6%	-6.6%	-5.2%	-3.7%
CAB + DISCREPANCY	-4.9%	-3.5%	-3.2%	-5.1%	-3.2%	-6.1%	-7.1%

*Provisional

Source: Economic Survey, 2009

Outlook

Although faced with challenges arising from high world oil prices and unfavourable weather conditions, the Kenyan economy showed signs of resilience during the first half of 2011. With the ongoing public investment in transport and ICT infrastructure and supply of bank credit to meet the demand for private sector investment, the economy is expected to remain resilient in the latter half of 2011.

3. INFLATION

The Kenya consumer price index (CPI) rose by 14.49 percent from 105.6 in June 2010 to 120.9 in June 2011 (Table 3.1). Taking into account price changes throughout the year, the index rose on average by 6.88 percent by June 2011 compared with an annual average increase of 5.43 percent in June 2010.

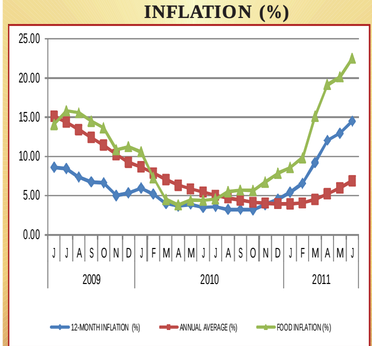
TABLE 3.1: CPI, 12-MONTH AND ANNUAL AVERAGE INFLATION

	2010							2011					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Kenya CPI, Feb 2009=100	105.61	105.98	106.25	106.74	106.97	107.86	109.38	110.57	112.06	114.62	118.29	119.48	120.91
12-month overall inflation, percen	3.49	3.57	3.22	3.21	3.18	3.84	4.51	5.42	6.54	9.19	12.05	12.95	14.49
Annual average inflation, percent	5.43	5.03	4.69	4.40	4.12	4.02	3.96	3.93	4.05	4.49	5.20	5.96	6.88

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

The rise in overall inflation in the year to June 2011 largely reflected an increase in prices of food and fuel (Charts 3A-3C). The increase in food prices was in the 'Food and Non-Alcoholic Beverages' index, which rose by 22.5 percent from 107.8 in June 2010 to 132.1 in June 2011 and in the price charged on food served in hotels and restaurants. The 'Restaurants and Hotels' index rose by 13.7 percent from 105.3 in June 2010 to 119.8 in June 2011. The average retail price of dry maize more than doubled from Ksh 19.4 per kilogram in June 2010 to Ksh 41.6 per kilogram in May 2011. This increase was reflected in overall food inflation as the price of the staple food accounted for 8.4 percent of the 'Food and Non-Alcoholic Beverages' index. The general increase in food prices reflects constrained food production in the year to June 2011 owing to drought and unfavourable distribution of rainfall.

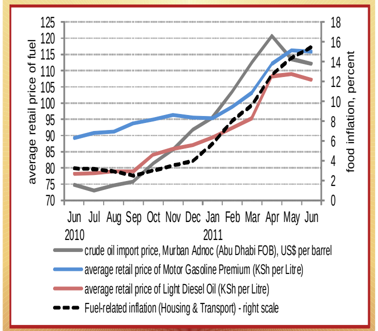
CHART 3A:12-MONTH, ANNUAL AVERAGE AND FOOD INFLATION (%)



Source:Kenya National Bureau of Statistics

The increase in fuel prices was reflected in the 'Transport' index, which rose by 22.7 percent from 107.4 percent in June 2010 to 131.8 percent in June 2011 as well as in the 'Housing, Water, Electricity, Gas and other Fuels' index, which rose by 11.9 percent from 104.1 in June 2010 to 116.5 in June 2011. Domestic fuel prices rose in tandem with the increase in world oil prices. The import price of murban crude oil rose from US dollars 74.8 per barrel in June 2010 to US dollars 120.7 per barrel in April 2011 before declining to US dollars 112.2 per barrel in June 2011. The rise in oil import price during the

CHART 3B:TRENDS IN FUEL PRICES AND FUEL RELATED INFLATION

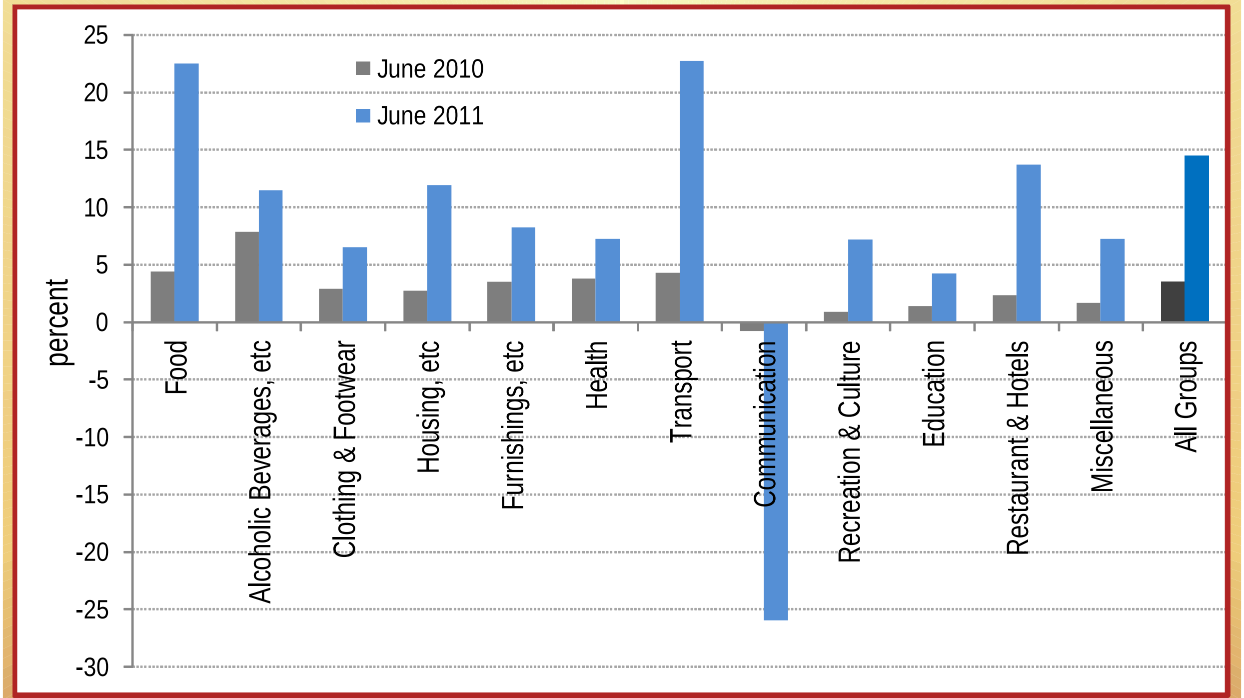


Source:Kenya National Bureau of Statistics

period under review was directly reflected in the average retail prices of petrol and diesel (Chart 3B). The rise in fuel prices was also reflected in the upward adjustment in fees charged on public transport services and electricity.

Inflation was much lower in other goods and services and averaged 5.64 percent in June 2011 (Chart 3C). The cost of communication declined notably during the period under review mainly due to reduced charges on mobile telephone services.

CHART 3C: 12-MONTH INFLATION RATES FOR GOODS AND SERVICES - JUNE 2011



Source: Kenya National Bureau of Statistics

In terms of the distribution of inflationary pressures, a significant increase in food prices was recorded in Nairobi as well as in other urban centres outside Nairobi, while the increase in prices of housing and utilities, and healthcare services was higher outside Nairobi (Table 3.2). Within Nairobi, the rise in food prices and the fall in the cost of mobile telephone services was most significant for the lower income group, while inflationary pressures on transport services was significant across all income groups.

TABLE 3.2: 12-MONTH INFLATION ACROSS INCOME GROUPS BY LOCATION JUNE 2011

	Nairobi			Total	Rest of
	lower income	middle income	upper income	Nairobi	Kenya
Food & Non-Alcoholic Beverages	25.28	13.75	10.06	21.98	22.89
Alcoholic Beverages, Tobacco & Narcotics	9.83	11.19	2.61	9.89	12.58
Clothing & Footwear	4.47	6.95	7.71	5.18	7.47
Housing, Water, Electricity, Gas & other Fuels	10.81	6.76	4.43	9.63	13.57
Furnishings, Household Equipment & Routine Household Maintenan	7.68	8.46	3.37	7.70	8.60
Health	5.04	1.66	0.89	4.08	9.52
Transport	24.60	22.94	24.87	24.22	21.60
Communication	-33.33	-9.21	-15.81	-26.89	-25.38
Recreation & Culture	6.74	7.86	7.04	7.02	7.33
Education	5.04	10.71	4.42	6.42	2.75
Restaurant & Hotels	17.69	5.51	3.80	14.26	13.31
Miscellaneous Goods & Services	5.17	5.46	2.88	5.15	8.68
All Groups	15.96	9.57	10.14	14.24	14.66

Source: Kenya National Bureau of Statistics & Central Bank of Kenya

TABLE 3.3: ESTIMATED CONTRIBUTIONS TO OVERALL INFLATION, PERCENT

	FY 2009/10	FY 2010/11
Food & Non-Alcoholic Beverages	57.7	60.8
Transport	8.6	14.3
Housing, Water, Electricity, Gas & Other Fuels	11.3	13.5
Clothing & Footwear	5.1	5.5
Furnishings, Household Equipment & Routine Household Maintenance	3.6	5.3
Restaurants & Hotels	3.7	5.2
Health	3.5	3.0
Alcoholic Beverages, Tobacco & Narcotics	3.3	2.8
Miscellaneous Goods & Services	3.2	2.4
Education	0.1	1.5
Recreation & Culture	0.4	1.3
Communication	-0.6	-15.6

Source: Kenya National Bureau of Statistics & Central Bank of Kenya

Much of the inflationary pressures experienced during the fiscal year 2010/11 were attributed to supply side factors particularly related to food and fuel. Table 3.3 shows that food inflation on average contributed 60.8 percent to overall inflation in the fiscal year 2010/11, while inflation in Transport and Housing, Water, Electricity, Gas and Other Fuels contributed 27.8 percent to overall inflation. The deflation in the Communication basket, however, served to reduce overall domestic inflation pressure during the year under review. While monetary policy was initially geared to support economic growth through a low interest rate regime, the stance was reviewed in the second half of the fiscal year 2010/2011 to rein in inflationary expectations as the Government worked to resolve food shortages. The prudent stance of monetary policy and supporting measures taken by the Central Bank managed to mitigate excessive turbulence in the foreign exchange market and restrained arbitrage in the money market.

Inflation Outlook

Two key factors will determine the outturn of domestic inflation in the near term. The ongoing importation of maize is expected to improve the supply of maize domestically and eventually dampen growth in the domestic food price index. Political developments in the Middle East and North Africa region had put upward pressure on world oil prices but the actual outturn of oil prices going forward will also depend on relative demand conditions as determined by major consumers, particularly USA, China and Japan. Oil prices showed signs of stabilizing in the second quarter of 2011 following among other factors weak performance of the US economy. With much of the domestic inflationary pressures being attributed to food and fuel, resolution of supply constraints of the two commodities in the coming months are likely to lower overall inflation towards the 5 percent target. Monetary policy will also work to prevent higher prices from being more permanently reflected in price structures through appropriate monetary policy operations.

4. MONEY AND CREDIT DEVELOPMENTS

Monetary Policy for Fiscal Year 2010/11

The Central Bank implemented monetary policy focused on achieving and maintaining low inflation, and also supportive of economic growth. Inflation as measured by the GDP deflator was projected to decline from 6.7 percent in June 2010 to 6.4 percent in June 2011. The real GDP was projected to grow at 5.4 percent by June 2011. Accordingly, the Central Bank set out the optimal path for both reserve money and money supply expansion consistent with the achievement of price stability and the expected economic growth. Money supply, M3, and reserve money were targeted to grow by 16.8 percent and 2.4 percent, respectively, in the year to June 2011 (Table 4.1).

TABLE 4.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2010/11 MONETARY PROGRAMME

	Jun'10	Sep'10	Dec'10	Mar'11	Jun'11
Broad money supply (M3) (Ksh billion)	1,106.6	1,240.2	1,281.6	1,355.6	1,400.2
Reserve money (Ksh billion)	181.4	186.4	202.6	211.8	215.4
NFA of CBK (Ksh billion)	239.2	254.0	266.0	261.9	266.7
Memo:					
Annual change in reserve money	13.4	14.0	11.3	19.4	2.4
Annual change in extended broad money (M3)	16.5	25.7	22.6	22.4	16.8
Real GDP growth	4.1				5.4
GDP Deflator	6.7				6.4

Source: Central Bank of Kenya

The Central Bank continued to apply the Central Bank Rate (CBR) to signal the monetary policy stance and to guide money market participants on the direction of short-term interest rates. During the first half of the fiscal year, the Central Bank pursued an accommodative monetary policy that dates to the on set of the global financial crisis in the last quarter of 2008. The policy stance supported lowering of interest rates in order to support economic growth through provision of adequate credit to the domestic economy, and the private sector in particular. In this regard, the Monetary Policy Committee (MPC) reduced the CBR by 100 basis points between July 2010 and January 2011 to signal to the banks to lower lending rates. The MPC reversed monetary easing at the March 2011 meeting to address incipient inflationary pressures and exchange rate depreciation attributed to supply side shocks. The tight stance of monetary policy was to signal that temporary shocks such as exchange rate volatility and seasonal food shortages should not be allowed to persist and be factored into pricing structures. The Committee raised the CBR by 50 basis points between April 2011 and June 2011 and increased the reserve requirements by 25 basis points to 4.75 percent in May 2011 from 4.5 percent to complement the CBR increases. To mitigate exchange rate volatility the Central Bank cautiously accessed foreign exchange from the interbank market required to build its foreign exchange reserves to the minimum statutory requirement equivalent to value of 4 months of imports of goods and non factor services.

The Bank implemented the March 2011 targets under the three year Extended Credit Facility (ECF) (2011-2014), negotiated by the Kenya Government with the IMF. The ECF to Kenya as approved by the IMF Executive Board Meeting on 31st January 2011 entails disbursements amounting to SDR 328.68 million (equivalent to US$ 508.7 million) of program loans in tranches spread over a three year period to facilitate foreign exchange reserves build-up and eventual strengthening of Kenya's external position. Notwithstanding the need to accommodate Government public investment, the ECF provided for a gradual fiscal consolidation and reduction of the public debt to GDP ratio towards debt sustainability in the medium term.

The ECF provides for performance criteria and structural benchmarks in the fiscal, monetary and financial policy areas, with emphasis on public finance management reform. For the Central Bank, the ECF require monitoring of quantitative performance (PC) targets on Net International Reserves (NIR) and Net Domestic Assets (NDA) for test dates of March and June 2011. The target on the NIR is a floor to ensure strengthening of Kenya external position, while the target on the NDA is a ceiling to reduce the risk of inflationary pressure following excessive credit creation. Upon approval in January 2011, Kenya received SDR 65.1 million equivalent to US$ 101.7 million and a further SDR 43.424 million (equivalent to US$ 69.5 million) in July 2011 following successful conclusion of the first review of the ECF Programme as at end March 2011.

Monetary Policy Implementation

The Bank applied open market operations (OMOs) mainly REPOs and reverse REPOs to implement monetary policy. The Bank effectively stabilised interbank liquidity by providing reverse repos to commercial banks from June 2010 through February 2011. The reverse repos activity was more pronounced towards the end of December 2010 with liquidity injections amounting to Ksh 31.3 billion compared with injections of Ksh 6.5 billion in July 2010, Ksh 11.9 billion in August 2010, Ksh 11.3 billion in November 2010.

The tight market conditions that warranted liquidity injection through reverse repos obtained from accumulation of Government deposits at the Central Bank (partly through tax collection and proceeds from issuances of Government Treasury bonds and bills) following challenges in absorbing these resources to fund Government's investment programme.

Conscious of the need to minimize pressure on the exchange rate, the Central Bank cautiously purchased foreign exchange from the interbank market to build foreign exchange reserves to the level equivalent to the value of the statutory 4-months of import cover of goods and non-factor services.

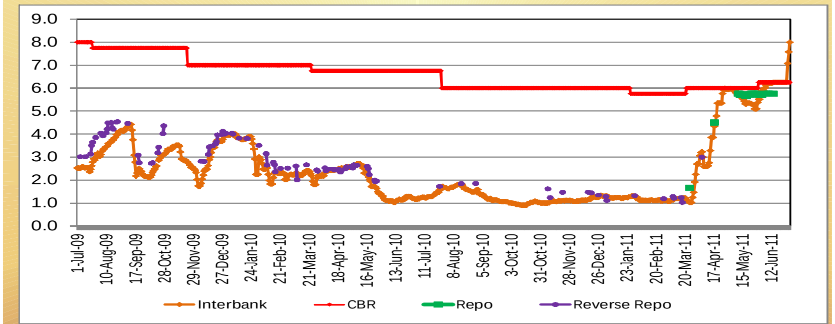
The Bank tightened monetary policy stance in March 2011 to rein in inflationary expectations and to stabilize the exchange rate volatility. In this regard, and beyond raising the CBR, the Bank commenced mop up operations of excess liquidity from the interbank market through REPOs. The Bank mopped Ksh 3.85 billion in April 2011 and Ksh 16.8 billion in May 2011. As the market tightened, commercial banks borrowing from the Central Bank discount window increased from Ksh 16.4 billion in March 2011 to Ksh 353.6 billion in June 2011.

Short term interest rates were low and stable in the first seven months of the fiscal year consistent with the CBR (Chart 4B). Furthermore, efficiency in the money market had improved with enhanced utilisation of the horizontal repo - a monetary policy instrument for re-distribution of liquidity among commercial banks. However, some degree of skewness in the liquidity distribution remained due to lack of credit lines for some banks that occasionally resorted to the overnight window. The Central Bank applied reverse repos to mitigate the skewness of liquidity in the market and the resultant shortfall of liquidity created by an accumulation of government deposits. However, the average interbank rate rose from 1.2 percent in March 2011 to 4 percent in April 2011and to 6.4 percent in June 2011.

During the April -June quarter when the Central Bank tightened monetary policy, the Bank noted challenges in monetary policy implementation owing to arbitrage in the interbank market and abuse of its overnight window, particularly when the interbank market traded above the CBR (the rate at which the Central Bank accommodates banks at the overnight window facility). The Kenya Shilling also depreciated substantially against major international currencies partly on account of arbitrage in the money market. Overnight borrowing by commercial banks from the Central Bank discount window increased to peak at Ksh 30.7 billion on June 21, 2011. To restore the statutory purpose of the CBR and remove arbitrage opportunities, Central Bank announced new measures to guide the operations of the Central Bank Discount Window.

The Central Bank initially raised its discount window rate above the CBR in an effort to penalize commercial banks overnight borrowing and ensure that the Central Bank is indeed the lender of last resort. The Central Bank stipulated rules for overnight borrowing making it more expensive for banks to access the window.

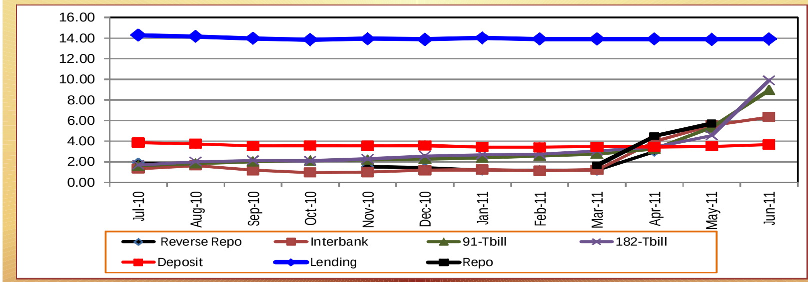
CHART 4A: REPO AND INTERBANK RATES JULY 2009 TO JUN 2011



Source: Central Bank of Kenya

Efforts by the Central Bank to catalyze reduction in cost of bank credit to the private sector were hindered by inefficiencies in the transmission of monetary policy impulses from short term interest rates to long term (lending) interest rates. The short term interest rates, particularly the interbank rate and reverse repo rate positively reflected the monetary policy conditions and stance during the first seven months of the fiscal year (Chart 4A). But commercial banks lending rates declined marginally from 14.39 percent in June 2009 to 13.88 percent in May 2011, reflecting the higher risk perception by commercial banks, the interest rate spread rose from 9.94 percent in June 2010 to 10.23 percent in June 2011.

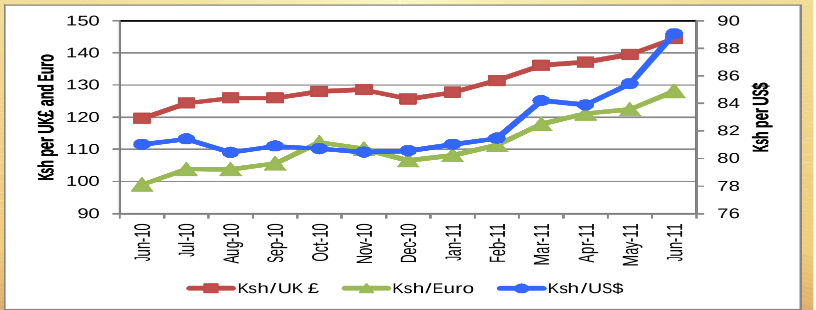
CHART 4B: INTEREST RATES JULY 2010- JUNE 2011 (PERCENT)



Source: Central Bank of Kenya

The Bank policy to purchase foreign exchange from commercial banks to build-up its reserves and to align the Net International Reserves (NIR) towards the IMF ECF targets was maintained in principal. The drive to purchase foreign exchange lost steam on account of the depreciation of the Shilling (Chart 4C) following the Greek debt crisis and the turbulence in the interbank market from March 2011 due to effects of the political turmoil in the MENA region coupled with a rise in international oil prices. The Bank, therefore, took a cautious strategy when accessing the market to minimise the pressure in the foreign exchange market.

CHART 4C: SELECTED KSH NOMINAL EXCHANGE RATES JUL 2009 TO JUN 2011



Source: Central Bank of Kenya

Money Supply

Money supply, M3, grew at 15.1 percent in the year to June 2011 compared with a growth rate of 26.2 percent in a corresponding period in 2010 and the projected 16.8 percent growth for the year to June 2011. The expansion in money supply in June 2011 was supported by growth in net domestic assets (NDA) and in the net foreign assets (NFA) of the Banking system (Table 4.2).

TABLE 4.2: PERFORMANCE OF MONETARY AGGREGATES JUNE 2010 - JUNE 2011(Percent)

	RM		M3		Private Sector Credit	
	Act.	Targ.	Act.	Targ.	Act.	Targ.
2010						
Jun	31.5	13.4	26.2	16.5	16.8	18.5
Jul	26.5	18.5	24.6	24.6	19.5	18.3
Aug	28.1	16.5	23.7	24.6	19.1	17.2
Sep	28.4	14.0	26.0	25.7	22.9	20.1
Oct	32.8	15.9	24.7	24.6	21.5	18.9
Nov	25.7	9.8	23.1	24.0	21.7	21.0
Dec	22.4	11.3	21.6	22.6	20.3	20.1
2011						
Jan	16.1	10.7	20.4	21.8	21.0	21.8
Feb	19.7	20.4	20.5	23.3	23.3	22.6
Mar	18.0	19.4	19.6	22.4	25.7	23.1
Apr	20.1	18.5	18.9	22.4	27.3	23.1
May	7.9	9.1	16.5	17.0	27.4	26.8
Jun	4.3	2.4	15.1	16.8	30.5	23.7

Source: Central Bank of Kenya

The NDA grew by Ksh 179.9 billion or 19.6 percent in the year to June 2011 compared with Ksh 236.4 billion or 34.6 percent a year earlier on account of increased credit provision to private sector and other public sectors. The NDA accounted for 99.21 percent of the expansion in M3. The NFA of the banking system also increased, by Ksh 1.4 billion or 0.5 percent in the twelve months to June 2011 compared with an increase of Ksh 12.3 billion or 4.6 percent in a corresponding period in 2010. The build up in the NFA was reflected in holdings of the Central Bank of Kenya (Table 4.3).

TABLE 4.3: MONEY SUPPLY AND ITS SOURCES (KSH BN)

	Jun 2009 Act	Jun 2010 Act	Jun 2011 Act	Absolute Change 2009/10	Absolute Change 2010/11	Annual % Change 2009/10	Annual % Change 2010/11
1.0 Liabilities							
Money Supply							
Money supply, M2 \1	812.1	1,033.7	1,183.4	221.6	149.7	27.3	14.5
Money supply, M3 \2	950.2	1,198.9	1,380.3	248.7	181.4	26.2	15.1
Overall Liquidity, L \3	1,166.9	1,443.4	1,720.1	276.5	276.7	23.7	19.2
2.0 Assets (2.1+2.2)	950.2	1,198.9	1,380.3	248.7	181.4	26.2	15.1
2.1 Net foreign assets	268.0	280.3	281.7	12.3	1.4	4.6	0.5
Central Bank	208.8	242.9	282.6	34.1	39.7	16.3	16.3
Banking Institutions	59.2	37.4	-0.8	-21.8	-38.2	-36.8	-102.2
2.2 Net domestic assets (2.21+2.22)	682.3	918.7	1,098.6	236.4	179.9	34.6	19.6
2.21 Domestic Credit (2.210+2.211)	864.2	1,086.8	1,341.2	222.5	254.4	25.8	23.4
2.210 Government (net)	173.9	277.7	276.4	103.8	-1.2	59.7	-0.4
2.211 Private sector and other public sector	690.3	809.1	1,064.7	118.7	255.7	17.2	31.6
2.22 Other assets net	-181.9	-168.1	-242.6	13.8	-74.5	-7.6	44.3
Memorandum Item:							
Reserve Money	159.9	210.3	219.3	50.3	9.0	31.5	4.3

\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.*

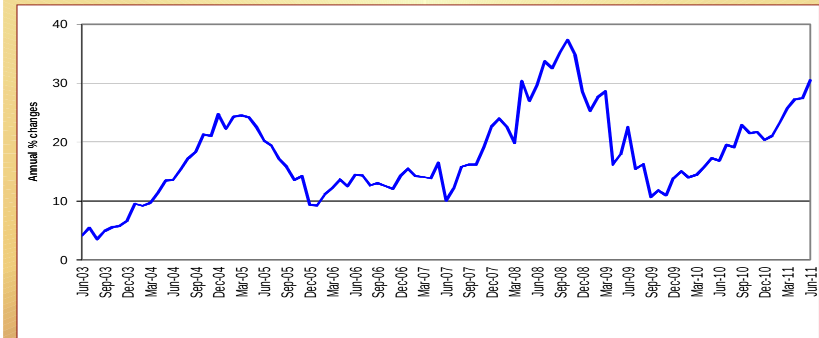
\3 *Overall liquidity L, comprises M3 plus non-bank holdings of government securities.*

Source: Central Bank of Kenya

Domestic Credit

Domestic credit increased by Ksh 254.4 billion or 23.4 percent in the year to June 2011 compared with Ksh 222.5 billion or 25.8 percent in a similar period in 2010 and a target of Ksh 205.9 billion or 18.9 percent expansion. Growth in net credit to Government declined by Ksh 1.2 billion (- 0.4 percent) in the year to June 2011 from Ksh 103.8 billion (59.7 percent) in the corresponding period in 2010. The decline was attributed to reduced borrowing by the Government. Meanwhile, credit extended to the private sector increased by Ksh 243.8 billion (30.5 percent) in the year to June 2011 compared with Ksh 115.2 billion (16.8 percent) in the year to June 2010 and the target growth of 23.4 percent in June 2011(Table 4.4). The private sector accounted for 77.8 percent of total lending in June 2011 compared with 73.5 percent in June 2010. The rate of credit growth to the private sector lags behind the pre-crisis level in 2008 (Chart 4D).

CHART 4D: ANNUAL PERCENTAGE CHANGES IN PRIVATE SECTOR CREDIT



Source: Central Bank of Kenya

The expansion in the private sector credit supported economic activities in the productive sectors. The activities and respective credit share included: trade (16.4 percent), real estate (14.9 percent), private households (13.5 percent), manufacturing (12.4 percent), consumer durables (6.2 percent), Agriculture (4.4 percent) and other activities (16.9 percent).

TABLE 4.4: CREDIT TO PRIVATE AND OTHER PUBLIC SECTORS (KSH BN)

	2010 Jun		2011 Jun		Annual Change		Share of private sector credit expansion (%)
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)	
1. Credit to other public sector	**9.9**	**1.2**	**21.7**	**2.0**	**11.9**	**120.7**	
Local government	-4.5	-0.6	1.0	0.1	5.5	-122.4	
Parastatals	14.3	1.8	20.8	1.9	6.4	45.0	
2. Credit to private sector	**799.2**	**98.8**	**1043.0**	**98.0**	**243.8**	**30.5**	**100.0**
Agriculture	38.6	4.8	49.3	4.6	10.7	27.7	4.4
Manufacturing	98.8	12.2	129.0	12.1	30.2	30.6	12.4
Trade	130.4	16.1	170.3	16.0	39.9	30.6	16.4
Building and construction	31.1	3.8	39.5	3.7	8.4	27.1	3.5
Transport & communications	66.4	8.2	75.5	7.1	9.0	13.6	3.7
Finance & insurance	23.7	2.9	24.3	2.3	0.6	2.4	0.2
Real estate	81.7	10.1	118.0	11.1	36.3	44.5	14.9
Mining and quarrying	16.3	2.0	25.5	2.4	9.2	56.0	3.8
Private households	118.0	14.6	150.9	14.2	32.9	27.8	13.5
Consumer durables	50.4	6.2	65.6	6.2	15.2	30.1	6.2
Business services	74.9	9.3	85.1	8.0	10.2	13.6	4.2
Other activities	68.8	8.5	110.0	10.3	41.2	59.8	16.9
3. TOTAL (1+2) *	**809.1**	**100.0**	**1064.7**	**100.0**	**255.7**	**31.6**	

Source: Central Bank of Kenya

Reserve Money

Reserve money, which comprises currency in circulation and commercial banks deposits at the Central Bank increased by Ksh 9.0 billion (4.3 percent) to Ksh 219.3 billion in June 2011 from Ksh 210.3 billion in June 2010. As shown in Table 4.5, the increase in reserve money wholly reflected Ksh 17.7 billion (17.5 percent) in currency outside banks which fully off set Ksh 8.7 billion or 8.0 percent decline in bank reserves. At Ksh 219.3 billion in June 2011, reserve money was Ksh 3.9 billion above target.

The source of reserve money in the twelve months to June 2011 was an increase in the net foreign assets (NFA) of the Central Bank. The NFA of the Bank rose by Ksh 39.7 billion or 16.3 percent to Ksh 282.6 billion in the year to June 2011 reflecting purchases of foreign exchange from domestic banks to boost the level of gross reserves.

The NDA of the Central Bank declined by Ksh 30.6 billion (93.9 percent) to Ksh -63.3 billion in the year to June 2011, from Ksh -32.6 billion in the previous year. The decrease in NDA reflected build up of government deposits. Other net domestic liabilities also increased largely on account of revaluation gains on the Bank foreign exchange deposits following the depreciation of the Kenya Shilling (Table 4.5).

TABLE 4.5: RESERVE MONEY AND ITS SOURCES (KSH BN)

	2009 June	2010 June	2011 June	Absolute Change 2009/10	Absolute Change 2010/11	%age Change 2009/10	%age Change 2010/11	2011 June Target	Deviation
1. Net Foreign Assets	208.8	242.9	282.6	34.1	39.7	16.3	16.3	266.7	15.9
2. Net Domestic Assets	-48.8	-32.6	-63.3	16.2	-30.6	-33.2	93.9	-51.3	-12.0
2.1 Government Borrowing (net)	-23.5	7.5	-8.5	31.0	-15.9	-131.7	-213.6	2.5	-10.9
2.2 Advances & Discounts	17.5	2.8	22.8	-14.7	20.0	-84.0	714.3	-6.4	29.2
2.3 Other Domestic Assets (net)	-42.8	-42.9	-77.6	-0.1	-34.7	0.2	81.0	-47.4	-30.2
3. Reserve Money	159.9	210.3	219.3	50.3	9.0	31.5	4.3	215.4	3.9
3.1 Currency outside banks	87.3	101.3	119.0	14.0	17.7	16.0	17.5	118.8	0.2
3.2 Bank reserves	72.6	109.0	100.3	36.4	-8.7	50.1	-8.0	96.6	3.7

Source: Central Bank of Kenya

Outlook

Over the next twelve months to June 2012, the Bank will target 16.0 percent expansion in broad money supply, M3, and 12.7 percent in reserve money (Table 4.6). The implied credit supply is consistent with modest acceleration in economic growth from 5.4 percent through June 2011 to 5.7 percent in the twelve months to June 2012. Inflation as measured by the GDP deflator is projected to rise from 6.4 percent in June 2011 to 9.1 percent in June 2012 owing to supply constraints related to food and oil prices. Bank credit to private sector is projected to increase by 15.1 percent in the year to June 2012 from 30.5 percent in June 2011 reflecting the tight monetary policy stance adopted since March 2011 to rein in inflationary expectations. The Bank will continue to use open market operations to implement monetary policy.

TABLE 4.6: MONETARY PROGRAMME FOR 2011/12

	Jun-11 Est	Jun-12 Proj.
Ksh Billion		
Reserve Money	219.3	247.1
Net Foreign assets	285.3	303.3
Money Supply (M3)	1,380.3	1,600.7
Annual Growth Rates		
Money Suppy (M3)	15.1	16.0
Reserve Money	4.3	12.7
Real GDP	5.4	5.7
Credit to Private Sector	30.5	15.1
GDP deflator	6.4	9.1
Months of import cover	3.9	4.1

Source: Central Bank of Kenya

5. INTEREST RATES

Central Bank Rate (CBR)

In July 2010, the Monetary Policy Committee reduced the Central Bank Rate (CBR) by 75 basis points to 6.00 percent to support private sector investment with adequate and affordable credit. The CBR was lowered further by 25 basis points to 5.75 percent in January 2011 in order to provide impetus for further growth through lower cost of bank credit. The Monetary Policy Committee lowered the CBR to signal to the market easing of monetary policy with the direction of the CBR guiding money market participants on the direction of interest rates.

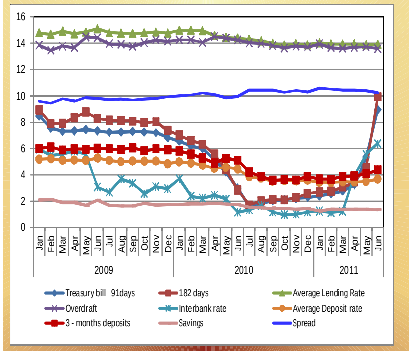
In March 2011, the MPC tightened the monetary policy stance by raising the CBR by 25 basis points, from 5.75 percent to 6 percent to contain inflationary pressures and to stabilize the exchange rate. The CBR was raised further by 25 basis points in May 2011 to 6.25 percent to endorse the tight monetary policy stance. To re-inforce this stance, the cash reserve ratio was raised by 25 basis points to 4.75 percent.

Short-Term Rates

The CBR coordinated the movements in short-term interest rates, which trended downwards in the first seven months of the fiscal year 2010/11 consistent with the reduction of the CBR (Table 5.1 and Chart 5A). In tandem, the average interbank rate declined by 11 basis points from 1.35 percent in July 2010 to 1.24 percent in March 2011. Following the tightening of monetary policy in March 2011 short-term interest rates, particularly the interbank rate trended upwards. The average interbank rate increased by 513 basis points from 1.24 percent in March 2011 to 6.36 percent in June 2011. The rise in interbank rate reflected reduced liquidity following the suspension of liquidity provision by the Central Bank through the reverse repo operations.

The 91-day Treasury bill rate and the 182-day Treasury bill rates, trended upward during the fiscal year 2010/11. The 91-day Treasury bill rate increased by 732 basis points from 1.63 percent in July 2010 to 8.95 percent in June 2011, while the 182-day Treasury bill rate increased by 821 basis points from 1.72 percent in July 2010 to 9.93 percent in June 2011. The

CHART 5A: INTEREST RATES



Source: Central Bank of Kenya

cost of accessing funds to finance the budget deficit, therefore, increased in the year to June 2011.

Lending Rates

Average lending rate to the private sector declined by 48 basis points in the fiscal year 2010/11 from 14.39 percent in June 2010 to 13.91 percent in June 2011. The decline in overall lending rate was reflected in all loan categories (overdraft, 1-5 years and over 5 years loans category) in both the corporate and business loans. The decline in interest rates was mainly attributed to the push by Central Bank to have commercial banks lower their rates in the first nine months through March 2011. The lending rate in the over 5 years loans category in the private loans increased marginally by 3 basis points from 14.16 percent in July 2010 to 14.19 percent in June 2011.

TABLE 5.1: INTEREST RATES (%)

	2010							2011					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91-day	3.06	1.63	1.83	2.04	2.12	2.21	2.28	2.41	2.57	2.77	3.26	5.35	8.95
Treasury bill 182-day	2.86	1.72	2.03	2.14	2.10	2.28	2.59	2.70	2.76	3.06	3.44	4.57	9.93
Average Lending Rate	14.39	14.29	14.18	13.98	13.85	13.95	13.87	14.03	13.92	13.92	13.92	13.88	13.91
Overdraft	14.23	14.03	13.97	13.81	13.64	13.77	13.69	13.93	13.65	13.60	13.68	13.72	13.59
Interbank rate	1.15	1.35	1.66	1.18	0.98	1.01	1.18	1.24	1.13	1.24	3.97	5.54	6.36
Average Deposit rate	4.45	3.85	3.74	3.53	3.58	3.54	3.59	3.43	3.41	3.47	3.47	3.51	3.68
3 - months deposits	5.11	4.21	3.89	3.59	3.65	3.61	3.86	3.67	3.67	3.88	3.92	4.08	4.38
Savings	1.75	1.55	1.50	1.47	1.46	1.40	1.45	1.25	1.41	1.37	1.38	1.38	1.37
Spread	9.94	10.44	10.44	10.45	10.27	10.41	10.28	10.60	10.51	10.45	10.46	10.37	10.23

Source: Central Bank of Kenya

Deposit Rates

Average deposit rates declined by 77 basis points from 4.45 percent in June 2010 to 3.68 percent in June 2011. The deposit rates for all maturities declined. The decline in the deposits rate was more pronounced for over 3 months deposits, which declined by 120 basis points to 5.28 percent. The deposit rate on demand deposits declined from 0.97 percent in June 2010 to 0.87 percent in June 2011. The savings deposits rate also declined from 1.75 percent in July 2010 to 1.37 percent in June 2011.

The decline in the overall lending rate in the year to June 2011 was much higher than the decline in overall deposits rate. Consequently, the interest rate spread increased from 9.94 percent in June 2010 to 10.23 in June 2011. Since September 2010, interest rates spread declined from 10.45 percent to 10.23 percent in June 2011 due to increase deposit rates from 3.53 percent to 3.68 percent. Chart 5A and Table 5.1 show the movement in interest rates during the period.

Interest Rates Outlook

In the medium term, interest rates are expected to remain low and stable consistent with stability in most of the macroeconomic fundamentals. The Central Bank will support interest rates stability by continued implementation of prudent monetary policy. However, in order to stimulate savings and investments, deposit rates must increase and lending rates must decline in line with return on investments and improvement in efficiency of the money market. Lower interest rates spread will signal increasing efficiency in the financial market.

6. EXCHANGE RATES

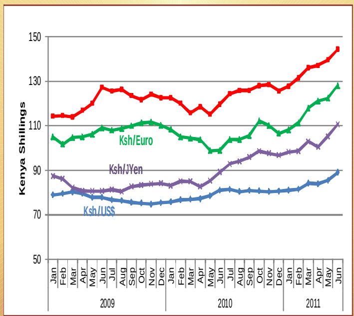
The Kenya Shilling Exchange Rates

The level of the Kenya shilling exchange rate continues to be determined by the forces of demand and supply in the foreign exchange market.

The Kenya shilling weakened against major world currencies in fiscal year 2010/11 (Table 6.1 and Chart 6A). The shilling depreciated against the US dollar by 10 percent between June 2010 and June 2011 to exchange at an average of Ksh 89.05 per US dollar in June 2011 compared with Ksh 81.02 per US dollar in June 2010.

The weakening of the Kenya shilling mainly reflects developments in international currency market, largely influenced by the effect of the Debt Crisis in the Euro zone, and pressures from Kenya's balance of payments. The strengthening of the US dollar against the Euro in the international market fuelled the weakening of the shilling against the US dollar. The shilling weakened against the Sterling Pound and the Euro to exchange at Ksh 144.40 per Sterling Pound and Ksh 128.11 per Euro in June 2011 compared with Ksh 119.62 per Sterling Pound and Ksh 98.99 per Euro in June 2010.

CHART 6A: KENYA SHILLING EXCHANGE RATES



Source: Central Bank of Kenya

TABLE 6.1: KENYA SHILLING EXCHANGE RATES

	2007			2008			2009			2010			2011		% Change
	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Jun-10 to Jun-11
Kshs/US$	69.9	66.6	63.3	68.1	63.8	78.0	78.9	77.9	75.4	75.8	81.0	80.6	81.0	89.0	**9.9** [b]
Kshs/Stg. £	136.9	132.3	128.5	134.0	125.3	116.5	114.3	127.2	122.5	122.5	119.6	125.7	127.7	144.4	**20.7** [b]
Kshs/Euro	90.9	89.3	92.2	100.2	99.2	105.0	105.0	109.0	110.3	108.3	99.0	106.5	108.2	128.1	**29.4** [b]
Kshs/Yen	58.1	54.3	56.5	63.2	59.6	85.4	87.4	80.6	84.1	83.1	89.2	96.8	98.1	110.6	**24.0** [b]
Kshs/Rand	9.7	9.3	9.3	9.8	8.0	7.8	8.0	9.6	10.1	10.2	10.6	11.8	11.7	13.1	**23.7** [b]
Ushs/Kshs*	26.0	25.0	27.1	25.2	25.1	25.1	25.1	27.5	25.2	25.5	27.9	28.6	28.8	27.6	**-1.1** [a]
Tshs/Kshs*	18.6	19.0	18.4	17.1	18.6	16.6	17.0	16.9	17.6	17.7	18.0	18.2	18.4	17.8	**-1.1** [a]
Rwf/Kshs*													7.3	6.7	
Bif/Kshs*													15.1	13.8	

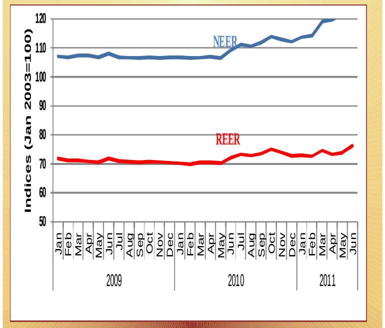
*Currency per Kenya shilling

[a] --appreciation

[b] --depreciation

Source: Central Bank of Kenya

CHART 6B: KENYA SHILLING REER AND NEER



NEER: Nominal Effective Exchange Rate Index (2003=100)
REER: Real Effective Exchange Rate Index (2003=100)

Source: Central Bank of Kenya

In the EAC, the Kenya shilling gained against the Uganda shilling and the Tanzania shilling by 1 percent in the fiscal year 2010/2011 to exchange at Ush 27.61 per Kenya shilling and Tsh 17.79 per Kenya shilling in June 2011.

International Trade Competitiveness

The performance of the Kenya shilling against bilateral currencies was reflected in the basket of Kenya's major trading partner country currencies. The trade-weighted nominal exchange rate index (NEER) depreciated between June 2010 and June 2011 (Chart 6B), but real effective exchange rate stabilised, affirming that exports have remained competitive despite the turmoil in the money market.

Outlook for the Kenya Shilling

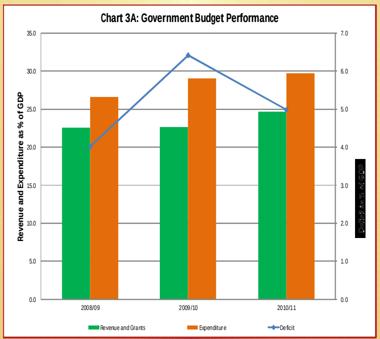
Demand for foreign currency is expected to continue in the next fiscal year consistent with expectations for continued growth momentum. The performance of the Kenya shilling is expected to be underpinned by trade and capital flows.

The continued pursuit of prudent monetary policy by the Central Bank of Kenya mitigates the negative effect of the domestic inflation on the country's external competitiveness.

7. GOVERNMENT BUDGETARY OPERATIONS

Government budgetary operations in the fiscal year 2010/11 resulted in a reduction of budget deficit to Ksh 137.6 billion or 5.0 percent of GDP on commitment basis compared with Ksh 157.8 billion (6.4 percent of GDP) in a similar period in the fiscal year 2009/10. The deficit was within the revised budget target of Ksh 187.9 billion or 6.8 percent of GDP for the fiscal year (Table 7.1 and Chart 7A).

CHART 7A: GOVERNMENT BUDGET PERFORMANCE



Sources: Central Bank of Kenya and Treasury

TABLE 7.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS

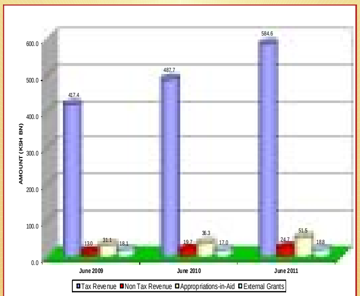
	FY 2007/2008	FY 2008/2009	FY 2009/2010	FY 2010/2011		
	Actual	Actual	Actual	Prov.	Rev. Target	Over(+) / Below (-)
1. REVENUE & GRANTS	**457.7**	**506.0**	**560.8**	**679.5**	**730.2**	**-50.6**
Revenue	432.2	487.9	543.8	660.8	686.4	-25.7
Tax Revenue	381.1	417.4	487.7	584.6	580.9	3.7
Non Tax Revenue	15.4	13.0	19.7	24.7	25.0	-0.3
Appropriations-in-Aid	35.7	31.1	36.3	51.5	80.5	-29.0
External Grants	25.4	18.1	17.0	18.8	43.7	-25.0
2. EXPENDITURE AND NET LENDING	**534.8**	**595.7**	**718.6**	**817.1**	**918.1**	**-101.0**
Recurrent Expenditure	403.4	435.5	519.8	582.5	611.6	-29.1
Development Expenditure	131.5	160.2	198.8	234.6	306.4	-71.8
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-77.2**	**-89.8**	**-157.8**	**-137.6**	**-187.9**	50.3
Deficit on a commitment basis as a % of GDP	-4.5	-4.0	-6.4	-5.0	-6.8	
4. ADJUSTMENT TO CASH BASIS	9.3	-27.3	-9.0	19.7	0.0	**19.7**
5. DEFICIT ON A CASH BASIS	**-67.9**	**-117.0**	**-166.8**	**-117.8**	**-187.9**	**70.1**
Deficit on a cash basis as a % of GDP	-4.0	-5.2	-6.8	-4.3	-6.8	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**-7.9**	**0.0**	**-3.2**	**1.6**	**0.0**	**1.6**
7. FINANCING	**59.9**	**117.0**	**163.7**	**-119.5**	**-187.9**	**68.4**
Domestic (Net)	-13.9	75.9	152.5	90.4	125.0	-34.6
External (Net)	6.3	41.1	11.1	29.1	62.9	-33.8
Capital Receipts (net of restructuring costs)	67.5	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Treasury and Central Bank of Kenya

Government Revenue

Government revenue (including grants) increased by 21.2 percent to Ksh 679.5 billion in the fiscal year 2010/11 from Ksh 560.8 billion in fiscal year 2009/10 (Chart 7B). The improvement was recorded in all components. As a percentage of GDP, revenue and grants increased from 22.8 percent to 24.7 percent during the period. Despite the improved revenue performance in the fiscal year 2010/11, overall target was missed by 6.9 percent largely due to underperformance in Appropriation-in-Aid (A-in-A) and external grants. Tax revenue in fiscal year 2010/11 increased by 19.9 percent over the collection of the previous year and surpassed the target by Ksh 3.7 billion or 0.6 percent. Non-tax revenue underperformed marginally, and A-in-A recorded 36 percent shortfall in relation to the revised target and 41.9 percent growth in 2010/11 compared with 2009/10 collections. The latter performance is

CHART 7B: COMPOSITION OF REVENUE



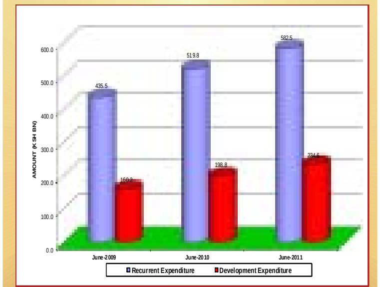
Sources: Central Bank of Kenya and Treasury attributed to inclusion of income from public universities private students fees in the A-in-A account in 2010/11.

External grants received amounted to Ksh 18.8 billion which was below target by 57 percent.

Expenditure and Net Lending

As shown in Chart 7C, Government expenditure and net lending increased by 13.7 percent, from Ksh 718.6 billion in the fiscal year 2009/10 to Ksh 817.1 billion in the fiscal year 2010/11. Recurrent and development expenditures increased by 12.1 percent and 18.0 percent, respectively.

CHART 7C: GOVERNMENT EXPENDITURE



Sources: Central Bank of Kenya and Treasury

The recurrent expenditure of Ksh 582.5 billion in the fiscal year 2010/11 was Ksh 29.1 billion or 4.7 percent below target. All recurrent expenditure items underperformed in relation to the targets except domestic interest which surpassed its target by Ksh 2 billion. Development expenditure at Ksh 234.6 billion was Ksh 71.8 billon or 30.6 percent below target. The shortfall emanates from a lower absorption rate with respect to the externally financed projects. However, the share of development expenditure in total expenditure rose from 27.7 percent in fiscal year 2009/10 to 28.7 percent in the fiscal year 2010/11, while that of recurrent expenditure declined from 72.3 percent to 71.3 percent. The reallocation is consistent with the Government's fiscal policy objective of prioritizing infrastructural developments in order to create a conducive environment for doing business, and therefore, provide the investments to achieve and sustain high economic growth in line with the Vision 2030.

Financing

During the 2010/11 fiscal year, budgetary operations of the Government resulted in a financing requirement of Ksh 134 billion (Table 7.2). The funds were allocated to finance the budget deficit of Ksh 119.5 billion, retire domestic debt by Ksh 10 billion and build up government deposits by Ksh 4.5 billion. The Government accessed about 80 percent of the funds from domestic sources via additional borrowing.

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TABLE 7.2: GOVERNMENT OVERALL BORROWING REQUIREMENTS AND ITS SOURCES, JULY-JUNE (KSH BN)

I. FINANCING REQUIREMENTS	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
1. Budget deficit	-	36.52	36.97	57.98	83.49	163.68	119.47
2. External debt reduction	0.63	-	1.69	-	-	-	-
3. Domestic debt reduction	19.59	5.60	5.64	6.24	6.30	-	9.96
3.1 Central Bank (incl. items in transit)	4.27	5.60	5.64	-	6.30	-	9.96
3.2 Commercial banks (net of deposits)	15.33	-	-	6.24	-	-	-
3.3 Non-bank sources	-	-	-	-	-	-	-
4. Increase in GoK deposits at CBK	6.13	15.40	-	26.44	-	-	4.52
TOTAL	**26.35**	**57.52**	**44.31**	**90.66**	**89.79**	**163.68**	**133.95**
II. FINANCING SOURCES	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2008/10**	**2008/11**
1. Budget surplus	7.30	-	-	-	-	-	-
2. External debt increase	-	1.27	-	4.37	11.56	11.91	29.09
3. Increase in domestic debt	19.06	49.26	22.19	18.79	72.39	131.08	104.86
3.1 Central Bank	-	-	-	9.32	-	9.84	-
3.2 Commercial banks	-	27.14	7.28	-	43.56	91.34	22.44
3.3 Non-bank sources	19.06	22.12	14.91	9.47	28.82	29.69	82.43
4. Reduction in GoK deposits at CBK	-	-	18.11	-	3.34	20.61	-
5. Privatisation proceeds	-	7.00	4.00	67.50	2.50	-	-
TOTAL	**26.35**	**57.52**	**44.31**	**90.66**	**89.79**	**163.70**	**133.95**

Source: Treasury and Central Bank of Kenya

Outlook for the fiscal year 2011/12

In the budget estimates for the fiscal year 2011/12, Government revenue excluding external grants is estimated at Ksh 789.5 billion (25.7 percent of GDP) and external grants at Ksh 41.1 billion (1.3 percent of GDP). Government expenditure is estimated at Ksh 1,066.8 billion or 34.7 percent of GDP. The main components of expenditure include Ksh 663.6 billion (21.6 percent of GDP) in recurrent expenditure and Ksh 401.1 billion or 13.1 percent of GDP in development expenditure.

The overall budget deficit including grants is, therefore, estimated at Ksh 236.2 billion (7.7 percent of GDP) in 2011/12. The deficit will be financed through net external borrowing of Ksh 116.7 billion (3.8 percent of GDP) and net domestic borrowing of Ksh 119.5 billion (3.9 percent of GDP).

8. PUBLIC DEBT

Kenya's public and publicly guaranteed debt stood at Ksh 1,491.4 billion as at end June 2011. This represented a 21.7 percent increase from Ksh 1,225.7 billion held at the end of June 2010 (Table 8.1). The increase in the overall Government debt stock comprised Ksh 103.9 billion in domestic debt and Ksh 161.8 billion in external debt. The percentage of domestic debt in total debt declined from 53.9 percent to 51.2 percent during the period, while that of external debt increased from 46.1 percent to 48.8 percent. As a percentage of GDP, overall public debt stock increased from 49.9 percent to 54.0 percent during the period. In particular, the proportion of external debt in GDP increased from 23.0 percent to 26.3 percent, while domestic debt increased from 26.9 percent of GDP to 27.7 percent.

TABLE 8.1: PUBLIC DEBT (KSH BN)

	June 2009		June 2010		June 2011**	
	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT						
Securitised debt	511.6	98.7	640.6	97.0	752.9	98.5
Treasury Bills	150.1	29.0	191.3	29.0	157.3	20.6
Of which Repo Treasury bills	33.3	6.4	32.2	4.9	30.7	4.0
Treasury Bonds	360.7	69.6	448.6	67.9	595.7	78.0
Government Stocks	0.8	0.1	0.8	0.1	0.0	0.0
Non Securitised debt	6.9	1.3	19.6	3.0	10.1	1.3
Overdraft/Advances	5.1	1.0	19.2	2.9	9.8	1.3
others	1.8	0.3	0.4	0.1	0.3	0.0
TOTAL DOMESTIC DEBT	518.5	100.0	660.3	100.0	764.1	99.9
(as a % of GDP)	23.2		26.9		27.7	
(as a % of Total Debt	49.1		53.9		51.2	
EXTERNAL DEBT**						
Bilateral	185.9	34.6	196.3	34.7	257.0	35.3
Multilateral	327.6	61.0	348.6	61.7	445.3	61.2
Comm. Banks	0.0	0.0	0.0	0.0	0.0	0.0
Export Credit	23.8	4.4	20.5	3.6	25.0	3.4
TOTAL EXTERNAL DEBT	537.4	100.0	565.5	100.0	727.3	100.0
(as a % of GDP)	24.0		23.0		26.3	
(as a % of Total Debt	50.9		46.1		48.8	
TOTAL PUBLIC DEBT	1055.9		1225.7		1491.4	
(as a % of GDP)	47.2		49.9		54.0	

* External debt stock Revised
** Provisional

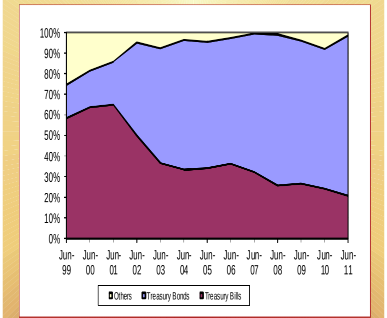
Sources: Central Bank of Kenya and Treasury

The overall objective of the debt management strategy is to meet the central government borrowing requirement at minimal cost and with prudent degree of risk. The strategy also aims at facilitating the government's access to the financial market, and supporting the development of a well functioning domestic financial market.

Public Domestic Debt

Total domestic debt increased by 103.9 billion during the fiscal year 2010/11 from Ksh 660.3 billion in June 2010 to Ksh 764.1 billion in June 2011, largely as a result of increased securitized debt during the period. Total Government securities (including repos), held at the end of June 2011 amounted to Ksh 752.9 billion compared with Ksh 640.6 billion held at the end of June 2010. The outstanding stock as at June 2011 comprised 79.1 percent in Treasury bonds and 20.9 percent in Treasury bills (excluding repos). During the year to June 2011, total Treasury bonds increased by Ksh 147.1 billion compared with holdings of the previous year, reflecting the government debt management strategy of restructuring domestic debt to benchmark-long dated instruments in order to minimize the risks associated with short term domestic borrowing. Government overdraft at Central Bank, which is the main component of other domestic debt, declined from Ksh 17.6 billion in June 2010 to Ksh 7.6 billion in June 2011.

CHART 8A:COMPOSITION OF GOVERNMENT DOMESTIC DEBT

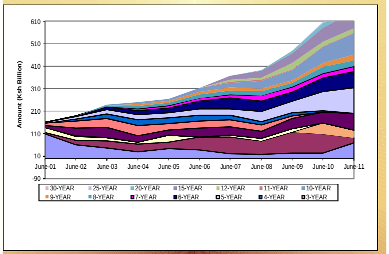


Sources: Central Bank of Kenya and Treasury

As shown in Chart 8A, the percentage of Treasury bonds in total domestic debt increased from 67.9 percent in June 2010 to 78.0 percent in June 2011, while that of Treasury bills declined from 29.0 percent of total domestic debt to 20.6 percent during the period. Treasury bills (including Repos) increased from Ksh 191.3 billion to Ksh 157.3 billion during the period.

Reflecting the rise in the stock of Treasury bonds, the average maturity of domestic debt (by the period to maturity) increased from 4 years and 3 months in June 2010 to 5 years and 10 months in June 2011. As shown in Chart 8B, the Government made significant progress in issuing long-term instruments during the fiscal year 2010/11. The 5-year Treasury bond accounted for the largest proportion of outstanding Government securities during the period, increasing from 14.2 percent in June 2010 to 15.9 percent in June 2011. The percentage of Treasury bonds with maturities of between 10-years and 30-years increased to 35.9 percent during the year ending June 2011 up from 30.0 percent in June 2010 following successful issuance of longer dated Treasury bonds.

CHART 8B: OUTSTANDING TREASURY BILLS & BONDS BY TENOR



Sources: Central Bank of Kenya

The trends in the holdings of Treasury bills and bonds by creditor categories are shown in Tables 8.2 and 8.3. Commercial banks reduced holdings of Treasury bills from 69.9 percent in June 2010 to 55.8 percent in June 2011 and raised holdings of Treasury bonds from 46.6 percent to 48.4 percent during the period.

The continued re-opening of Treasury bond issues to add to their liquidity and support bond trading was a resounding success during the year. The infrastructure bonds issued during the year also exhibit popularity in the bond market due to its attractive features like tax exemptions.

TABLE 8.2: OUTSTANDING STOCK OF TREASURY BILLS BY HOLDER (KSH BN)

Holders	Jun-09		Jun-10		Jun-11	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	108.0	78.3	167.2	87.4	119.4	75.9
Central Bank*	33.3	24.2	33.2	17.4	31.7	20.1
Comm. Banks	74.6	54.2	133.8	69.9	87.7	55.8
NBFIs	0.0	0.0	0.2	0.1	0.0	0.0
Insurance Companies	17.0	12.4	8.4	4.4	4.7	3.0
Parastatals	2.3	1.7	1.9	1.0	3.2	2.1
of which NSSF	0.0	0.0	0.0	0.0	0.0	0.0
Building Societies	0.0	0.0	0.0	0.0	0.0	0.0
Others	10.5	7.6	13.8	7.2	30.9	19.6
Total	137.8	100.0	191.3	100.0	157.3	100.0

* Includes Repo Treasury bills

Source: Central Bank of Kenya

TABLE 8.3: OUTSTANDING STOCK OF TREASURY BONDS BY HOLDER (KSH BN)

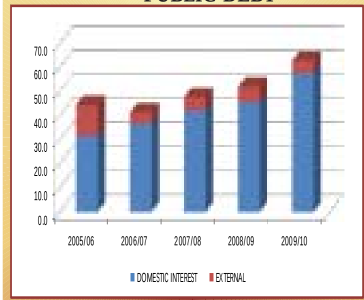
Holders	Jun-09		Jun-10		Jun-11	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	176.8	49.0	211.7	47.2	290.9	48.8
Central Bank	0.0	0.0	0.0	0.0	0.0	0.0
Comm. Banks	176.0	48.8	208.9	46.6	288.4	48.4
NBFIs	0.8	0.2	2.8	0.6	2.5	0.4
Insurance Companies	38.3	10.6	53.8	12.0	74.7	12.5
Parastatals	31.4	8.7	38.0	8.5	23.7	4.0
of which NSSF	15.8	4.4	20.1	4.5	22.5	3.8
Building Societies	0.5	0.1	0.4	0.1	0.3	0.0
Others	113.8	31.5	124.7	27.8	206.1	34.6
Total	360.7	100.0	448.6	100.0	595.7	100.0

Source: Central Bank of Kenya

Debt Service

As shown in Chart 8C, cumulative Government expenditure on interest and other charges on domestic debt increased from

CHART 8C: INTEREST PAYMENTS ON PUBLIC DEBT



Ksh 57.4 billion in the fiscal year 2009/10 to Ksh 69.2 billion in the fiscal year 2010/11. Interest accumulated on external debt also increased by Ksh 1.8 billion from Ksh 5.2 billion to Ksh 7.0 billion, during the same period.

Public and Publicly Guaranteed External Debt

Kenya's external debt increased by 28.6 percent from Ksh 565.5 billion (US$ 7.0 billion) in June 2010 to Ksh 727.3 billion (US$ 8.09 billion) in June 2011 (Table 8.4) largely as a result of the depreciation of the Kenya shilling against the Euro, dollar, Sterling Pound and other major world currencies. The increase in external debt comprised external loans disbursement of Ksh 77.1 billion and revaluation loss of Ksh 107.4 billion, which more than offset repayment of Ksh 28.1 billion.

TABLE 8.4: DISTRIBUTION OF EXTERNAL PUBLIC DEBT

	Jun-09	%	Jun-10	%	Jun-11	%
Bilateral	185.4	34.6	196.3	34.7	257.0	35.3
Multilateral	326.9	61.1	348.6	61.7	445.3	61.2
Commercial loans	0.0	0.0	0.0	0.0	0.0	0.0
Export Credit	23.1	4.3	20.5	3.6	25.0	3.4
Total	**535.3**	**100.0**	**565.5**	**100.0**	**727.3**	**100.0**

Sources: Central Bank of Kenya and Treasury

CHART 8D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2011

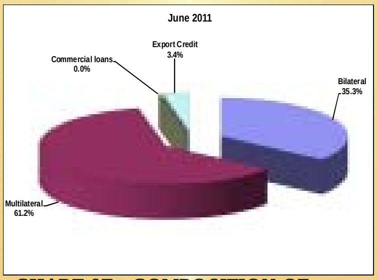
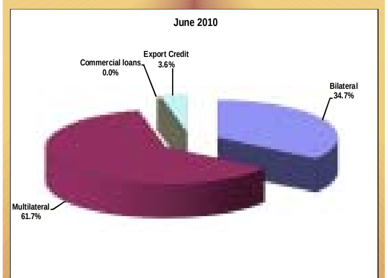


CHART 8E: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2010



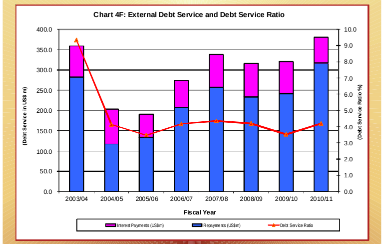
Sources: Central Bank of Kenya and Treasury

The percentage of external debt owed to multilateral corporations (including loans from the IMF) declined from 61.7 percent in June 2010 to 61.2 percent in June 2011, while that owed to bilateral creditors increased from 34.7 percent to 35.3 percent (Table 8.4 and Charts 8D and 8E). The percentage of external debt contracted through export credits decreased from 3.6 percent in June 2010 to 3.4 percent in June 2011.

External Debt Service

External debt service increased from Ksh 26.2 billion or 4.0 percent of ordinary revenue to Ksh 34.2 billion or 5.9 percent of ordinary revenue following the weakening of the shilling against the major currencies. The external debt service in the period comprised Ksh 28.5 billion in principal repayments and Ksh 5.7 billion in interest payments. The debt service ratio, which is the ratio of external debt service payments to export earnings of goods and services, increased from 3.5 percent in the fiscal year 2009/10 to 4.2 percent in the fiscal year 2010/11. As shown in Chart 8F, the debt service ratio has generally

CHART8F: EXTERNAL DEBT SERVICE AND DEBT SERVICE RATIO



Sources: Central Bank of Kenya and

been stable at an average of 4.0 percent since the fiscal year 2004/05 and much lower than in the fiscal year 2003/04 when it stood at 9.3 percent.

Prospects for Fiscal Year 2011/12

The budget estimates for 2011/12 has Government domestic borrowing projected at Ksh 119.5 billion (3.9 percent of GDP) while external borrowing is estimated at Ksh 116.7 billion (3.8 percent of GDP). However, as indicated in the Budget Strategy Paper for 2009/10 to 2012/13, gross domestic debt-to-GDP ratio is projected to increase from 24.2 percent in June 2010 to 27.1 percent in June 2011.

Overview

Kenya's balance of payments developments in 2010 were mainly influenced by domestic and external events. World GDP growth rebounded to 5.1 percent in 2010 from a 0.5 percent decline in 2009. Global growth is estimated at an annualized rate of 4.3 percent in the first quarter of 2011, while Kenya's economy grew by 4.9 percent in the first quarter of 2011.

Receipts from Kenya's exports of goods increased by 5.4 percent while those from services increased by 40 percent in the fiscal year 2009/10. Kenya's current account position worsened as the deficit widened by 75.7 percent to US$ 3,374 million in 2010/11 from US$ 1,920 million in 2009/10. This was due to US$ 2,375 million increase in imports compared with US$ 609 million increase in exports. Kenya's balance of

TABLE 9.1: BALANCE OF PAYMENTS (US $ M)

ITEM	Year to June 2010*	Year to June 2011* Q1 Jul-Sep	Q2 Oct- Dec	Q3 Jan- Mar	Q4 Apr- Jun	Year to June 2011*	Absolute Change
1. OVERALL BALANCE	592	264	-54	43	8	261	-330
2. CURRENT ACCOUNT	-1,920	-631	-828	-841	-1,074	-3,374	-1,454
2.1 Goods	-6,351	-1,815	-2,130	-2,036	-2,137	-8,118	-1,767
Exports (fob)	4,932	1,256	1,411	1,435	1,439	5,541	609
Coffee	194	59	42	46	66	213	19
Tea	1,127	261	270	291	286	1,108	-19
Horticulture	715	163	200	188	181	732	17
Oil products	99	31	16	39	34	120	21
Manufactured Goods	570	159	160	169	182	670	100
Raw Materials	219	41	48	95	80	264	45
Re-exports	317	70	92	78	73	313	-5
Other	869	254	327	282	266	1,129	260
Imports (cif)	11,283	3,071	3,541	3,471	3,576	13,659	2,375
Oil	2,636	561	733	988	1,017	3,299	664
Chemicals	1,427	416	423	515	493	1,847	420
Manufactured Goods	1,625	446	490	511	574	2,021	396
Machinery & Transport Equipment	3,212	990	1,208	822	922	3,942	731
Other	2,384	659	687	634	570	2,549	165
2.2 Services	4,431	1,184	1,302	1,195	1,063	4,744	313
Non-factor services (net)	2,274	620	732	553	553	2,457	183
of which tourism	750	193	267	219	207	886	136
Income (net)	-112	1	-67	97	-24	8	120
of which official interest	-73	-20	-25	5	-21	-61	13
Current Transfers	2,269	563	637	545	533	2,279	9
Private (net)	2,000	508	582	550	538	2,178	178
Public (net)	269	55	55	-5	-5	100	-169
3. CAPITAL & FINANCIAL ACCOUNT	2,512	895	774	884	1,082	3,635	1,124
3.1 Capital Tranfers (net)	180	15	86	94	35	229	49
3.2 Financial Account	2,331	881	688	790	1,047	3,406	1,075
Official, medium & long-term	531	28	122	75	110	335	-197
Inflows	758	101	164	153	164	582	-176
Outflows	-227	-72	-43	-78	-54	-248	-21
Private, medium & long-term (net)	474	165	229	-110	366	649	175
Commercial Banks (net)	443	204	37	-115	340	466	23
Other private medium & long-term (net)	32	-39	192	4	26	183	152
Short-term (net) incl. errors & omissions	1,325	688	337	825	572	2,422	1,097
memo:							
Gross Reserves	5,009	5,141	5,123	5,454	5,249	5,249	239
Official	3,799	4,063	4,002	4,138	4,142	4,142	344
*imports cover***	*3.7*	*3.8*	*3.5*	*3.5*	*3.5*	*3.5*	-0.2
*imports cover****	*3.9*	*4.0*	*3.9*	*3.9*	*3.9*	*3.9*	0.1
Commercial Banks	1,211	1,078	1,121	1,316	1,106	1,106	-104

* Provisional

** Based on current 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

payments surplus declined from US$ 592 million during the fiscal year 2009/10 to US$ 261 million during the fiscal year 2010/11 (Table 9.1).

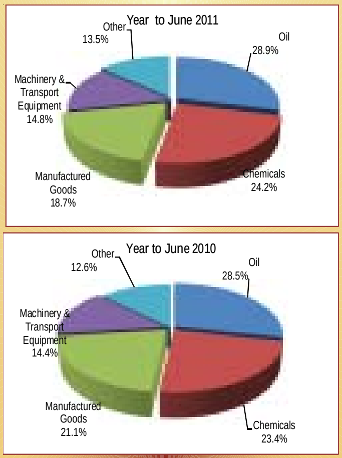
Trade in Goods and Services

Merchandise Account

Kenya's trade deficit worsened from US$ 6,351 million during the fiscal year 2009/10 to US$ 8,118 million in 2010/11. Imported goods increased by 21.1 percent to US$ 13,659 million, exceeding export growth of 12.3 percent. The increase in merchandise imports was driven by increased spending on machinery and transport equipment, chemicals, and oil.

Imports

CHART 9A: COMPOSITION OF KENYA'S IMPORTS



Sources: Central Bank of Kenya

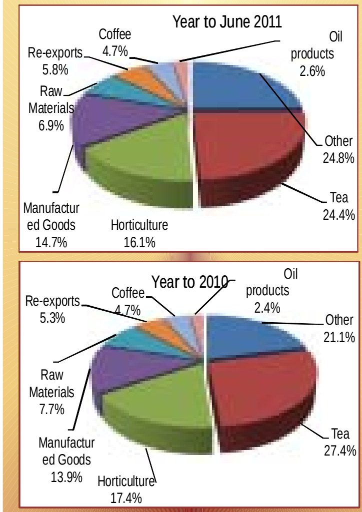
The value of Kenya's commodity imports rose to US$ 13,659 million during the fiscal year 2010/11 from US$ 11,283 million in the fiscal year 2009/10.

The share of oil imports increased from 23.4 percent to 24.2 percent of total imports due to higher international oil prices. Imports of machinery and transport equipment accounted for 28.9 percent of the import bill in 2010/11 increasing from 28.5 percent in 2009/10, reflecting ongoing infrastructure development. Imports of manufactured items mainly intermediate goods accounted for 15 percent of the import bill and increased from US$ 1,625 million to US$ 2,021 million (Chart 9A).

Exports

The value of goods exported increased by 12.3 percent from US$ 4,932 million in the fiscal year 2009/10 to US$ 5,541 million during the fiscal year 2010/11. The improvement in export performance came mainly from exports of manufactures, chemicals and raw materials whose share increased from 11.6 percent, 8.5 percent and 4.4 percent in 2009/10 to 12.1 percent, 9.0 percent and 4.8 percent in 2010/11, respectively. The value of tea exports, which account for about 20 percent of Kenya's exports of goods declined by 1.7 percent. Receipts from horticultural exports also declined from US$ 1,127 million to US$ 1,108 million in 2010/11. Horticulture accounted for

CHART 9B: COMPOSITION OF KENYA'S EXPORTS



Sources: Central Bank of Kenya

13.2 percent of Kenya's commodity exports in the fiscal year 2010/11, declining from 14.5 percent in 2009/10. Non-fuel commodity prices in international markets are high and are projected to increase by 21.6 percent in 2011 and to decline by 3.3 percent in 2012 (IMF World Economic Outlook-July 2011 Update), implying that the weak performance in Kenya's commodity exports is due to lower production in 2010/11 largely attributed to depressed and poorly distributed rainfall. Receipts from coffee exports improved from US$ 194 million to US$ 213 million in 2010/11. However coffee accounts for only 4 percent of Kenya's total exports (Chart 9B).

Services, Income and Current Transfer Account

The surplus on the services account improved from US$ 4,431 million in the fiscal year 2009/10 to US$ 4,744 million in fiscal year 2010/11. The services account comprise non-factor services, income and current transfers.

Earnings from non-factor services, which mainly include tourism, transport and financial services increased by 8 percent from US$ 2,274 million in 2009/10 to US$ 2,457 million in the fiscal year 2010/11. This was mainly driven by inflows from tourism which increased from US$ 750 million in 2009/10 to US$ 886 million in 2010/11. Net receipts from transportation services, however, declined from US$ 473 million to US$ 347 million.

Net receipts on the current transfer account increased from US$ 2,269 million to US$ 2,279 million in 2010/11, an increase of 0.4 percent. Remittance transfers performed well increasing by 21.2 percent.

A recent World Bank survey shows that remittances to Kenya from outside of Africa and also from within Africa are used for investment, real estate and education (Table 9.2).

TABLE 9.2: REMITTANCES TO KENYA BY USE: PERCENTAGE OF TOTAL REMITTANCES 2010/11

	Source		
Use	**Outside Africa**	**Within Africa**	**Domestic**
New-house construction	11.2	27.5	1.3
Education	9.6	22.9	20.5
Investment	24.2	0.6	4.7
Food	12.8	14.5	29.7

Source: World Bank Study (2010), Remittance Markets in Africa

The income account position improved from an outflow of US$ 112 million in fiscal year 2009/10 to an inflow of US$ 4 million fiscal year 2010/11. Interest rates in advanced economies are still low leading to reduced interest payments on both official and private foreign debt. Although global inflation is increasing due to high food and energy prices, the experience in advanced economies show that price increases in these commodities can be accommodated since their weight in the consumer basket is low.

Capital and Financial Flows

The surplus on the capital and financial account improved from US$ 2,512 million in the fiscal year 2009/10 to US$ 3,635 million in the fiscal year 2010/11.

Capital flows to the Government comprising project grants increased from US$ 180 million to US$ 229 million in the fiscal year 2010/11. However, medium and long-term flows to Government declined from US$ 531 million in 2009/10 to US$ 335 million in 2010/11. The high position in the fiscal year 2009/10 reflected additional allocation of Special Drawing Rights from the IMF in August 2009 to mitigate adverse impacts of the global recession.

Net medium and long-term financial inflows to the private sector increased to US$ 183 million in 2010/11 from US$ 32 million in 2009/10, driven mainly by private sector financing in the airline industry. The Banking sector reduced its deposits held abroad by US$ 466 million in 2010/11 compared with US$ 443 million in 2009/10. The drawdown is attributed to portfolio re-allocation in favour of Kenya shilling denominated assets during the period. Net short term financial inflows, including errors and omissions in recorded transactions, were US$ 2,422 million in the fiscal year 2010/11 compared with US$ 1,325 million in 2009/10.

Direction of Trade

As shown in Table 9.3, the main destination countries for Kenya's merchandise exports in the fiscal year 2010/11 were Uganda (14.6 percent), United Kingdom (9.2 percent), Tanzania (8.0 percent), the Netherlands (6.5 percent), Pakistan (4.2 percent), United States of America (5.6 percent), Sudan (4.6 percent), and Egypt

(4.1 percent). Overall, African countries absorbed 46.9 percent of Kenya's merchandise exports.

TABLE 9.3: KENYA'S EXPORTS: MAIN DESTINATION COUNTRIES (US$ M)

Destination Country	Fiscal Years			Proportion (%)		
	2008/09	2009/10	2010/11	2008/09	2009/10	2010/11
Uganda	601	601	808	12.9	12.2	14.6
Tanzania	407	402	442	8.7	8.1	8.0
Egypt	185	212	226	4.0	4.3	4.1
Sudan	169	196	257	3.6	4.0	4.6
Somalia	148	167	152	3.2	3.4	2.7
DRC	148	150	178	3.2	3.0	3.2
Rwanda	134	134	142	2.9	2.7	2.6
Others	406	385	396	8.7	7.8	7.1
Total Africa	2,200	2,247	2,600	47.2	45.6	46.9
United Kingdom	486	539	507	10.4	10.9	9.2
Netherlands	337	349	362	7.2	7.1	6.5
USA	271	214	309	5.8	4.3	5.6
Pakistan	202	218	231	4.3	4.4	4.2
United Arab Emirates	92	208	225	2.0	4.2	4.1
Germany	89	95	90	1.9	1.9	1.6
India	83	87	101	1.8	1.8	1.8
Afghanistan	68	157	146	1.5	3.2	2.6
Others	829	818	970	17.8	16.6	17.5
Total Exports	4,656	4,932	5,541	100.0	100.0	100.0

Source: Central Bank of Kenya

On the other hand, Kenya sourced most imports in 2010/11 from the United Arab Emirates (13.0 percent), China (12.1 percent), India (11.6 percent), South Africa (5.8 percent), Japan (5.1 percent), United Kingdom (4.6 percent), Singapore (4.0 percent) United States of America (3.5 percent), Indonesia (2.8 percent), Saudi Arabia (2.6 percent), and Germany (2.6 percent) (Table 9.4).

TABLE 9.4: KENYA'S IMPORTS: MAIN SOURCE COUNTRIES (US$ M)

Source Country	Fiscal Years			Fiscal Years		
	2008/09	2009/10	2010/11	2008/09	2009/10	2010/11
South Africa	815	833	797	7.5	7.4	5.8
Egypt	134	172	233	1.2	1.5	1.7
Others	348	394	549	3.2	3.5	4.0
Total Africa	**1,296**	**1,400**	**1,579**	**11.9**	**12.4**	**11.6**
India	1,186	1,221	1,581	10.9	10.8	11.6
United Arab Emirates	1,201	1,566	1,780	11.0	13.9	13.0
China	940	1,140	1,651	8.6	10.1	12.1
Japan	614	686	697	5.6	6.1	5.1
USA	494	572	483	4.5	5.1	3.5
United Kingdom	421	497	622	3.9	4.4	4.6
Singapore	417	302	551	3.8	2.7	4.0
Germany	354	308	353	3.2	2.7	2.6
Saudi Arabia	375	434	350	3.4	3.8	2.6
Indonesia	278	295	389	2.5	2.6	2.8
Netherlands	230	212	244	2.1	1.9	1.8
France	232	195	241	2.1	1.7	1.8
Bahrain	209	82	81	1.9	0.7	0.6
Italy	184	165	137	1.7	1.5	1.0
Others	2,488	2,210	2,919	22.8	19.6	21.4
Total Imports	**10,919**	**11,283**	**13,659**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Kenya

Kenya's Trade Structure

The proportion of Kenya's total trade with Asia increased from 44.2 percent in 2009 to 47.9 percent in 2010. The proportion of trade with European countries and America, however, declined to 22.4 percent and 5.9 percent in 2010 compared with 24 percent and 7.4 percent in 2009, respectively (Table 9.5).

TABLE 9.5: KENYA'S TRADE STRUCTURE

	Total Trade in Billions of Kenya Shillings							Proportion (%)							
	2004	2005	2006	2007	2008	2009	2010*	2003	2004	2005	2006	2007	2008	2009	2010*
Europe	159.5	172.5	206.9	220.4	265.0	272.2	304.4	28.9	27.5	24.5	26.8	25.1	23.8	24.0	22.4
Western Europe	151.9	165.8	194.5	207.2	241.5	242.3	287.1	27.3	26.2	23.6	25.2	23.6	21.7	21.4	21.2
European Union	143.9	155.7	180.2	193.7	222.4	229.0	270.4	25.6	24.8	22.1	23.3	22.0	19.9	20.2	19.9
Others	7.9	10.1	14.3	13.5	19.2	13.4	16.7	1.7	1.4	1.4	1.8	1.5	1.7	1.2	1.2
Eastern Europe	7.6	6.7	12.4	13.1	23.4	29.9	26.2	1.5	1.3	1.0	1.6	1.5	2.1	2.6	1.9
America	30.5	65.1	53.8	76.0	65.6	83.8	80.1	4.7	5.3	9.3	7.0	8.6	5.9	7.4	5.9
U.S.A	18.9	54.6	45.1	63.7	48.1	67.5	61.8	3.7	3.3	7.8	5.8	7.2	4.3	6.0	4.6
Others	11.6	10.5	8.8	12.2	12.3	16.3	10.0	1.0	2.0	1.5	1.1	1.4	1.1	1.4	0.7
Africa	154.3	183.5	171.9	196.0	248.5	267.4	303.9	26.2	26.6	26.1	22.3	22.3	22.3	23.6	22.4
E.A.Community	67.2	78.3	59.1	77.0	96.5	103.0	121.7	12.1	11.6	11.1	7.7	8.8	8.7	9.1	9.0
Tanzania	19.9	23.1	22.8	29.0	36.5	37.9	43.8	3.4	3.4	3.3	3.0	3.3	3.3	3.3	3.2
Uganda	38.1	44.1	28.8	39.5	47.5	50.7	61.3	6.8	6.6	6.3	3.7	4.5	4.3	4.5	4.5
Comesa[a]	42.1	49.8	56.7	66.8	79.6	72.7	99.4	7.1	7.3	7.1	7.3	7.6	7.1	6.4	7.3
Other Countries	45.0	55.4	56.1	52.2	72.4	91.7	82.7	7.0	7.8	7.9	7.3	5.9	6.5	8.1	6.1
Asia	219.1	257.6	324.2	380.3	526.0	501.4	649.5	37.5	37.8	36.6	42.0	43.2	47.2	44.2	47.9
Middle East	107.7	116.8	129.5	143.6	199.8	168.2	199.3	17.6	18.6	16.6	16.8	16.3	17.9	14.8	14.7
Far East	111.4	140.8	194.7	236.7	326.2	333.2	450.3	19.9	19.2	20.0	25.2	26.9	29.2	29.4	33.2
Australia & Oceanic	2.1	2.5	3.8	3.1	2.5	5.3	4.7	0.5	0.4	0.4	0.5	0.4	0.2	0.5	0.3
All other Countries N.E.S	13.9	22.3	11.8	3.9	3.4	3.0	5.5	2.1	2.4	3.2	1.5	0.4	0.3	0.3	0.4
Grand Total	**579.4**	**703.5**	**772.5**	**879.7**	**1115.6**	**1133.0**	**1357.2**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

*Provisional

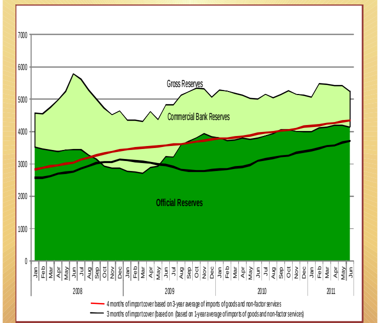
[a] Excluding member countries Uganda, Rwanda & Burundi

Source: Economic Survey, 2008

There was increased trade with Asia mainly United Arab Emirates and Far East. Much of the trade between Kenya and European countries was with Western Europe. Trade with African countries fell to 22.4 percent in 2010 from 23.6 percent in 2007.

Foreign Exchange Reserves

CHART 9C: FOREIGN EXCHANGE RESERVES



Source: Central Bank of Kenya

Gross foreign assets of the banking system increased from US$ 5,009 million at the end of June 2010 to US$ 5,249 million at the end of June 2011 (Chart 9C). In value terms, the official foreign exchange reserves held by the Central Bank of Kenya increased from US$ 3,799 million (3.9 months of import cover) to US$ 4,142 million (3.9 months of import cover). The improvement in gross official foreign exchange reserves reflected domestic interbank purchases by the Central Bank to enhance import cover, and program disbursement under the IMF's Three-Year Extended Credit Facility.

Foreign exchange assets of commercial banks declined from US$ 1,211 million at the end of June 2010 to US$ 1,106 million at the end of June 2011, reflecting relatively higher returns from holding domestic assets. Most of the foreign assets are held as balances with banks abroad amounting to US$ 793 million in June 2011 compared with US$ 989 million in June 2010. Foreign assets of commercial banks also include shares and securities, foreign loans and other accounts receivable. Besides these holdings, foreign currency deposits held locally by residents stood at US$ 2,331 million at the end of June 2011 compared with US$ 2,140 million at the end of June 2010.

10. BANKING SECTOR DEVELOPMENTS

Overview

During the period ended June 30, 2011, the Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 2 credit reference bureaus, 3 representative offices of foreign banks and 124 foreign exchange bureaus.

The Banking Sector performance improved in the year to June 2011, with total assets, loans and advances, deposits and profit before tax increasing by 21 percent, 32 percent, 16 percent and 17 percent, respectively (Tables 10.1 and 10.4). The number of bank customer deposit accounts, bank branch network and bank loan accounts increased by 26.7 percent, 8.4 percent and 5.0 percent, respectively to 12.8 million customer deposit accounts, 11.0 million bank branches and 2.1 million bank loan accounts.

Structure of the Balance Sheet

The banking sector aggregate balance sheet grew by 21 percent from Ksh 1,548.4 billion in June 2010 to Ksh 1,873.8 billion in June 2011. The major components of the balance sheet were loans and advances, government securities and placements, which accounted for 55.0 percent, 22.0 percent and 6.0 percent of total assets, respectively (Table 10.1).

TABLE 10.1: BALANCE SHEET (KSH MILLION)

	Jun-11	Jun-10	% Change
Cash	36,319	29,641	23
Balances at CBK	80,298	89,860	-11
Placements	115,954	102,614	13
Govt. Securities	421,570	392,702	7
Other Investments	46,550	36,439	28
Loans & Advances (Net)	1,038,853	786,591	32
Foreign Assets	6,218	3,744	66
Other Assets	128,004	106,817	20
Total Assets	**1,873,766**	**1,548,408**	**21**
Deposits	1,412,841	1,219,531	16
Foreign Liabilities	45,211	22,500	101
Other Liabilities	150,803	84,038	79
Capital & Reserves	264,911	222,339	19
Total Liabilities and Shareholders' Funds	**1,873,766**	**1,548,408**	**21**

Source: Central Bank of Kenya

Loans and Advances

The banking sector gross loans and advances increased from Ksh 828.9 billion in June 2010 to Ksh 1,083.1 billion in June 2011 translating to a growth of 30.7 percent. The growth was registered in all the 11 sectors as indicated in Table 10.2.

TABLE 10.2: SECTORAL DISTRIBUTION OF LOANS (KSH BN)

Sectors	11-Jun	10-Jun	% Change
Personal/Household	296	235.5	26.0
Trade	198.5	151.3	31.0
Manufacturing	151.2	118.7	27.0
Real Estate	130.8	92.2	42.0
Transport and Communication	88.3	66.6	33.0
Agriculture	57.6	46.4	24.0
Financial Services	48.7	42.8	14.0
Building and Construction	33	22.7	45.0
Energy and Water	38.5	24.4	58.0
Tourism, Restaurant and Hotels	24.4	18.7	30.0
Mining and Quarrying	16.1	9.6	68.0
Gross/Total	**1,083.10**	**828.9**	**31.0**

Source: Central Bank of Kenya

Deposit Liabilities

Deposits from customers were the main source of funding for the banking sector, accounting for 75 percent of total funding liabilities. The deposit base increased by 15.9 percent from Ksh 1,219.5 billion in June 2010 to Ksh 1,412.8 billion in June 2011 mainly due to branch expansion, remittances inflows and receipts from exports.

Capital and Reserves

The banking sector registered strong capital levels in June 2011 with total capital, which comprises core and supplementary capital, growing by 25.6 percent from Ksh 191.1 billion in June 2010 to Ksh 240.1 billion in June 2011. Similarly, shareholders' funds increased by 19.2 percent from Ksh 222.3 billion in June 2010 to Ksh 264.9 billion in June 2011. However, the ratio of total capital to total risk-weighted assets decreased from 19.6 percent to 19.0 percent mainly due to a more than proportionate increase in total risk weighted assets than the increase in total capital.

Non–Performing Loans

The stock of gross non-performing loans (NPLs) declined by 5.2 percent from Ksh 61.5 billion in June 2010 to Ksh 58.3 billion in June 2011. Consequently, the ratio of gross NPLs to gross loans improved from 7.4 percent to 5.4 percent over the same period.

The reduction in NPLs is attributed to continued deployment of enhanced appraisal standards by the financial institutions. As a result, reduction in NPLs was registered in 6 out of 11 sectors with higher decline being recorded in trade sector from Ksh. 13.5 billion in June 2010 to Ksh 11.7 billion in June 2011. The sectoral distribution of NPLs is set out in Table 10.3.

TABLE 10.3: SECTORAL DISTRIBUTION OF NPLs LOANS (KSH BN)

Sectors	Jun-11	Jun-10	% Change
Personal/Household	18.8	18.1	4
Trade	11.7	13.5	-13
Manufacturing	7	7	0
Real Estate	6.7	7	-4
Transport and Communication	3.7	3.7	0
Agriculture	4.9	5.5	-11
Financial Services	1.6	2.2	-27
Building and Construction	1.7	1.5	13
Energy and Water	0.2	0.3	-33
Tourism, Restaurant and Hotels	1.8	2.6	-31
Mining and Quarrying	0.1	0.1	0
Gross/Total	**58.2**	**61.5**	**-5**

Source: Central Bank of Kenya

Profitability

During the period ended June 30 2011, the sector registered a 16.9 percent growth in pre-tax profits from Ksh 34.9 billion in June 2010 to Ksh 40.8 billion (Table 10.4). Total income increased by 8.7 percent from Ksh 101.5 billion in June 2010 to Ksh 110.3 billion in June 2011, while total expenses increased by 4.2 percent from Ksh 66.6 billion in June 2010 to Ksh 69.4 billion in June 2011.

Interest on loans and advances, fees and commissions and government securities were the major sources of income accounting for 54 percent, 23 per cent and 14 percent of total income respectively. On the other hand, staff costs, other expenses and interest on deposits were the key components of expenses, accounting for 36 percent, 29 percent and 20 percent, respectively.

TABLE 10.4: BANKING INDUSTRY PROFITS (KSH BILLION)

Item	Jun-11	Jun-10	% Change
Total income	110.3	101.5	9
Expenses before provisions	65.6	62.6	5
Profit before provisions	43.8	38.9	13
Provisions for bad debts	3.9	4	-3
Profit before tax	40.8	34.9	17

Source: Central Bank of Kenya

11. OTHER BANKING SECTOR DEVELOPMENTS

Credit Reference Bureaus

The sharing of credit information was launched in July 2010 and is picking up gradually. As at June 30, 2011, credit reports requested by institutions more than doubled to 728,553 from 284,722 reports in December 2010. The uptake of credit reports by banks is expected to increase as use of credit referencing becomes entrenched in banks credit appraisal processes.

The Central Bank of Kenya licensed Metropol Ltd. in April 2011 to operate as a credit reference bureau thus becoming the second bureau after CRB Africa, which was licensed in 2010.

Agency Banking

The agency banking model which was rolled out in May 2010 has drawn interest from the financial institutions. As at June 30, 2011, the Central Bank of Kenya had granted approval to 6 commercial banks to roll out Agent Banking Network. Over the same period, 6,513 agents had been granted approval. The introduction of agent banking is intended to enable institutions to provide banking services more cost effectively to customers. It is expected that this initiative will enhance financial access for those people who are currently unbanked or under banked.

Deposit Taking Microfinance (DTM) Institutions

In June 2011, the Central Bank of Kenya licensed Rafiki DTM Ltd to commence nationwide deposit taking microfinance business, making it the sixth DTM to be licensed after Faulu Kenya Ltd. in 2009, Kenya Women Finance Trust Ltd., Remu Ltd., Smep Ltd. and Uwezo Ltd. which were licensed in 2010.

The gross loans and advances for the 5 DTMs that were operating at end of June 2011 stood at Ksh.15.2 billion compared to Ksh. 14.9 billion recorded in December 2010 thus translating to a growth of 2.0 percent. Similarly, the deposits base stood at Ksh. 9.6 billion representing a growth of 20.0 percent from Ksh. 8.0 billion in December 2010. The number of deposit accounts stood at 1.4 million while the number of loan accounts were 0.5 million.

Representative Offices

In March 2011, the Central Bank of Kenya granted approval to the Hong Kong Shanghai Banking Corporation Ltd (HSBC) to open a representative office in Kenya. HSBC becomes the third bank to be granted approval for a representative office after HDFC Bank (India) in 2009 and Nedbank (South Africa) in 2010.

Banking Sector 2011 Outlook

Opportunities in regional markets and enhanced outreach through innovations in delivery channels and methodologies will sustain the banking sector's growth momentum in the second half of 2011.

MODES OF PAYMENTS

There are two main modes of payments, namely non-cash and cash instruments.

1 NON-CASH INSTRUMENTS

1.1 KENYA ELECTRONIC PAYMENT AND SETTLEMENT SYSTEM (KEPSS)

Kenya Electronic Payments and Settlement System (KEPSS) moved a volume of 1,048,206 transactions worth Ksh 18,793 billion in the year to June 30, 2011, compared to 673,368 transactions worth Ksh 16,806 billion in the same period last year. The growth represents a 55.6 percent increase in volume and 11.8 percent increase in value compared to the year to June 30, 2010. The average amount moved per transaction decreased from Ksh 28.78 million to Ksh 17.81 million, reflecting a decrease of 38.1 percent and signifying increased use of the system by the public for low value payments. The number of transactions moved per day, however, increased by 271.42 percent to 4,163 transactions from 2,663 transactions in the year to June 30, 2010. This increase is attributed to increased awareness by the public of KEPSS as a safe and efficient mode of payment for both high value and time critical payments, the continuing effects of both value capping and G-Pay system, which were implemented with effect from October 1, 2009. These factors have more than doubled the daily flows through the KEPSS System. The proportion of direct payments through KEPSS increased from 86.6 percent to 87.1 percent, while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS decreased from 13.4 percent to 12.9 percent in the same period (Tables 12.1 and 12.2).

TABLE 12.1: 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)	Per day Transactions
2006	7,641,197	120,249	61.38	227	32,919	532
2007	7,929,003	155,131	51.38	249	32,038	627
2008	14,506,951	232,516	62.30	247	59,419	949
2009	15,441,446	277,445	55.67	248	62,139	1,121
2010	16,806,252	673,368	28.78	254	66,259	2,663
2011	18,792,538	1,048,206	17.81	252	74,758	4,163

Source: Central Bank of Kenya, Banking/National Payments Division

TABLE 12.2: DIRECT PAYMENT VS. NET SETTLEMENT INSTRUCTIONS (NSI)

Year to June 30	Total value moved (Ksh)	Settlement proportions Direct (Ksh m)	%	Indirect {NSI (Ksh m)}	%
2006	7,461,197	6,878,229	92.20	582,968	7.80
2007	7,929,003	7,234,837	91.20	694,166	8.80
2008	14,506,951	13,606,759	93.79	900,193	6.21
2009	15,441,446	14,549,876	94.23	891,570	5.77
2010	16,806,252	14,549,876	86.57	2,256,376	13.43
2011	18,792,538	16,360,759	87.06	2,431,779	12.94

Source: Central Bank of Kenya, Banking/National Payments Division

MT 102 (a single customer transfer message that pays many beneficiaries) and MT 103 (a single customer transfer message that pays one beneficiary) are messages processed by commercial banks through KEPSS on behalf of their customers.

Multiple third parties Message Type MT 102 increased by 69.95 percent from 73,704 messages in the year to June 30, 2010 to 125,262 messages in the year to June 30, 2011. In the same period, single third party Message Type MT 103 increased by 74.02 percent from 561,768 messages to 977,569 messages. Overall, total third party messages processed through KEPSS increased by 73.55 percent from 635,472 messages to 1,102,831 messages in the year to June 30, 2011 (Table 12.3). The increase in these messages reflects growing awareness of KEPSS among the public as a safe and efficient payment system for large value and time critical payment systems.

TABLE 12.3: 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
2008	9,132	75,674	84,806
2009	9,410	115,443	124,853
2010	73,704	561,768	635,472
2011	125,262	977,569	1,102,831

Source: Central Bank of Kenya, Banking/National Payments Division

1.2 THE AUTOMATED CLEARING HOUSE OPERATIONS

Automated Clearing House (ACH) operated smoothly during the year to June 30, 2011. The ACH throughput for the period under review was 28.66 million transactions with a value of Ksh 2,284 billion for both Debit and Credit instruments compared to Ksh 2,321 billion in the same period last year as indicated in Table 12.4. This represents a reduction of 1.59 percent and 14.45 percent in value and volume throughput, respectively. This outcome is in line with the objective of making the ACH a low value, high volume system in furtherance of the value capping policy.

Cheques dominated the non-cash payment instruments accounting for 58.32 percent of total volume of transactions through the Clearing House. In the year to June 2011, the volume of cheques settled through the Nairobi Automated Clearing House was 16.71 million cheques valued at Ksh 1,939 billion compared to 15.73 million cheques valued at Ksh 1,954 billion in similar period in 2010.

Electronic Funds Transfer (EFT) transactions (credit) based payments decreased by 5.99 percent during this period from Ksh 367 billion to Ksh 345 billion (Table 12.4).

TABLE 12.4: CLEARING HOUSE KSH TRANSACTION TO JUNE 30, 2011

Financial Year	Items	Values (Ksh bn)	Volumes ('000')
2005	Debit Credit	1,943 355	11,287 3,633
	Total	**2,298**	**14,920**
2006	Debit Credit	2,642 479	14,513 5,032
	Total	**3,121**	**19,545**
2007	Debit Credit	3,063 592	16,859 5,601
	Total	**3,655**	**22,460**
2008	Debit Credit	3,616 676	18,670 5,496
	Total	**4,293**	**24,166**
2009	Debit Credit	3,901 766	18,549 7,859
	Total	**4,667**	**26,408**
2010	Debit Credit	1,954 367	15,732 9,304
	Total	**2,321**	**25,036**
2011	Debit Credit	1,939 345	16,713 11,942
	Total	**2,284**	**28,655**

Source: Central Bank of Kenya, Banking/National Payments Division

The ACH continued to witness increased transactions activity in Domestic Foreign Currency Cheque Clearing (DFCCC) in the year to June 30, 2011 compared to the same period last year. The US dollar and the Euro denominated Cheques processed through the clearing house increased by 11.53 percent and 23.49 percent from a volume of 302.4 and 10.0 thousand Cheques to 337.2 and 12.3 thousand Cheques respectively while the GBP denominated Cheques declined by 11.01 percent from 2.6 thousand Cheques to 2.3 thousand Cheques in the same period. In value terms, all the three foreign currencies recorded a decrease in the value moved (Table 12.5). The US dollar remained the preferred currency in the domestic foreign currency cheque clearing followed by the Euro and the Pound, respectively.

TABLE 12.5: DOMESTIC FOREIGN CURRENCY CHEQUE CLEARING TRANSACTIONS TO JUNE 30, 2011

Currency	USD		GBP		EURO	
	Value (m)	Volume ('000')	Value (m)	Volume ('000')	Value (m)	Volume ('000')
2005	1,202.67	159.4	19.83	2.0	78.37	5.1
2006	1,812.80	240.8	23.07	2.6	114.30	7.2
2007	2,124.75	272.4	23.86	2.6	108.13	7.5
2008	2,457.48	278.0	35.82	2.7	99.06	7.9
2009	2,637.32	282.0	52.98	2.9	138.31	9.8
2010	1,500.33	302.4	17.57	2.6	75.75	10.0
2011	1,239.25	337.2	11.41	2.3	77.01	12.3
Growth (%)	(17.40)		(35.05)		1.66	

Source: Central Bank of Kenya, Banking Services Division

1.3 AUTOMATED TELLER MACHINES (ATMS) AND PLASTIC CARD USAGE

The number of Automated Teller Machines (ATMs) in the payment card industry increased by 12.35 percent from 1,943 ATMs in December 2010 to 2,183 ATMs in June 2011. This growth may be attributed to commercial banks' business expansion strategies.

The value of transactions effected through cards in the year to June 2011 increased by 22.79 percent and 26.40 percent from Ksh 507.99 billion to Ksh 623.74 billion and Ksh 439.22 billion to Ksh 555.17 billion for acquirers and issuers respectively. Correspondingly, withdrawals increased by 18.34 percent and 38.06 percent from 93.43 million withdrawals to 110.56 million withdrawals and 83.80 million withdrawals to 115.70 million withdrawals for acquirers and issuers, respectively. The growing usage of cards signifies a growing shift from cash based payments to non-cash payments by the public (Table 12.6 A).

TABLE 12.6A: AUTOMATED TELLER MACHINE'S USAGE

	2005	2006	2007	2008	2009	2010	2011
Number of ATM machines	555	737	1,078	1,510	1,827	1,943	2,183
Number of transactions (m)							
Acquirers	-	-	58.63	77.92	86.72	93.43	110.56
Issuers	-	-	42.08	54.70	77.42	83.80	115.70
Other	-	-	-	3.44	3.56	-	-
Value of transactions (bn)							
Acquirers	-	-	312.87	396.93	431.79	507.99	623.74
Issuers	-	-	136.44	258.33	417.04	439.22	555.17
Other	-	-	-	18.51	18.93	-	-

Source: NPS Cards Statistics

The total number of cards in use rose by 22.06 percent from 5.5 million cards in June 2010 to 8.6 million cards in June 2011, with debit cards recording the highest growth of 68.47 percent from approximately 4.2 million cards in June 2010 to 7.0 million cards in June 2011(Table 12.6B).

TABLE 12.6B: NUMBER OF CARDS IN CIRCULATION

	2005	2006	2007	2008	2009	2010	2011
ATM cards	426,110	829,962	943,359	900,148	985,141	1,252,893	1,439,729
Debit cards	496,647	750,085	971,449	1,528,866	3,700,646	4,156,187	7,002,091
Credit cards	69,478	73,238	107,106	107,653	106,842	111,383	117,835
Charge cards	3,142	3,769	5,775	5,160	1,682	791	1,418
Total	995,377	1,657,054	2,027,689	2,541,827	4,794,311	5,521,254	8,561,073

Source: NPS Cards Statistics

1.4 MOBILE PHONE USAGE FOR FUNDS TRANSFER

Mobile phone money transfer service usage continued to increase among the Kenyan public as indicated by the growth in the number of transactions which increased by 44.90 percent from 251.25 million transactions in the year to June 30, 2010 to 364.06 million transactions in the year to June 30, 2011. The Central Bank of Kenya continues to monitor the developments in this sector in line with the Governments policy of enhancing financial inclusion and deepening to the rural poor and the un-banked. Numerous other service providers have approached the Central Bank of Kenya seeking permission to roll out mobile money transfer services and the Central Bank of Kenya is evaluating such applications on a case by case basis. In the period under review, one payment service provider (Tangaza) was evaluated and authorised to roll out these services.

Customer base increased by 72.40 percent from 10.44 million customers to 17.99 million customers, while the number of agents increased by 46.03 percent from 31,902 to 46,588 in the same period. M-Pesa accounted for 64.43 percent, Zap 24.42 percent, and Yu 11.15 percent. The value transferred through mobile money transfer services increased by 53.89 percent from Ksh 597.31 billion for the year to June 30, 2010 to Ksh 919.22 billion for the year to June 30, 2011 (Table 12.7).

TABLE 12.7: MOBILE PHONE MONEY TRANSFER

Year to	Jun 30, 2007	Jun 30, 2008	June 30, 2009	Jun 30, 2010	Jun 30, 2011
Amount transferred (Ksh billion)	1.49	61.07	318.44	597.31	919.22
Number of agents	527	3,011	10,735	31,902	46,588
Number of transactions (million)	0.48	21.77	125.12	251.25	364.06
Number of 'registered' customers/accounts	0.18	3.04	7.39	10.44	17.99

Source: Service providers

2. CASH INSTRUMENT

Currency in circulation increased from Ksh 125.17 billion as at the end of June 2010 to Ksh 147.76 billion as at end of June 2011 reflecting an increase of Ksh 22.59 billion or 18.04 percent from the previous year's issued currency as indicated in Table 12.8. In weighted terms, bank notes account for 96.83 percent, while coins account for 3.17 percent of currency in circulation.

TABLE 12.8: CURRENCY IN CIRCULATION (NOTES & COINS)

	Jun-07		Jun-08		Jun-09		Jun-10		Jun-11	
Item	Ksh bn.	%	Ksh bn.	%	Ksh bn.	%	Kshs bn.	%	Kshs bn.	%
Currency in circulation	89.94	100.00	99.89	100.00	108.25	100.00	125.17	100.00	147.76	100.00
Bank Notes	86.45	96.12	96.14	96.25	104.22	96.27	120.72	96.44	143.07	96.83
Coins	3.49	3.88	3.75	3.75	4.04	3.73	4.45	3.56	4.69	3.17

Source: Central Bank of Kenya, Currency Division

TABLE 12.9: CURRENCY IN CIRCULATION (PIECES)

	Bank notes					Coins			
	2008/2009	2009/2010	2010/2011	% change		2008/2009	2009/2010	2010/2011	% change
	Pieces (m)	Pieces (m)	Pieces (m)			Pieces (m)	Pieces (m)	Pieces (m)	
1000/=	78.69	90.22	108.99	20.8	40/=	1.92	2.25	2.51	11.51
500/=	20.86	25.33	29.87	17.9	20/=	69.84	75.95	81.20	6.91
200/=	31.74	38.21	43.67	14.3	10/=	111.34	125.80	128.75	2.35
100/=	61.80	70.71	75.39	6.6	5/=	151.19	170.60	183.25	7.42
50/=	44.39	55.28	62.24	12.6	1/=	511.45	539.00	569.13	5.59
20/=	10.10	10.05	10.04	-0.1	/50=	258.90	272.00	274.69	0.99
10/=	12.06	12.00	11.99	-0.1	/10=	358.64	360.00	358.61	(0.39)
5/=	5.80	5.80	5.77	-0.6	/05=	305.12	300.00	305.10	1.70
	265.44	307.60	347.96	13.1		1768.39	1845.60	1903.23	3.1

Source: Central Bank of Kenya, Currency Division

Notes in circulation grew by 13.1 percent from 308 million pieces in the year to June 30, 2010 to 348 million pieces in the year to June 30, 2011. There was notable increase in the usage of Ksh 1,000, Ksh 500, Ksh 200, Ksh 100 and Ksh 50 notes that increased by 20.8 percent, 17.9 percent, 14.3 percent, 6.6 percent and 12.6 percent in the year to June 30, 2011 respectively. Coins in circulation grew by 3.1 percent in the same period from 1,846 million pieces to 1,903 million pieces, with the Ksh 40 coin, Ksh 20 coin, Ksh 10 coin, and Ksh 5 coin increasing by 11.5 percent, 6.9 percent, 2.35 percent, and 7.4 percent, respectively. Public preference for bank notes explains the high proportion of currency in circulation being in Bank notes and the lower growth for coins in circulation compared to Bank notes (Table 12.9).

2.1 CASH INFLOWS AND OUTFLOWS

Deposits by banks (i.e. Cash inflows) decreased by 35.43 percent from Ksh 271.3 billion as at June 30, 2010 to Ksh 175.1 billion as at June 2011. Similarly withdrawals (i.e. cash outflows) decreased by 32.26 percent from Ksh 287.7 billion to Ksh 194.9 billion in the same period. This reflects a net currency outflow in the year to June 30, 2011 of Ksh 19.9 billion (Table 12.10).

TABLE 12.10: CURRENCY INFLOWS AND OUTFLOWS (KSHS M)

Inflow by banks	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011
Bank Notes	226,747	268,543	283,083	271,257	175,149
Coins	704	562	376	248	29
Total	**227,451**	**269,105**	**283,459**	**271,505**	**175,178**
Outflows by banks					
Bank Notes	239,983	278,236	291,161	287,754	194,935
Coins	1,077	831	657	658	147
Total	**241,060**	**279,066**	**291,818**	**288,412**	**195,082**
Net Outflows	**(13,609)**	**(9,961)**	**(8,359)**	**(16,907)**	**(19,904)**

Source: Central Bank of Kenya, Currency Division

2.2 DEVELOPMENT IN COUNTERFEITING PRACTICES

Counterfeit activity declined significantly as the number of counterfeit notes decreased by 38.7 percent from 1,042 counterfeit notes in the year to June 30, 2010 to 639 counterfeit notes in the year to June 30, 2011 (Table 12.11). The resultant impact in value terms was a decrease of 43.8 percent in the total value of counterfeit notes from Ksh 0.62 million in the previous year to Ksh 0.35 million in the year to June 30, 2011.

In terms of denomination, there were 259 pieces of Ksh 1,000 making up 40.53 percent, 75 pieces of Ksh 500 or 11.74 percent, 204 pieces of Ksh 200 or 31.92 percent, and 72 pieces of Ksh 100 or 11.27 percent of the counterfeit notes, respectively.

The reduction in number of counterfeits is attributed to increased public education, which is carried out by the Central Bank of Kenya in collaboration with KSMS and enforcement of sorting guidelines issued to commercial banks. These initiatives have resulted in more vigilance in the industry and the public in general.

TABLE 12.11: COUNTERFEIT NOTES BY DENOMINATION

	Pieces				Proportion
	2007/2008	2008/2009	2009/2010	2010/2011	2010/2011
1000/=	653	1,376	485	259	40.53
500/=	205	442	113	75	11.74
200/=	172	411	297	204	31.92
100/=	94	60	143	72	11.27
50/=	4	7	4	29	4.54
20/=	0	0	0	0	0.00
10/=	0	0	0	0	0.00
5/=	0	0	0	0	0.00
Total	**1,128**	**2,296**	**1,042**	**639**	**100.00**

	Amounts (KSH)				Proportion
	2006/2007	2007/2008	2009/2010		2010/2011
1000/=	653,000	1,376,000	485,000	259,000	74.87
500/=	102,500	221,000	56,500	37,500	10.84
200/=	34,400	82,200	59,400	40,800	11.79
100/=	9,400	6,000	14,300	7,200	2.08
50/=	200	350	200	1,450	0.42
20/=	0	0	0	0	0.00
10/=	0	0	0	0	0.00
5/=	0	0	0	0	0.00
Total	**799,500**	**1,685,550**	**615,400**	**345,950**	**100.00**

Source: Central Bank of Kenya, Currency Department

3 CURRENT AND FUTURE DEVELOPMENTS

3.1 LEGAL FRAMEWORK

Central Bank of Kenya continued consultation with the Ministry of Finance and the Attorney General's office on the enactment of the National Payment Systems (NPS) Bill, 2010. Once enacted, the Bill will enhance the Bank's oversight powers for non-bank based payment and clearing settlement systems. In order to provide a sound legal basis for the Cheque Truncation System, the Bank made recommendations for amendment to the Bills of Exchange Act.

In the period under review, the Bank issued draft regulations and guidelines for the retail payments sub-sector (Mobile Money and Electronic Money) of our National Payments System. These regulations are aimed at ensuring that E-Money Issuers and Payment Service Providers conduct their businesses prudently and in accordance with the provisions of the Central Bank of Kenya Act.

3.2 CONNECTIVITY TO KEPSS

The integration between Kenya Revenue Authority's Common Cash Receipting System and KEPSS was finalised and is currently undergoing testing. Once fully operational, KRA will be able to receive and manage tax revenues efficiently for the benefit of the tax-paying public.

3.3 EAST AFRICAN CROSS BORDER PAYMENT SYSTEM

The Legal Framework for the proposed East Africa Payment System (Cross Border Payment System) that will involve connectivity of the Real Time Gross Settlement (RTGS) systems in the region was executed among the East African Central Banks, while execution of those between commercial banks and their respective Central Banks was ongoing. The system is currently undergoing technical testing. The system is aimed at ensuring efficient and safe settlement of intra-regional financial transactions.

3.4 CHEQUE TRUNCATION PROJECT

The Cheque Truncation System was launched and pilot testing commenced during the year. Cheque Truncation refers to the process in which physical cheques presented for payment are converted into images that are transmitted electronically to the Clearing House for processing and eventual payment. The achievement of this milestone demonstrates the Bank's focus in promoting the establishment of efficient and effective payment, clearing and settlement systems as crystallized in the Central Bank of Kenya. Some of the benefits that will accrue include: reduced costs associated with the handling of physical cheques, shorter clearing cycle and reduction of risks associated with manual and longer cheque clearing cycle, all of which translate to faster and safer access to funds by the public.

13. CURRENCY DEVELOPMENTS

Currency in Circulation

Overall Currency in Circulation increased by 18 percent in the year to June 2011. The currency was issued largely from two centres, Nairobi and Mombasa, as detailed below:-

TABLE 13.1: CURRENCY IN CURCULATION

CENTRE	CIRCULATION JUNE 30TH 2010 (KES.)	CIRCULATION JUNE 31ST 2011 (KES.)
Nairobi	161,274,545,921.00	180,983,527,921.20
Mombasa	33,694,527,926.25	38,006,595,526.25
Kisumu	-9,439,916,960.00	-4,277,980,560.00
Eldoret	-59,464,089,324.70	-63,771,263,524.70
Nyeri	-904,506,000.00	-110,303,000.00
Nakuru	-	-3,606,290,000.00
Meru	-	531,983,000.00
Total	**125,160,561,562.75**	**147,756,269,362.75**

Source: Central Bank of Kenya, Currency Operations and Branch Administration Department

Currency Centres

The banking sector has undergone major transformation in the last five years in light of changing consumer needs. The most notable changes have been the rapid expansion of branch networks, increase in client accounts and in the number of Automated Teller Machines (ATM) across the country, use of agents and mobile phone infrastructure by banks to provide financial services and increased outsourcing of cash processing and movement services.

These developments have significantly impacted currency in circulation patterns in the country making it inevitable for the Central Bank of Kenya and commercial banks to review the manner in which they conduct their operations.

The Central Bank of Kenya in conjunction with the Kenya Bankers Association embarked on establishing Currency Centres two years ago as a way of supporting commercial banks to efficiently provide financial services in various regions of the country and reduce the distance over which cash is moved between one Central Bank of Kenya Office and the upcountry branches of commercial banks.

The first Currency Centre under this initiative was established in Nyeri in December 2009 followed by Nakuru Currency Centre in December 2010 and Meru in February 2011. The three currency centres currently serve a total of 172 commercial bank's branches and account for over 12 percent of the total currency activities in the country. The lessons learnt from the experiences from the three centres will inform policy and strategies for the next phase of this initiative. Further establishment of similar facilities in other parts of the country will continue to be driven by viability and cash-in-circulation as the key considerations.

National Coin Mobilisation Campaign

During the year in review, the Bank carried out a National Coin Re-circulation campaign. The campaign followed establishment by the Bank that challenges in coin circulation were as a result of inefficient re-circulation trends and not supply. Many people were holding coins in their homes, cars and workplaces hence curtailing the free circulation. The campaign, which was conducted in collaboration with the major supermarket outlets and Kenya Bankers Association was a success and the Bank will continue with such sensitisation efforts in future.

Improvements In Currency Sorting

The Central Bank of Kenya continued to work closely with commercial banks in implementing a clean currency policy. The opening of Currency Centres helped in getting the clean currency into circulation, especially in the towns where they were opened. The Bank has also continued to invest in machinery that ensures improvements in the field of currency sorting. Commercial banks are also being continually encouraged to invest in good sorting equipment, which in turn reduces the cost of operations for them. The amount of counterfeits getting through the Banking system is also significantly reducing following weeding out at the Commercial Bank level during sorting.

Combating Counterfeits

During the financial year, the Central Bank of Kenya increased efforts to minimize counterfeiting. The Bank through its

Currency Operations and Branch Administration Department participated in public events such as the Nairobi International Trade Fair and the Kisumu, Mombasa and Eldoret National shows. In all these forums, public education on currency security features was extensively carried out. The Bank collaborated with the Kenya School of Monetary Studies to train commercial bank cash handlers on security features of currency.

14. REGIONAL INTEGRATION DEVELOPMENTS

1.0 INTRODUCTION

The Central Bank of Kenya is involved in a number of regional integration initiatives and programmes, particularly those relating to monetary and financial integration. The Bank participated in the implementation of monetary cooperation programmes of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB). This chapter reviews the progress in the implementation of macroeconomic convergence and other financial and monetary developments in these regional integration initiatives in 2010.

2.0 THE EAC MONETARY COOPERATION PROGRAMME

2.1 Background Information

Pursuant to economic integration efforts, Articles 5, 82 to 85 of the EAC Treaty, provides that Partner States undertake to co-operate in monetary and fiscal matters in accordance with the approved macro-economic policies, harmonization programmes and convergence framework.

Partner States Central Banks through the Monetary Affairs Committee of Governors (MAC) are mandated to steer aspects of the EAC treaty relating to monetary and financial cooperation. MAC is tasked to laying the foundation for a common monetary union encompassing one currency and one central bank among other monetary related issues in East Africa. The specific objectives of MAC include the following: Monetary Policy Harmonization; Macroeconomic Convergence; Capital Account Liberalization; Harmonization of Legal and Regulatory Framework of Banking Supervision; Development of the Payment System; Information Technology Infrastructure Development; and Financial Markets Integration, among others.

On the progress towards the establishment of the East African Monetary Union (EAMU), the EAC Central Banks have apportioned their work programme into three distinct blocks during an extraordinary MAC meeting in June 2010. The first, the analytical and design block encompasses activities to improve understanding of the pre-conditions for establishment and the institutional set up for the EAMU. Second, the harmonizing operating frameworks block, which entails the activities that will ensure that the EAC Partner States' operating frameworks convergence in policies, and the required structures. Finally, the policy regimes block that entail the actual development and implementation of the common monetary and exchange rate regime for EAMU, integrating the Payment Systems for the region and approximation of laws, among other medium term activities. This block has been entrusted to the High Level Task Force (HLTF). The first and the second blocks will provide technical inputs to inform the High Level Task Force (HLTF) in identifying the beacons of the integration process.

The MAC, therefore, will provide technical input on monetary issues to the HLTF when and as will be required. The entire spectrum of EAMU protocol negotiation is being handled by the HLTF. MAC is the technical input from the EAC central banks to the HLTF targets to achieve following objectives:

- Attain a common exchange rate policy
- Attain currency convertibility
- Attain a common monetary policy
- Attain macroeconomic convergence
- Attain harmonized monetary and financial statistics
- Harmonize frameworks for monetary and exchange rate policy operations
- Harmonize supervisory and legal and regulatory frameworks
- Promote financial stability
- Attain uniform infrastructure for payments and securities transactions

In the work programme, the Monetary Affairs Committee (MAC) of the EAC central banks Governors identified activities in the Analytical and Design block, and the Harmonizing Operational Frameworks block and shared out leadership of the implementation of these tasks. The Committee meets regularly and on a quarterly basis to review status of implementation of its decisions. The first and second review meetings were held in Zanzibar in December 2010 and in Bujumbura in May 2011. The EAC central banks have made significant progress towards achieving these objectives as per agreed timeliness.

2.1 EAC Macroeconomic Convergence Criteria and Progress in 2010

Since May 2007, the Governors of EAC Partner States adopted a new set of convergence criteria. The criteria were classified into primary criteria and secondary criteria. The primary criteria sets the preconditions for convergence, which must be met, while secondary criteria reinforce the primary criteria. The primary criteria include benchmarks on fiscal deficits, inflation and external reserves. The secondary criteria include areas of policy and real convergence.

The primary criteria are:

(a) Overall budget deficit/GDP ratio (excluding grants); of not more than 3 percent;
(b) Annual average inflation rate not exceeding 5 percent;
(c) Minimization of central bank financing to 0 percent target; and
(d) Foreign exchange reserves equivalent to six months of imports of goods and non-factor services.

The Secondary Criteria are:

(a) Achievement and maintenance of Stable Real Exchange Rates;
(b) Achievement and maintenance of Market Based Interest Rates;
(c) Achievement of sustainable Real GDP Growth Rate of not less than 7.0 percent;
(d) Sustained pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to sustainable level;
(e) National Savings to GDP Ratio of not less than 20 percent;
(f) Reduction of Current Account Deficit (excluding grants) as a percentage of GDP to sustainable level consistent with debt sustainability;

(g) Implementation of the 25 Core Principles of Bank Supervision and Regulation based on agreed Action Plan for Harmonization of Bank Supervision; and

(h) Adherence to the Core Principles for Systematically Important Payment Systems by modernizing payment and settlement systems.

Against the backdrop of the gradual global economic recovery, all the Partner States recorded improved economic performance in 2010. The 2010 performance was driven by global recovery in all economic activities and prudent macroeconomic management in most of these countries. In particular, the Kenyan economy remained resilient in 2010 with real GDP expanding by 5.6 percent after suppressed growth of 1.5 percent and 2.6 percent in 2008 and 2009 respectively. The improvement is attributed to a favorable macroeconomic environment, increased credit to private sector, low inflationary pressure, and favorable weather conditions. Kenya also benefited from increased remittances following global economic recovery. The major drivers of the growth were: agriculture and forestry, wholesale and retail trade, transport and communication, manufacturing and financial intermediation, which expanded by 6.3 percent, 7.8 percent, 5.9 percent, 4.4 percent, and 8.8 percent in 2010 compared to -2.6 percent, 3.9 percent, 6.4 percent, 1.3 percent, and 4.6 percent in 2009, respectively. Consistent with the sustained momentum of economic recovery in Kenya in 2010, economic growth accelerated to 4.9 percent in the January-March 2011 Quarter over a 4.3 percent growth in a similar period in 2010. Despite this good performance, the outlook on economic growth for 2011 is subdued on account of adverse developments including high oil prices, drought since the beginning of the year, high commodity prices including prices of food items in the domestic market and exchange rate depreciation against internationally traded currencies. Furthermore, these factors are expected to add to inflationary pressures in 2011.

In 2010, most central banks in the region eased their monetary policy stance to support liquidity in the money markets and provide credit to the private sector. However, given the underlying price pressures arising from rising international food and fuel prices, the exchange rate depreciation, and buoyant aggregate demand in most Partner States, most central banks in the region have reversed policy, monetary easing to monetary tightening to meet the inflation objectives and anchor inflation expectations in the near term.

The performance of Kenya and other countries of EAC in respect to each convergence criteria are provided in Table 14.1

TABLE 14.1: MACROECONOMIC PERFORMANCE AND CONVERGENCE UNDER THE EAC CRITERIA

Criteria	Target level and Date	2006	2007	2008	2009	2010
Budget Deficit (Excl. Grants) / GDP*	< 6% by 2010	3.71	3.97	5.03	6.02	6.22
Budget Deficit (Incl. Grants) / GDP*	<3% by 2010	2.59	2.86	3.97	4.98	5.25
2. Inflation rate– annual average	not > 5% per year by 2010	6.40	4.30	16.30	9.20	3.96
Gross Foreign Exchange Reserves in Months of Imports of goods & non-factor services**	Equivalent to more than 4 months of imports of goods and non-factor services by 2010	3.60	4.00	2.80	4.10	4.00
GDP Growth Rate At Factor Cost-constant prices***	At least 7% p.a. by 2010	6.30	7.00	1.60	2.60	5.60
Stable Real exchange rates	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	79.18	75.71	70.46	70.97	72.08
Current Account (Excl. Grants) / GDP	Sustainable levels by 2010	-2.49	-4.44	-7.18	-5.33	-7.93
Gross National Savings/GDP***	at least 20% by 2010	14.80	13.90	16.00	13.30	12.20

* Actual as a percentage of GDP on commitment basis from various Quarterly Economic and Budgetary Reviews
** Based on average of calender year imports
*** Various Economic Surveys

THE COMESA MONETARY COOPERATION PROGRAMME

Background Information

The mandate to establish a Monetary Union in COMESA region is derived from Article 4 (4) of the COMESA Treaty signed at Kampala, Uganda on November 5, 1993, which states that the Member States shall "in the field of monetary affairs and finance, co-operate in monetary and financial matters and gradually establish convertibility of their currencies and a payments union as a basis for the eventual establishment of a monetary union". To be consistent with the Africa Monetary Cooperation Programme led by the Association of African Central Banks and to fast tract achievement of a monetary union, the Seventh

Meeting of the Ministers of Finance held in Lusaka, Zambia on November, 2004 adopted revised macroeconomic convergence criteria aimed at establishing a monetary union in COMESA by 2018. The revised convergence criteria, are categorized into primary (preconditions for convergence) and secondary (reinforcement conditions) criteria, and will be implemented in three phases; (i) Stage 1 (2005-2010), Stage 2 (2011-15) and; Stage 3 (2016-18). The following are convergence criteria in the first stage.

Primary Criteria:

(a) Overall budget deficit/GDP ratio (excluding grants) of not more than 5 percent;
(b) Annual average inflation rate not exceeding 5 percent;
(c) Minimize the central bank financing of the budget towards 0 percent target; and
(d) External reserves of equal to or more than 4 months of imports of goods and non-factor services;

Secondary Criteria

(a) Achievement and maintenance of stable real exchange rates;
(b) Achievement and maintenance of market based positive real interest rates;
(c) Achievement of a sustainable real GDP of not less than 7 percent;
(d) Pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to sustainable level;
(e) Total domestic revenue to GDP ratio of not less than 20 percent
(f) Reduction of current account deficit (excluding grants) as a percent of GDP to sustainable level;
(g) Achievement and maintenance of domestic investment rate of at least 20 percent;
(h) Implementation of the 25 Core Principles of Bank Supervision and Regulation based on agreed Action Plan for Harmonization of Bank Supervision for the COMESA region; and
(i) Adherence to the Core Principles for Systematically Important Payments Systems, by modernizing the payment and settlements system.

The COMESA Committee of Governors of Central Banks held its Fifteenth Meeting from 3 to 4 November 2010 in Khartoum Sudan to review progress on; attainment of COMESA macroeconomic convergence, operations of the COMESA Monetary Institute; and the status of implementation of the Regional Payments and Settlement System. The COMESA Monetary Institute (CMI), which is located at the Kenya School of Monetary Studies (KSMS), Nairobi, Kenya became operational on 7 March 2011. The CMI is an institution of COMESA, which among other objectives, will monitor implementation of the Monetary Cooperation Programme under COMESA, harmonize regulation of financial markets in the region; and provide work and studies towards monetary policy in the region as well as the establishment of a common currency in the COMESA region.

Implementation of the Regional Payment and Settlement System (REPSS), which was launched at the COMESA Summit in 2009 is on course. REPSS allows member countries to transfer funds more easily and promptly within the region. It had been estimated that member States could save up to US$45.8 million when channeling intra-COMESA trade through REPSS increasing up to US$229.0 million when the region starts trading on an open account.

2.2 Kenya's Progress in the Implementation of COMESA Monetary Harmonization Programme

Kenya made progress in meeting convergence criteria for Stage 1 (Year 2005-2010) of the COMESA Monetary Harmonization Programme. With regard to primary criteria, the overall average inflation rate declined in 2010 to 3.96 percent and was within the COMESA target of 5 percent. Kenya's official external reserves at 4.0 months of import cover in 2010, was within the 4 months of import cover COMESA Monetary Harmonization Target (Table 14.2).

Kenya met several of the secondary criteria targets. Total domestic revenues to GDP were 23.7 percent for 2010, well within the target of COMESA. The ratio of debt relative to GDP showed an increasing trend from 44 percent in 2009 to 51 percent in 2010. Real GDP grew by 5.6 percent in 2010 compared with 2.6 percent in 2009.

TABLE 14.2: KENYA'S PROGRESS IN IMPLEMENTATION OF COMESA MONETARY COOPERATION PROGRAMME DURING STAGE 1 (YEAR 2005-2009)

Primary Criteria	Target for Stage I (2005-2010)	Year					
		2005	2006	2007	2008	2009	2010
1. Overall budget deficit/GDP ratio (excluding grants)*	< 5 percent	4.71	3.71	3.97	5.03	6.02	6.22
2. Inflation rate– annual average	< 5 per cent	9.90	6.40	4.30	16.30	9.20	3.96
3. Minimization of Central Bank financing of budget **	towards 0 percent	0.00	0.00	0.00	0.00	0.00	0.00
4. External reserves in months of imports of goods and non-factor services***	= or > 4 months	3.20	3.60	4.00	2.80	4.10	4.00
Secondary Criteria	Target Stage I (2005-2010)	2005	2006	2007	2008	2009	2010
1. Real GDP growth rate****	> 7 percent	5.90	6.30	7.00	1.60	2.60	5.60
2. Domestic fiscal receipts/GDP ratio*****	= or > 20 percent	21.50	20.20	20.40	21.20	21.40	23.70
3. Current account (excluding grants) as percent of GDP	Sustainable level	-1.80	-2.50	-4.40	-7.20	-5.33	-7.93
4. Achievement and maintenance of domestic investment rate	at least 20 percent	15.70	18.10	19.20	24.60	25.70	25.60
5. Maintenance of real exchange rate stability - REER Index	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	85.89	79.18	75.71	70.46	70.97	72.08

* Actual as a percent of GDP on commitment basis from various Quarterly Economic and Budgetary Reviews
** Based on Government Audited revenues for the Fiscal year and Central Bank overdraft as at end-Dec
*** Based on average of calendar year imports
**** Various Economic Surveys
***** Based on revenues as a percent of GDP at current market prices for each fiscal year

3.0 THE AFRICAN MONETARY COOPERATION PROGRAMME (AMCP)

3.1 Background Information

The AMCP was adopted during the 26th ordinary Assembly of the Association of African Central Banks (AACB) Governors held in Algiers on September 4, 2002. The programme involves the adoption of collective policy measures aimed at implementing a harmonized monetary system and common management institution in Africa. It envisages the harmonization of the monetary cooperation programme of the various sub-regional groupings as building blocks with the ultimate aim of evolving to a single monetary zone by the year 2021 with a common currency and a common central bank at the continental level. It has both primary and secondary convergence criteria under the AMCP which should be attained by at least 51 percent of the AACB Membership before the launching of the African Monetary Union by 2021:

i) Primary Criteria

- Overall budget deficit (excluding grants)/GDP ratio, < 3 percent;
- Inflation rate, <3 percent;
- Minimization of Central Bank financing of budget deficit;
- External Reserves of equal to or more than 6 months of imports of goods and services.

ii) Secondary Criteria

- Elimination of domestic arrears and non-accumulation of new arrears;
- Tax revenue/GDP ratio of equal to or more than 20 percent;
- Wage bill/total tax revenue ratio, < 35 percent;
- Maintenance of real exchange rate stability;
- Public investments financed by domestic sources/tax revenue ratio equal to or more than 20 percent
- Maintenance of positive real interest rates

3.2 Progress in Implementation of the AMCP

The year 2010 was the second year of the stage III of the AMCP implementation. For most countries, a number of targets under the primary criteria were not met as standards became tighter with the transition to stage III of the AMCP implementation. Most of the secondary criteria of the AMCP were observed. Table 14.3 shows Kenya's performance in the implementation of the AMCP.

Stage III Criteria (Year 2009 - 2012)

Observance of the following macroeconomic indicators by year 2012

- Budget deficit/GDP ratio not exceeding 3 per cent by 2012.
- Elimination of Central Bank credit to government.
- Inflation rate of less than 5 per cent.
- External reserves/imports cover of equal or greater than 6 months.

TABLE 14.3: KENYA'S MACRO-ECONOMIC PERFORMANCE AND CONVERGENCE CRITERIA UNDER THE AMCP

Primary Criteria	Target for Stage II (2004-2008)	Year 2005	2006	2007	2008	2009	2010
1. Overall budget deficit/GDP ratio (Excluding grants)*	< 5 percent	4.71	2.70	5.23	4.81	8.30	
2. Inflation rate - Annual Average	< 10 per cent	9.90	6.40	4.30	16.30	9.20	3.96
3. Contain Central Bank financing of budget**	< 10 per cent	0.00	0.00	0.00	0.00	0.00	0.00
4. External reserves of equal to or more than 3 months of imports of goods and services***	= or > 3 months	3.20	3.60	4.00	2.80	4.10	4.00
Secondary Criteria	**Target for Stage II (2004-2008)**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
1. Domestic fiscal receipts/GDP ratio****	= or > 20 percent	21.50	20.20	20.40	21.20	21.40	23.70
2. Current account (excluding grants) as a percent of GDP	Sustainable level	-1.80	-2.50	-4.40	-7.20	-5.33	-7.93
3. Achive and maintain domestic investment rate of 20%	= or > 20 percent	15.70	18.10	19.20	24.60	25.70	25.60
4. Maintenance of real exchange rate stability	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	85.89	79.18	75.71	70.46	70.97	72.08

* Actual as a percentage of GDP on commitment basis from various Quarterly Economic and Budgetary Reviews
** Based on Government Audited revenues for the fiscal year and Central Bank overdraft as at end-Dec
*** Based on average of the calendar year imports
**** Based on Revenues as a percent of GDP at current market prices for each fiscal year

Kenya's overall deficit to GDP (excluding grants) was 4.2 percent during the 10 months to April, 2011 compared to 4.8 percent over a similar period in 2010. The budget deficit during the period was within the programmed target of 6.2 percent of GDP on a commitment basis, but above the AMCP target for 2010. However, Kenya's overall annual average inflation was within the target declining to 4.0 percent in 2010 from 9.2 percent in 2009. The declined reflected the global disinflationary trend and falling domestic prices attributed to a relatively stable exchange rate, modest increase in monetary aggregates, as well as good performance of the agricultural sector that kept domestic food prices low. However, the inflation outcome worsened in 2011, rising from 3.96 percent in December, 2010 to 6.88 percent in June 2011. The upward trend in inflation observed across the region for most of 2011 reflects the high international oil and food prices attributed to political unrest in oil producing nation of North Africa and Middle East, and drought, respectively. Overdraft financing was negligible thus meeting the criteria on the elimination of Central Bank credit to Government. This can be attributed to prudent macroeconomic management and strict fiscal discipline in the face global economic recession. The sub-region experienced declines in their respective levels of foreign exchange reserves with Kenya recording 4.0 month of import cover in 2010 compared with 4.1 months of import cover in 2009.

Kenya met all the secondary criteria targets in 2010. The domestic fiscal receipt to GDP ratio, salary mass to total domestic receipts ratio, and government capital investments to fiscal receipts ratio were 23.7 percent, 32.3 percent and 25.6 percent in 2010 compared to 21.4 percent, 31.7 percent and 25.7 percent in 2009, respectively.

15. ECONOMIC OUTLOOK

The Kenyan economy is expected to grow by 5.3 percent in 2011. Although first quarter indications are strong, second quarter indicators point to a slowdown in growth stemming from adverse weather conditions on agricultural output. Supply side constraints due to rising fuel prices have presented a challenge to production activity through increased cost of transport services and energy. Further, domestic inflationary pressures arising from a weaker Kenya shilling motivated a tightening of monetary conditions. In the short term, the Central Bank of Kenya will continue to pursue prudent monetary policy is order to secure stability of the macro-economy in terms of lower inflation and stable long-term interest rates, so as to support private investment. The Central Bank of Kenya will also continue to spearhead reforms aimed at lowering the operational costs of lending institutions and further support innovations in the banking sector in order to improve efficiency in the financial markets thereby ensuring appropriate pricing of bank credit. On the fiscal side, ongoing public expenditure on infrastructure development should help to lock in gains achieved in the past year and in the medium term, enhance the country's production capacity and competitiveness by improving on efficiencies especially in terms of lower energy and data costs, and improved accessibility via road, air and sea ports.

CENTRAL BANK OF KENYA
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

TABLE OF CONTENTS

CENTRAL BANK OF KENYA
BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2011

DIRECTORS

Prof. Njuguna Ndung'u	-	Governor and Chairman	Reappointed on 4 March 2011
Dr. Hezron Nyangito	-	Deputy Governor and Deputy Chairman	
Mr. Joseph K. Kinyua	-	Permanent Secretary - Treasury, Member	
Mr. Joseph K. Waiguru	-	Member	Retired on 28 September 2010
Dr. William O. Ogara	-	Member	Reappointed on 14 March 2011
Mr. Nicholas A. Nesbitt	-	Member	Retired on 28 September 2010
Ms. Agnes Wanjiru	-	Member	Retired on 4 January 2011
Dr. Mbui Wagacha	-	Member	Appointed on 14 March 2011
Ms. Vivienne Y. Apopo	-	Member	Appointed on 14 March 2011
Ms. Florence K. Muindi	-	Member	Appointed on 1 June 2011
Mr. John G. Msafari	-	Member	Appointed on 1 June 2011

SENIOR MANAGEMENT

Prof. Njuguna Ndung'u	-	Governor		
Dr. Hezron Nyangito	-	Deputy Governor		
Mr. Kennedy K. Abuga	-	Director	–	Governors' Office & Board Secretary
Mr. Aggrey J.K. Bett	-	Director	–	Finance, Planning & IMS Department
Mr. Fredrick Pere	-	Director	–	Banking Supervision Department
Prof. Kinandu Muragu	-	Executive Director	–	Kenya School of Monetary Studies
Mr. William Nyagaka	-	Director	–	Internal Audit Department
Mr. Charles Koori	-	Director	–	Research & Policy Analysis Department
Mr. Casssian J. Nyanjwa	-	Director	–	Department of Estates, Supplies and Transport
Mr. James T. Lopoyetum	-	Director	–	Currency Operations and Branch Administration Dept.
Mr. Jackson M. Kitili	-	Director	–	Banking Services & Risk Management Department (Transferred on 3 December 2010)
Mr. Gerald Nyaoma	-	Director	–	Financial Markets (Transferred on 3 December 2010)
Mr. Peter K. Rotich	-	Director	–	Human Resources and Administration Department

REGISTERED OFFICE

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

BRANCHES AND CURRENCY CENTRES

Mombasa Branch
Central Bank of Kenya Building
Nkrumah Road
P.O Box 86372
80100 **Mombasa**, Kenya

Kisumu Branch
Central Bank of Kenya Building
Jomo Kenyatta Highway
P.O Box 4
40100 **Kisumu**, Kenya

Nyeri Currency Centre
Kenya Commercial Bank Building
Kenyatta Street
P.O Box 840
10100 **Nyeri**, Kenya

Eldoret Branch
Kiptagich House
Uganda Road
P.O Box 2710
30100 **Eldoret**, Kenya

Kenya School of Monetary Studies
Thika Road
P.O Box 65041
00200 **Nairobi**, Kenya

Nakuru Currency Centre
George Morara Street
P.O.Box 14094
20100 **Nakuru**, Kenya

Meru Currency Centre
Co-operative Bank Building
Njuri Ncheke Street
P.O Box 2171
60200 **Meru**, Kenya

CENTRAL BANK OF KENYA
BANK INFORMATION - CONTINUED
FOR THE YEAR ENDED 30 JUNE 2011

AUDITORS

KPMG Kenya
Lonrho House, 16th Floor
Standard Street
P.O Box 40612
00100 Nairobi, Kenya

MAIN LAWYERS

Oraro and Co. Advocates
ACK Garden House
1st Ngong Avenue
P.O Box 51236
00200 Nairobi, Kenya

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2011

The directors submit their report together with the audited financial statements for the year ended 30 June 2011, 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 liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

3. Results

3.1 Financial Results

The results for the year are set out on page 85. During the year under review, the Bank registered total income amounting to KShs 49,485m consisting of KShs 9,182m from ordinary operations, KShs 38,934m from foreign currency revaluations and KShs 1,369m from revaluation of fixed assets. During the same year, total expenditure amounting to KShs 8,560m was also recorded. As a result, the Bank recorded a net surplus of Kshs 40,925m including unrealized foreign currency revaluation gains amounting to KShs 38,934m and Kshs 1,369m from revaluation of fixed assets. The foreign currency revaluation gains were accumulated as the Kenya Shilling heavily lost value against major convertible currencies particularly towards the end of the year compared to the closing position as at June 30, 2010. The comparative amount for previous year was a loss of KShs 1,639 million (inclusive of foreign currency translation losses of KShs 1,247 million). The performance in the year 2010-2011 is higher than the previous year due to improved international deposit interest rates in the year under review and the effects of the depreciation of the local currency against the Bank's reserve currencies. Owing to expenditure control during the year, operating expenses were generally lower than the previous year. However, these savings were more than offset by higher depreciation charge for the year brought about by fixed asset census and revaluation carried out during the year that generated higher depreciation owing to new asset values. Overall, the financial performance of the Bank has over the last two years been about 60% lower than normal owing to the effects of the sluggish World economy which has adversely affected the Bank's main source of income.

3.2 Financial Position

The financial position of the Bank is set out in the statement of financial position on page 86. During the year under review, the assets of the Bank increased by KShs 72,694 million (20%). This was mainly due to net purchases of foreign currency, receipt of some money from IMF and weakening of the Kenya Shilling against World main currencies. The other factor that added to the growth in assets is overnight lending to commercial banks whose balance stood at KShs 19,873m at the end of the year compared to nil balance at the end of the previous year. This rise was mitigated by Government borrowing from the Bank that reduced by KShs 10 billion from the position at the end of the previous year.

CENTRAL BANK OF KENYA
DIRECTORS' REPORT (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2011

3.2. Financial Position (Continued)

Tight liquidity in the market towards end of the year compelled commercial banks to resort to lender of last resort.

Total liabilities and equity correspondingly went up by KShs 72,694m mainly due to rise in currency in circulation (10%) and increase in IMF liabilities in USA Dollars that were allocated to the Bank by the Fund for BOP purposes. The recorded net surplus for the period of KShs 40,925m also significantly contributed to the growth in equity and therefore totals liabilities. These increases were mitigated by a net decrease of KShs 7.4 billion in commercial bank and Government deposits.

4. Dividend

The Board of Directors does not recommend payment of a dividend (2010: KShs 2 billion).

5. Directors

The directors who served during the year and up to the date of this report are listed on page 76.

6. Auditors

The auditors, KPMG Kenya, were appointed during the financial year 2009/2010 in line with the Public Procurement and Disposal Act, 2005 for a period of three years and are serving their second year in the audit of the year under review.

BY ORDER OF THE BOARD

Date: 12 September 2011

CENTRAL BANK OF KENYA
STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the financial statements of Central Bank of Kenya set out on pages 85 to 135 which comprise the statement of financial position as at 30 June 2011, and the statement of comprehensive income, statement of changes in equity and statement of cashflows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Central Bank Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of the Bank's operating results.

The Directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

The Directors have made an assessment of the Bank's ability to continue as a going concern and have no reason to believe the Bank will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 12 September 2011 and were signed on its behalf by:

Governor

Director

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 be composed of 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.

Currently there are four Non-Executive Directors namely Dr. Mbui Wagacha, Mr. John Gerin Msafari, Ms. Vivienne Yeda Apopo and Ms. Florence Kagendi Muindi who are all serving their first term. Dr. William Otiende Ogara is serving his second 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.

Audit Committee

The members of the Audit Committee are Dr. William Otiende Ogara (Chairman), Dr. Mbui Wagacha, Mr. John Gerin Msafari and Ms. Vivienne Yeda Apopo. The members are all Non-Executive Directors having experience in Accounting, Auditing, Economics, Banking, Financial and Business Management and Legal matters. The committee currently meets on 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 improve the quality of financial reporting with particular attention to compliance with legal and reporting requirements;
- Receive and consider the Bank's Annual Budget and recommend to the Board for approval;
- 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;

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (continued)

- Review the Bank's Risk Management Policies and Procedures.
- Monetary Policy Committee (MPC)

Section 4D of the CBK (Amendment) Act 2008 establishes the Monetary Policy Committee. The committee is responsible for formulating monetary policy and is required to meet at least once in two months. Members of the committee are appointed by the Minister for Finance for an initial period of three years each and may be reappointed for another final term of three years.

The Committee is currently made up of the following:

- The Governor who is also the Chairman-internal member
- The Deputy Governor who is the Deputy Chairman-internal member
- Permanent Secretary to the Treasury or his representative who shall be non-voting member
- Professor T. C. Ryan-external member appointed by Minister for Finance (Reappointed on 1 May 2011)
- Dr. Rose W. Ngugi-external member appointed by Minister for Finance (Resigned on 17 September 2010)
- Mrs. Sheila S.M.R. M'Mbijjewe-external member appointed by Minister for Finance (Reappointed on 1 May 2011)
- Mr. Wycliffe Mukulu-external member appointed by Minister for Finance (Resigned on 30 April 2011)
- Prof. Francis M. Mwega-external member appointed by Minister for Finance (Appointed on 1 May 2011)
- Mrs. Farida Abdul-external member appointed by Minister for Finance (Appointed on 1 May 2011)
- Mr. Charles Koori- internal member appointed by Governor
- Mr. John K. Birech-internal member appointed by Governor

Human Resources Committee

The Committee was previously chaired by Ms Agnes Wanjiru till her retirement on January 4, 2011 and membership included three other Non-Executive Directors with the Governor and the Deputy Governor in attendance. The Committee is yet to be constituted under the new board which was appointed during the year. The committee once in place will meet regularly and 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 76. The positions of Governor and Deputy Governor are set out 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 several 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.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (continued)

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial 2010/2011 is disclosed in note 30 (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 a monthly salary 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 and Risk Management

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 Statements are published in the Kenya Gazette are placed in the website of the Bank.

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

We have audited the financial statements of Central Bank of Kenya set out on pages 85 to 135which comprise the statement of financial position at 30 June 2011, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

As stated on page 80, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

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 relevant 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 our 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, we consider 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 management, 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 opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of Kenya Act.

KPMG Kenya

Date: 12 September 2011

CENTRAL BANK OF KENYA
STATEMENT COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2011

	Note	2011 KShs'million	2010 KShs'million
Interest income	4	4,303	3,089
Interest expense	5	(30)	(91)
Net interest income		**4,273**	**2,998**
Fee and commission income	6	3,003	3,005
Foreign exchange gain/(loss)	7	40,017	(1,247)
Other operating income	8	793	984
Operating income		**48,086**	**5,740**
Operating expenses	9	(8,530)	(7,379)
Profit/(loss) for the year		**39,556**	**(1,639)**
Other comprehensive income			
Revaluation surplus		1,369	-
Total comprehensive income		**40,925**	**(1,639)**

The notes set out on pages 89 to 135 form an integral part of these financial statements.

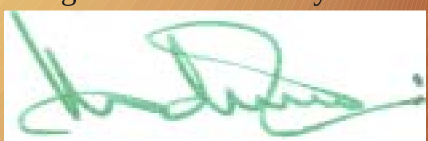
CENTRAL BANK OF KENYA

STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2011

	Note	2011 KShs million	Restated 2010 KShs million
ASSETS			
Balances due from banking institutions and gold holdings	10	368,835	284,682
Funds held with International Monetary Fund	11	2,731	26,272
Items in the course of collection	12	409	316
Advances to banks	13	49	31
Loans and advances	14	30,642	20,674
Other assets	15	5,385	4,802
Retirement benefit asset	16	1,897	1,894
Property and equipment	17	2,849	1,024
Prepaid operating lease rentals	18	268	272
Intangible assets	19	1,171	853
Due from Government of Kenya	20	32,380	33,102
TOTAL ASSETS		**446,616**	**373,922**
LIABILITIES			
Currency in circulation	21	147,718	125,024
Deposits	22	135,792	143,228
Amounts due to International Monetary Fund	11	81,829	63,276
Other liabilities	23	9,447	9,474
Dividends payable	24	2,641	2,641
Provisions	25	98	113
TOTAL LIABILITIES		**377,525**	**343,756**
EQUITY AND RESERVES			
Share capital	26	5,000	5,000
General reserve fund	27	62,722	23,166
Revaluation reserve		1,369	-
Proposed dividend	28	-	2,000
TOTAL EQUITY AND RESERVES		**69,091**	**30,166**
TOTAL LIABILITIES AND EQUITY		**446,616**	**373,922**

The financial statements were approved by the Board of Directors for issue on 12 September 2011 and signed on its behalf by:



Governor

Director

The notes set out on pages 89 to 135 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30 2011

	Share capital KShs million	General reserve fund KShs million	Revaluation Reserve KShs million	Proposed Dividend KShs million	Total KShs million
At 1 July 2009	5,000	26,805	-	7,200	39,005
Comprehensive income for the year					
Loss for the year	-	(1,639)	-	-	(1,639)
Total comprehensive income for the	**-**	**(1,639)**	**-**	**-**	**(1,639)**
Transactions with owners directly recorded in equity					
2009 dividends paid	-	-	-	(4,559)	(4,559)
Transfer to dividends payable (Earmarked)	-	-		(2,641)	(2,641)
Proposed dividends	-	(2,000)	-	2,000	-
Total contributions by and distribution to the owners	**-**	**(2,000)**	**-**	**(5,200)**	**(7,200)**
As at 30 June 2010	**5,000**	**23,166**	**-**	**2,000**	**30,166**
At 1 July 2010	5,000	23,166	-	2,000	30,166
Comprehensive income for the year					
Profit for the year	-	39,556	-	-	39,556
Other comprehensive income for the year					
Revaluation surplus	-	-	1,369	-	1,369
Total comprehensive income for the	**-**	**39,556**	**1,369**	**-**	**40,925**
Transactions with owners directly recorded in equity					
2010 dividends paid	-	-	-	(2,000)	(2,000)
Proposed dividends	-	-	-	-	-
Total contributions by and distribution to the owners	**-**	**-**	**-**	**(2,000)**	**(2,000)**
As at 30 June 2011	**5,000**	**62,722**	**1,369**	**-**	**69,091**

The notes set out on pages 89 to 135 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30 2011

	Note	2011 KShs'million	2010 KShs'million
Operating activities			
Net cash generated by operating activities	29(a)	**24,966**	**52,738**
Investing activities			
Receipts of government loan		722	227
Purchase of property and equipment		(1,523)	(650)
Purchase of intangible assets		(334)	(379)
Proceeds from disposal of property and equipment		1	-
Utilisation of/Proceeds from International Monetary Fund - SDR accounts		23,541	(25,358)
Net cash generated/ (used) in investing activities		**22,407**	**(26,160)**
Financing activities			
Dividends paid		(2,000)	(4,559)
Net cash outflow from financing activities		**(2,000)**	**(4,559)**
Net increase in cash and cash equivalents		45,373	22,019
Cash and cash equivalents at start of year		277,314	256,542
Exchange rate effects		40,017	(1,247)
Cash and cash equivalents at end of year	29(b)	**362,704**	**277,314**

The notes set out on pages 89 to 135 form an integral part of these financial statements

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

1. REPORTING ENTITY

The Central Bank of Kenya (the "Bank") 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 "Act") and is domiciled in Kenya. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

2. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

(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 and revaluation of property and equipment.

(ii) Statement of compliance

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS) and interpretations of those Standards.

(iii) 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.

(iv) 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.

In particular information about significant areas of estimations and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 3 – *Critical accounting estimates and judgements*.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Basis of preparation (continued)

(v) Functional and presentation currency

These financial statements are presented in Kenya shillings (KShs), which is the Bank's functional currency.

Except for where indicated, financial information presented in Kenya shillings has been rounded to the nearest million.

(vi) Change in accounting policy

During the year, the Bank adopted the requirements of IAS 39 by fair valuing the staff loans and advances granted at low interest rates. The effect of this has been accounted for in the current year and prior year in line with IAS 8, on changes in Accounting policies. Three statement of financial position have not been presented as required by IAS 1 where retrospective adjustments have been made.

The impact of this restatement does not affect opening and prior period reserves and the impact of presentation of the third statement of financial position is deemed immaterial.

(b) Revenue recognition

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

(i) Interest income and expenses

Interest income and expense are recognised in the profit or loss for all interest bearing instruments on an accrual basis using the effective interest 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.

(ii) Fees and commission income

Fees and commission income, which arise from financial services provided by the Bank, are recognised when the corresponding services are provided.

(c) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at rates ruling at the transaction dates. Monetary assets and liabilities at the reporting 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 profit or loss in the year in which they arise.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Currency printing and minting expenses

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the profit or loss from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition. The life span of each bank note denomination is as described in note(3 (d)) below.

(e) Employee benefits

(i) 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 and employees of the Bank. Kenya School of Monetary Studies (KSMS), Central Bank of Kenya Staff Pension Scheme, Deposit Protection Fund Board, and other related parties, reimburses the Bank the costs of contributions relating to staff seconded to them by the Bank.

The defined benefit obligation is calculated annually by an independent actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of government bonds that have terms to maturity approximating to the terms of the related pension liability.

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.

Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised as income or expense when the net cumulative unrecognised actuarial gains and losses at the end of the previous report year exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets as at that date. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plan.

Past service cost is recognised as an expense on a straight line basis over the average period until the benefits become vested. If the benefits vest immediately, the past service cost is recognised immediately. Any net defined benefit surplus is limited to the benefit that is available to the Bank.

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 profit or loss over the remaining working lives of the employees participating in the scheme.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Employee benefits (continued)

(i) Retirement benefits - continued

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.

(ii) Other employee benefits

The estimated monetary liability for employees' accrued leave entitlement at the reporting date is recognised as accrued expense.

(f) Property and equipment

Items of property and equipment are measured at cost or as professionally revalued from time to time less accumulated depreciation and impairment losses. Depreciation is computed on the straight line basis over the estimated useful lives of the assets at the following rates:

Building improvements	Ten years
Motor vehicles, furniture and equipment	Two years

Property that is being constructed or developed for future use to support operation is classified as Work–in–Progress (WIP) and stated at cost until construction or development is complete, at which time it is reclassified as property and equipment in use.

Subsequent expenditures are capitalized only when they increase the current economic benefits and meet the recognition criteria. Expenditure incurred to replace a component of item of property and equipment is accounted for separately and capitalized while the major replaced component is derecognised.

All other expenditure items which do not meet recognition criteria are recognised in the profit or loss as expenses as they are incurred.

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 profit or loss in the year the asset is derecognised

The assets residual values, useful lives and methods of depreciation are reviewed and adjusted if appropriate at the each financial year end. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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 impairment loss.

Intangible assets that are being developed for future use to support operations are classified as Work –in – Progress (WIP) and stated at cost until development is complete, at which time they are reclassified as Intangible assets.

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 profit or loss.

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 - two years

(h) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the statement of comprehensive income. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro-rata basis.

(i) Financial instruments

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.

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, which is the date that the Bank commits to purchase or sell the asset.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(ii) Recognition and initial measurement

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

(iii) Classification and measurement

The Bank determines the classification of its investments at initial recognition. The main categories include:

Loans, advances and receivables
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. The Bank has classified the following financial assets as loans and receivables originated by the entity: loans and advances, amounts due from the Government, other assets, International Monetary Fund (IMF) related assets and cash and cash equivalents. After initial measurement, loans and receivables are carried at amortised cost using effective interest method less any allowance 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 of Kenya (GoK), 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 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.

Loans granted at a lower than market interest rates are measured at present value of anticipated future cash flows discounted using market interest rates. The difference between the fair value of the loans and the carrying amount is treated as a long term employee benefit and is accounted for as a prepayment. The long term benefit is recognised as interest income while prepayment is expensed to staff costs as the services are rendered to the bank over the period of the loan.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(iii) Classification and measurement - continued

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 has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in 'Interest income' in the profit or loss. The losses arising from impairment of such investments are recognised in the profit or loss line 'Impairment losses on financial investments'. 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 term deposits, Government securities, repurchase and reverse purchase instruments as held to maturity.

Financial liabilities
Financial liabilities are measured at amortised cost except for financial liabilities designated at fair value through profit and loss. Financial liabilities are initially recognised at fair value less, in the case of liabilities carried at amortised cost (including due to banks, due to International Monetary Fund other deposits and other funds borrowed), transaction costs incurred and any difference between the proceeds net of transaction costs and the redemption amount is recognised in the profit or loss as interest expense over the period to maturity using the effective interest rate method. Financial liabilities which are repayable on demand are recorded at nominal value. Deposits represent reserve deposits of depository institutions' participants and current accounts of the Bank. The Bank has classified the following financial instruments as financial liabilities: currency in circulation, deposits, IMF related liabilities and other liabilities.

Financial assets at fair value through profit or loss: Held for Trading
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 profit or loss. The Bank has classified the Reserve Asset Management Programme (RAMP) financial instruments as held for trading.

(iv) Derecognition

Financial assets are de-recognized 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.

A financial liability is de-recognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the profit or loss.

The gains and losses on investments held to maturity and loans and receivables are recognized in the profit or loss when the investments are derecognized.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(v) Gains and losses on subsequent measurement

Gains and losses on amortisation of premiums or discounts of financial instruments carried at amortised cost are recognised in the profit or loss of the period in which they arise. Gains and losses due to impairment are recognised as stated in the paragraph dealing with impairment.

(vi) Offsetting

Financial assets and financial liabilities are offset and the net amount reported on the reporting date where 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.

(vii) Impairment of financial assets

At each reporting date, the Bank assesses whether there is objective evidence that a financial asset not carried at fair value through profit or loss is impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows on the assets that can be estimated reliably.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar risk characteristics.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in the statement of comprehensive income and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(vii) Impairment of financial assets - continued

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the statement of comprehensive income. Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of other comprehensive income to the statement of comprehensive income. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in other comprehensive income. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

(j) Amounts repayable under Repurchase Agreements (REPOs)

REPO is an arrangement involving the sale for cash, of security at a specified price with a commitment to repurchase the same or similar securities at a fixed price either at a specific future date or at maturity.

For monetary purposes (liquidity management), the Bank from time to time mops up money from the market (REPO) or injects money into the economy (Reverse REPO). The Bank engages in the above with commercial banks only.

When the Bank mops money from commercial banks, it creates a liability in its books and secures this borrowing (liability) by assigning part of the securitized debt owing from Government to the Bank to the commercial banks it has mopped from. The Bank freezes the money mopped and pays interest at market rates on the money. The money mopped stays until maturity (7 to 91 days).

Similarly the Bank also lends money to commercial banks (reverse repo). In this process, the Bank creates an asset in its books and takes a security from the borrowing bank usually in form of Treasury Bills or Bonds. The Bank earns interest from the borrowing commercial bank on this lending. The injected money stays with the borrowing bank until maturity (1 to 7 days).

(i) The Bank treats reverse REPOs as collateralized loans for accounting purposes. In this case, a reverse REPO is recorded as a secured advance and is shown separately as Advance to Banks while repurchase agreements are shown as a liability in the books of bank.
(ii) REPOs continue to be recognised in the statement of financial position and are measured in accordance with policies for non-trading investment.
(iii) The difference between sales and repurchase price is treated as interest expenditure and is recognised in the profit or loss.

The Bank also accepts deposits from commercial banks on a voluntary basis at market terms for an agreed period. This is a relatively new monetary instrument that the Bank uses in addition to REPO and is similar to REPO only that it is not secured.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Currency in circulation

Currency issued by the Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at face value in these financial statements. Currency in circulation represents the face value of notes and coins in circulation. Notes and coins held by the Bank as cash in main vault, intermediary vault, and cashier at the end of financial year are excluded from the liability of notes and coins in circulation because they do not represent currency in circulation.

(l) Deposits

Deposits are non-derivative financial liabilities with fixed or determinable receipts that are not quoted in an active market. They arise when the Bank receives money or services directly from counterparty with no intention of trading the payable. Deposits held are carried at cost with interest income accruing on an effective interest rate basis.

Cash Ratio Deposits are taken from commercial banks for liquidity management (monetary policy purposes) of the Bank in accordance with the Banking Act and are interest free. Cash Ratio Reserves is a monetary policy instrument used to manage liquidity. The deposits earn no interest to commercial banks and the Bank does not trade on these deposits in any way. The deposits are currently computed at 4.75% of each commercial bank's deposits it has taken from the public. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

(m) Provisions

A provision is recognised when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to that liability.

(n) Leasing

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

(i) Bank as a lessee

Finance leases, which transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in 'Property and equipment' with the corresponding liability to the lessor included in 'Other liabilities.' Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in 'Interest and similar expense.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Leasing (continued)

(i) Bank as a lessee - continued

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Bank will obtain ownership by the end of the lease term. Operating lease payments are not recognised in the statement of financial position. Any rentals payable are accounted for on a straight-line basis over the lease term and included in 'Other operating expenses'.

(ii) Bank as a lessor

Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. The Bank leases out all of its properties as operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

(o) Dividends

The Central Bank of Kenya Act (Cap 491) allows the Bank to retain at least 10% of realized income after taking into account expenses. In addition to this, the Board of Directors in the year 2007 set a policy that all dividends shall be net of unrealized income and other revaluations gains in addition to the retention allowed by the Act.

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.

(p) Other liabilities

Other liabilities are stated at their nominal value/cost, which approximates fair value due to the short term nature thereof.

(q) Cash and cash equivalents

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

(r) Commitments on behalf of Treasury

Commitments on behalf of Treasury arising from the issue of Treasury bills and Treasury bonds are not included in these financial statements as the Bank is involved in such transactions only as an agent

(s) Comparatives

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

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 30 June 2011, and have not been applied in preparing these financial statements as follows:

- IFRS 9 *Financial Instruments* IFRS 9 will become mandatory for the Bank's 2014 financial statements.
- IAS 24 *Related Party Disclosures*. The amendments to IAS 24 will become mandatory for the Bank's 2011 financial statements.
- IFRS 10 *Consolidated Financial Statements* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 11 *Joint Arrangements* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 12 *Disclosure of Interests in Other Entities* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 13 *Fair Value Measurement* (effective for annual periods beginning on or after 1 January 2013).
- IAS 27 (2011) *Separate Financial Statements.*
- IAS 28 (2011) *Investments in Associates and Joint Ventures.*

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including experience of future events that are believed to be reasonable under the circumstances. The most significant use of judgement and estimates are as follows:

(a) 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 profit or loss. 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.

(b) 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 16 for assumptions used.

(c) 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) above.

(d) Useful life of currency

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the income statement from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Previously the costs were expensed upon delivery of currency stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition.

Useful lives of the various banknotes denominations are currently estimated as follows:

KShs 1,000	2 years
KShs 500	2 years
KShs 200	2 years

The useful life for all other denominations is estimated at 1 year.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

		2011 KShs million	2010 KShs million
4	**INTEREST INCOME**		
	Cash and cash equivalents (Note 4a)	42	57
	Held to maturity investments (Note 4b)	1,513	1,015
	Loans and advances (Note 4c)	2,393	1,726
	Held for trading investments (Note 4d)	355	291
		4,303	**3,089**
(a)	**Interest income from cash and cash equivalents**		
	Income from IMF	42	57
		42	**57**
(b)	**Interest income from held to maturity investments**		
	Interest on Sterling Pound term deposits	547	372
	Interest on US Dollar term deposits	339	328
	Interest on Euro term deposits	627	315
		1,513	**1,015**
	The weighted average interest rates for term deposits were:		
	US Dollar	0.21%	0.36%
	UK Sterling Pounds	0.70%	0.48%
	Euro	1.18%	0.54%
(c)	**Interest income from loans and advances**		
	Interest on loan due from Government Debt	958	993
	Interest on Government overdraft	890	314
	Interest on staff loans	271	80
	Interest on reverse REPOs	36	245
	Interest on local commercial banks overnight loans	115	11
	Interest on foreign commercial banks overnight loans	2	3
	Other interest income	121	80
		2,393	**1,726**
(d)	Interest income from held for trading investments		
	Interest income – World Bank RAMP	**355**	**291**

The Bank has engaged the services of Reserve Asset Management Programme (RAMP) which is the investment arm of the World Bank to assist in building capacity in foreign reserves management. The Bank has availed US $300 million (2010- US $ 300 million) for the Programme.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

4 INTEREST INCOME (Continued)

(e) Additional disclosure on income by source

	2011 KShs million	2010 KShs million
Foreign investments earnings	1,913	1,366
Local investments earnings	2,119	1,643
Other interest earnings	92	80
	4,124	**3,089**

5 INTEREST EXPENSE

	2011	2010
Interest on monetary policy issues/ REPOs	29	2
Interest paid to IMF	1	89
	30	**91**

6 FEE AND COMMISSION INCOME

	2011	2010
Commission on sale of Government securities	3,000	3,000
Poverty Reduction and Growth Facility (PRGF) (IMF-GoK) Commission	3	5
	3,003	**3,005**

The Bank earns from the Government a commission of 1.5% of amounts raised for its agency role in the issuance of Treasury bills and bonds. The commission income is limited to KShs 3 billion as per an agreement between the Bank and Treasury effective 1 July 2007. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.

7 FOREIGN EXCHANGE GAIN/ (LOSS)

	2011 KShs million	2010 KShs million
Foreign exchange dealing profit (Note 7a)	991	786
Foreign Bonds Pending Receivables	92	13
Foreign exchange translation gain/(loss) (Note 7b)	38,934	(2,046)
	40,017	**(1,247)**

(a) Foreign exchange dealing profit

	2011	2010
Gains on sale of foreign exchange to Government	989	784
Foreign exchange dealing profit on commercial banks	2	2
	991	**786**

(b) Foreign exchange translation gain/(loss)

	2011	2010
Revaluation gain/(loss) on current accounts	533	(378)
Revaluation gain/(loss) on foreign deposits	45,482	(3,545)
Revaluation loss on IMF accounts	(9,924)	(363)
Revaluation of RAMP securities	2,824	2,226
Others-Revaluation gains on Gold Holdings	19	14
	38,934	**(2,046)**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

7 FOREIGN EXCHANGE GAIN/ (LOSS) (Continued)

Exchange rates	**2011**	**2010**
US Dollar	89.70	81.80
GBP	144.3	123.01
Euro	130.0	99.88

	2011	**2010**
Foreign currency investment mix		
US Dollar	45%+ /-5%	45%+ /-5%
GBP Sterling Pound	30%+/-5%	35%+/-5%
Euro	25%+/-5%	20%+/-5%
	100%	**100%**

8 OTHER OPERATING INCOME

	2011 KShs million	**2010 KShs million**
Actuarial gain on retirement benefit obligations	3	468
Miscellaneous income	153	36
Licence fees from Commercial Banks and bureaus	182	159
Penalties Commercial banks and Forex Bureaus	48	-
Rent received	1	3
KSMS other operating income-hospitality services and tuition fee	405	318
Proceeds from disposal of property and equipment	1	-
	793	**984**

9 OPERATING EXPENSES

	2011 KShs million	**2010 KShs million**
Staff costs (Note 9(a))	3,992	3,790
Currency expenses (Note 9(b))	1,766	1,491
Property maintenance expenses (Note 9(c))	654	566
Depreciation on property and equipment (Note 17)	1,066	545
Amortisation on intangible assets (Note 19)	13	19
Other expenses (Note 9(d))	1,029	956
Auditors' remuneration	5	5
Banking expenses	1	4
Operating lease rentals (Note 18)	4	3
	8,530	**7,379**

(a) Staff costs

Personnel emoluments	3,417	3,355
Medical benefit	210	202
Staff training and development costs	179	218
Low interest benefit on staff loans	179	-
Directors' expenses	7	15
	3,992	**3,790**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

9 OPERATING EXPENSES (Continued)

	2011 KShs million	2010 KShs million
(b) Currency expenses		
Notes production	1,162	1,047
Coins production	584	429
Notes issue	10	8
Coin Issue	5	5
Agency Centres	5	2
	1,766	**1,491**
(c) Property maintenance expenses		
Upkeep of property	288	197
Security of premises	234	204
Property renovation	28	56
Electricity	60	57
Others	44	52
	654	**566**
(d) Other expenses		
Transport and travelling	179	136
Office expenses	165	130
Postal service expense	121	102
Legal and professional fees	100	100
Other administrative expenses	464	488
	1,029	**956**

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2011 KShs million	2010 KShs million
Cash and cash equivalents (Note 10(a))	14,058	15,651
Held for trading investments (Note 10(b))	37,734	33,515
Held to maturity investments (Note 10(c))	316,967	235,459
Gold holdings	76	57
	368,835	**284,682**

(a) Cash and cash equivalents

	2011	2010
Special project accounts	5,846	7,051
Current account	2,640	4,350
Domestic forex currency cheque clearing	5,572	4,244
Forex travellers cheques	-	6
	14,058	**15,651**

CENTRAL BANK OF KENYA
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10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS (Continued)

		2011 KShs million	2010 KShs million
(b)	**Held for trading**		
	US Dollar deposits	36	16
	Fixed income securities	37,612	33,346
	Accrued interest	86	153
		37,734	**33,515**
(c)	**Held to maturity investments**		
	Term deposits (Note 10 (c)(i))	316,719	235,264
	Accrued interest on term deposits	248	195
		316,967	**235,459**
	(i) Term deposits		
	Dollar deposits	118,853	75,773
	Sterling Pound deposits	94,548	94,070
	Euro deposits	103,318	65,421
		316,719	**235,264**

11. FUNDS HELD AT/AMOUNTS DUE TO INTERNATIONAL MONETARY FUND (IMF)

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.

	2011		2010	
	SDR Million	**KShs Million**	**SDR' Million**	**KShs Million**
Assets- Funds held at IMF				
IMF balances (SDR asset account)	19	2,731	218	26,272
Liabilities- Amounts due to IMF				
International Monetary Fund Account No. 1	20	2,886	20	2,430
International Monetary Fund Account No. 2	-	1	-	4
International Monetary Fund – PRGF Account	328	47,042	279	33,734
IMF-SDR Allocation account	223	31,900	218	26,867
International Monetary Fund loans to Government of Kenya	-	-	2	241
	571	81,829	519	63,276
Security at 30 June	241	32,550	238	28,079

Borrowings from and repayments to the IMF are denominated in Special Drawing Rights (SDRs). The SDR balances in IMF accounts are translated into KShs and any unrealized gains or losses are accounted for in accordance with accounting policy on foreign currencies.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
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11. FUNDS HELD AT/AMOUNTS DUE TO INTERNATIONAL MONETARY FUND (IMF) (Continued)

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository

Kenya's Quota in IMF and SDRs allocations amounting to SDR 271.4 million and SDR 259.6 million respectively. The Quota (SDR 271.4 million) and SDR allocations (36.99million) is not accounted for in the books of Bank.

12 ITEMS IN THE COURSE OF COLLECTION

	2011 KShs million	2010 KShs million
Items in the course of collection	**409**	**316**

The balance represents the value of clearing instruments which are held by the Bank while awaiting clearing by respective commercial banks.

13 ADVANCES TO BANKS

	2011 KShs million	2010 KShs million
Treasury Bonds Discounted	32	17
Treasury Bills Discounted	16	13
Accrued interest	1	1
	49	**31**

The Bank lends money to commercial banks through reverse Repo for a short duration of up to 7 days only. These advances are secured against government securities of any maturity. The discounted government securities held are of varying maturities.

14 LOANS AND ADVANCES

	2011 KShs million	2010 KShs million
Overnight Lending to commercial banks	19,873	-
Irrecoverable amount from banks under liquidation	3,706	3,767
Government overdraft account (see below and Note 30)	7,571	17,649
Loan from IMF to the Government of Kenya (Note 30)	(3)	241
Advances to employees		
Salary advance	177	186
Car loans	418	419
Housing scheme	2,227	1,916
Development loan	398	280
	34,367	24,458
Provision for loan impairment (banks & staff)	(3,725)	(3,784)
Net advances as at 30 June	**30,642**	**20,674**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

14 LOANS AND ADVANCES (Continued)

	2011 KShs million	2010 KShs million
Movement in the loan impairment allowance is as follows:		
At start of the year	(3,784)	(3,784)
Additional impairment allowance made during the year	(1)	-
Recoveries during the year	60	-
At end of the year	**(3,725)**	**(3,784)**

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 Government of Kenya audited financial statements. The limit stands at KShs 22,926,066,860.60 based on the Government financial statements for 2008/2009, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was Kshs 21,002,541,033.05 based on the Government financial statements for 2007/2008. The Government overdraft attracts an interest at the CBR rate determined by the Bank which varies from time to time based on the monetary policy.

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. Commercial banks had utilised this facility amounting to KShs 19.8 million (2010 Nil). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

15. OTHER ASSETS

	2011 KShs million	2010 KShs million
Prepayments and sundry debtors	2,374	3,018
Deferred currency expenses	2,796	1,570
Advances	215	214
	5,385	**4,802**

The policy of the Bank is to recognise currency notes expenses upon issuing out of currency notes for circulation over a predetermined useful life of the notes.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

16 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 employees of the Bank. The retirement benefit asset is wholly recognised in the financial statements of the Bank. All employees of Deposit Protection Fund Board (DPF) are staff of the Bank and DPF only reimburses the bank their emoluments.

The amounts recognised in the statement of financial position are determined on the basis of an actuarial review carried out by Actuarial Services (EA) Limited as at 30 June.

	2011 KShs million	2010 KShs million
Present value of funded obligations	12,137	11,550
Fair value of plan assets	(15,872)	(14,868)
Present value of net asset	(3,735)	(3,318)
Unrecognised actuarial gain	1,838	1,424
Balance at 30 June	**(1,897)**	**(1,894)**

The amounts recognised in the profit or loss are as follows:

	2011	2010
Current service costs	601	507
Interest costs	1,022	844
Expected return on plan assets	(1,334)	(1,087)
Adjustment for previous year values	58	(399)
Total expenses included in operating expenses	347	(135)

Movements in the net asset recognised at the reporting date are as follows:

	2011	2010
Net liability at start of period	(1,894)	(1,425)
Net expense recognised in the profit or loss	347	(135)
Employer contributions	(350)	(334)
Net liability at end of period	(1,897)	(1,894)
Actual return on plan assets	**1,173**	**2,852**

The principal actuarial assumptions at the reporting date were:

	2011	2010
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%

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

16 RETIREMENT BENEFIT ASSET (Continued)

Historical information	2011 KShs million	2010 KShs million	2009 KShs million	2008 KShs million	2007 KShs million
Fair value of plan assets	15,872	14,868	11,678	12,136	10,774
Present value of funded obligations	(12,137)	(11,550)	(9,582)	(10,496)	(9,416)
Retirement benefit asset	**3,735**	**3,318**	**2,096**	**1,640**	**1,358**

17 PROPERTY AND EQUIPMENT

30 June 2011	**Land and buildings KShs million**	**Motor vehicles KShs million**	**Furniture and Equipment KShs million**	**Total KShs million**
Cost				
At start of year	1,086	217	4,220	5,523
Additions	249	48	1,225	1,523
Disposals	-	(2)	(1)	(3)
At end of the year	1,335	263	5,444	7,042
Accumulated depreciation				
At start of the year	964	187	3,348	4,499
Charge for the year	22	29	1,015	1,066
Revaluation surplus	-	-	(1,369)	(1,369)
On disposal	-	(2)	(1)	(3)
At end of the year	986	214	2,993	4,193
Net book value at 30 June 2011	**349**	**49**	**2,451**	**2,849**

30 June 2010:	**Land and buildings KShs million**	**Motor Vehicles KShs million**	**Furniture and Equipment KShs million**	**Total KShs million**
Cost				
At start of year	988	196	3,813	4,997
Reclassification to intangible asset	-	-	(115)	(115)
At 30 June 2009 as restated	988	196	3,698	4,882
Additions	98	30	522	650
Disposals	-	(9)	-	(9)
At end of the year	1,086	217	4,220	5,523
Accumulated depreciation				
At start of the year	954	175	2,834	3,963
Charge for the year	10	21	514	545
On disposal	-	(9)	-	(9)
At end of the year	964	187	3,348	4,499
Net book value At 30 June 2010	**122**	**30**	**872**	**1,024**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

17 PROPERTY AND EQUIPMENT (continued)

Furniture and equipments were revalued by Gimco Limited a firm of professional valuers on an open market basis and the resulting revaluation surplus has been included in the revaluation reserve.

18 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:

	2011 KShs million	2010 KShs million
Cost		
At 30 June	300	300
Amortisation		
At 1 July	28	25
Amortisation for the year	4	3
At end of the year	32	28
Net carrying value at end of the year	**268**	**272**

The prepaid operating lease rentals relate to L.R. No. IR 53398 which has a lease term of 99 years. The leasehold land was acquired by the Bank in 2002 at a cost of KShs 300,000,000. The cost is amortised on the basis of the remaining life of the lease.

19 INTANGIBLE ASSETS

	Software KShs million	Work-in-Progress KShs million	2011 Total KShs million	2010 Total KShs million
Cost				
At 1 July	220	842	1,062	683
Impairment loss	(3)	-	(3)	-
Additions	19	315	334	379
At end of the year	236	1,157	1,393	1,062
Amortisation				
At 1 July	209	-	209	190
Amortisation for the year	13	-	13	19
At end of the year	222	-	222	209
Net carrying value at end of the year	**14**	**1,157**	**1,171**	**853**

The work-in-progress relates to software acquired for the System of Integrated Management Banking and Accounting (SIMBA) project.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
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20 DUE FROM GOVERNMENT OF KENYA

	2011 KShs million	2010 KShs million
At start of the year	33,102	33,329
Accrued interest receivable	716	328
Receipts during the year	(1,438)	(555)
At end of the year	**32,380**	**33,102**

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 to limit lending to GoK to 5% of GoK audited revenue.

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the Government agreed to repay KShs 1.11 billion 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.

The loan due from the Government of Kenya is categorised as a held-to-maturity investment and is carried at amortized cost. The Directors have assessed the loan for impairment and the amount of the impairment is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate of 3% per annum. The assessment has indicated that the loan is not impaired.

21 CURRENCY IN CIRCULATION

	2011 KShs million	2010 KShs million
Kenya notes	143,022	120,574
Kenya coins	4,690	4,444
Commemorative coins	6	6
	147,718	**125,024**
Balance at the beginning of the year	125,024	108,042
Deposits by banks	(317,596)	(271,430)
Withdrawals by banks	340,290	288,412
Balance at the end of the year	**147,718**	**125,024**

Currency in circulation represents the face value of notes and coins in circulation. Notes and coins held by the Bank as cash in main vault, intermediary vault, and cashier/ teller at the end of financial year have been excluded from the liability of notes and coins in circulation because they do not represent currency in circulation. Currency notes and coins are issued in the following denominations:

Notes: 1,000/=, 500/=, 200/=, 100/= and 50/=.
Coins: 40/=, 20/=, 10/=, 5/=, 1/=, /50, /10 and /05.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

22 DEPOSITS

	2011 KShs million	2010 KShs million
Local commercial banks (Note 22 a)	72,731	85,236
Local banks forex settlement accounts (Note 22 b)	5,129	3,669
External banks forex settlement accounts	310	94
Other public entities and project accounts	10,830	10,672
Government of Kenya(Note 22 c)	46,792	43,557
	135,792	**143,228**

a) Local commercial banks

	2011 KShs million	2010 KShs million
Clearing accounts	10,715	34,681
Cash reserve ratio	62,016	50,555
	72,731	**85,236**

The cash reserve ratio is a statutory ratio for monetary policy. Commercial Banks and Non-Bank Financial Institutions (NBFI's) are required to hold at the Central Bank of Kenya a prescribed percentage of their total deposits. The ratio was revised to 5% in December 2008 from 6% previously. It was again revised downwards to 4.5% in June 2009, and then to 4.75% in June 2011. The statutory deposits are determined from commercial banks monthly returns submitted to Central Bank of Kenya on or before the tenth day of every month. The banking institutions are required to maintain balances at the Central Bank equivalent to the cash reserve requirement of 4.75% based on monthly averages, but should not fall below 3% at any time. Currently there are 43 licensed commercial banks and 1 mortgage finance company.

b) Local banks forex settlement accounts

	2011 KShs million	2010 KShs million
Euro	930	441
Dollar	3,698	2,900
Sterling Pound	501	328
	5,129	**3,669**

c) Government of Kenya

	2011 KShs million	2010 KShs million
Paymaster General	20,791	22,504
Treasury Funding Account	17,207	17,151
The Exchequer Account	1,223	1,601
Others	7,571	2,301
	46,792	**43,557**

Under the Central Bank of Kenya Act Cap 491 section 4A (e) the Bank acts as the banker, advisor to, and as fiscal agent of the Government. The Bank receives instructions to transfer funds from the Exchequer Account to voted accounts as per the Exchequer and Audit Act 1955, Part IV Paragraph 17 (2). The instructions are given by the Treasury and specify the Exchequer Account to be debited.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

23 OTHER LIABILITIES

	2011 KShs million	2010 KShs million
Impersonal accounts	4,095	4,707
Sundry creditors	1,124	733
Bonds Pending payables	1,536	1,026
Refundable deposits	531	668
Long term employee loan benefit (low interest)	2,161	2,340
	9,447	**9,474**

24 DIVIDENDS PAYABLE

Dividends payable	**2,641**	**2,641**

The movement in dividends payable is as follows:

Balance at 1 July	2,641	-
Dividends approved in the year	-	7,200
Paid during the year	-	(4,559)
Funds earmarked for an on-going project	**2,641**	**2,641**

25 PROVISIONS

Leave accrual	75	60
Gratuity to staff members	23	53
	98	**113**

26 SHARE CAPITAL

Authorised share capital	**5,000**	**5,000**
Issued and fully paid	**5,000**	**5,000**

Ownership of the entire share capital is vested in the Permanent Secretary to the Treasury.

27 GENERAL RESERVE FUND

The general reserve fund is a fund into which 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. The Bank utilises funds accumulated in this account to pay dividends once declared by the Board of Directors, increase paid up capital when necessary and to absorb any negative external shocks.

28 DIVIDENDS

The Board of Directors does not recommend payment of a dividend (2010: KShs 2 billion).

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

29(a) NOTES TO THE CASH FLOW STATEMENT

Cash flows from operating activities	2011 KShs million	2010 KShs million
Net profit/(loss) for the year	39,556	(1,639)
Adjustments for:		
Depreciation of property and equipment	1,066	545
Amortization of prepaid operating leases	4	3
Amortization of intangible assets	13	19
Impairment loss on intangible assets	3	-
Exchange rate (gain)/loss effects	(40,017)	1,247
Gain on disposal of property and equipment	(1)	-
Surplus in defined benefit scheme	(4)	(469)
Operating profit before working capital changes	**620**	**(294)**
Net increase in loans and advances	(9,968)	(12,357)
Decrease in balance with International Monetary Fund	18,553	25,828
Increase in Project accounts	1,205	-
Decrease/(increase) in accrued interest on balances due from banking institutions	16	(2,196)
(Increase)/decrease in items in the course of collection	(93)	1,114
(Decrease)/increase in deposits	(7,436)	17,591
(Increase)/decrease in other assets	(583)	(1,932)
Increase in currency in circulation	22,694	16,982
(Decrease)/increase in other liabilities and provisions	(42)	8,002
Net cash generated by operations	**24,966**	**52,738**

(b) Cash and cash equivalents

Cash and cash equivalents included in the cash flow statement comprise the following:

	2011 KShs million	2010 KShs million
Term deposits	316,719	235,264
Current accounts	2,640	4,350
Domestic forex cheques clearing	5,572	4,244
Travellers Cheques	-	6
Gold holdings	76	57
	325,007	243,921
Advances to Banks	49	31
Investments with RAMP	37,648	33,362
	362,704	**277,314**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
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30 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 14) include advances to employees that as at 30 June 2011 amounted to KShs 3,218 million (2010: KShs 2,801 million). The advances are at preferential rates of interest determined by the Bank.

		2011 KShs million	2010 KShs million
(ii)	**Loans to executive directors**		
	At start of the year	6	9
	Loans advanced during the year	-	-
	Loan repayments	(3)	(3)
	At end of the year	**3**	**6**
(iii)	**Loans to key management personnel**		
	At start of the year	62	39
	Loans advanced during the year	22	57
	Loan repayments	(33)	(34)
	At end of the year	**51**	**62**
(iv)	**Directors' emoluments:**		
	Fees to non executive directors	7	15
	Other remuneration to executive directors	50	50
		57	**65**
(v)	**Remuneration to senior management**	**172**	**182**
(vi)	**Post –employment pension**	**2**	**2**

(vii) 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.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

30 RELATED PARTY TRANSACTIONS (Continued)

(vii) Government of Kenya - continued

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

	2011 KShs million	2010 KShs million
Due from Government of Kenya (Note 20)	32,380	33,102
Overdraft account (Note 14)	7,751	17,649
Loan from IMF to the Government of Kenya (Note 14)	(3)	241
Government of Kenya deposits (Note 22)	46,792	43,557

(vii) 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 86 million (2010: KShs 26million).

(viii) 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.

31 RISK MANAGEMENT

(a) Structure and Reporting

The Board of Directors is responsible for the overall risk management approach and for approving the risk management policy and strategies. There are other organs that monitor the assessment and management of risks within the Bank including:

(i) Audit Committee of the Board

The Audit Committee assists the Board in the fulfilment of its oversight responsibilities. Regarding risk management, the Committee oversees the process of risk management by receiving and discussing risk management reports and guiding and monitoring the implementation of recommended mitigating controls/ initiatives.

(ii) Bank Risk Management Committee

The purpose of the Bank Risk Management Committee is to identify the nature of risks affecting the Bank and the processes by which these risks are to be managed. The Committee monitors external developments relating to all financial, business and strategic risks associated with the operations of the Bank. The Committee is further, charged with the responsibility of reviewing the adequacy and overall effectiveness of the Bank's risk management and business continuity management frameworks and oversees the inculcation of a risk philosophy and implementation of a risk strategy and policy across the Bank. In executing its mandate, the Committee receives and considers risk assessment reports from Internal Audit Department and Risk Management Division in Banking & Risk Management Department.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(a) Structure and Reporting (continued)

(ii) Internal Audit Departmen(IA)

The Internal Audit Department employs risk-based audit approach in planning and carrying out its audit engagements. The Risk Management function facilitates risk assessments by individual departments where risks are identified, analyzed and mitigating measures agreed upon.

The business processes are assessed with regard to business continuity procedures, physical safety, system safety, conformity to legal requirements and regulations, sufficiency of human resources and information safety. In addition, the financial risks and reputation risks are also determined. Controls that are designed to reduce these risks to acceptable levels are assessed in terms of sufficiency and effectiveness; additional controls are recommended in order to increase effectiveness. Following the risk assessments, the major risks and recommendations are used to update the Bank's risk register and regularly reported to the Bank Risk Management Committee and the Board Audit Committee. Action plans that are taken to reduce the risks to acceptable levels are monitored.

(a) Strategy in Using Financial Instruments

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-debt government and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate movements. The Bank can only intervene in the foreign exchange market when there are sharp exchange rate movements which are likely to destabilize the financial market.

In view of the Bank's reserve management policy of safe investment, liquidity and return, respectively, the Bank, with a prudent approach, subjects its foreign exchange reserves to investments in international markets.

In this framework, almost all the financial risks to which the Bank is exposed arise while fulfilling its duties of managing foreign exchange reserves and rendering certain banking services to the banking sector and the Government of the Republic of Kenya.

The Bank is exposed to credit, market and liquidity risks due to the aforementioned operations. The financial risks that arise during the management of foreign exchange reserves are the outcome of an investment choice. Nevertheless, the Bank endeavours to minimize such risks by managing them with a conservative approach.

Foreign exchange reserves are managed by observing the investment criteria defined in the Bank's Guidelines on Foreign Exchange Reserves Management.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(a) Risks facing the Bank

The following are the main types of risks that the Bank is exposed to in the course of executing its operations:

- Financial risks include:
  - Credit risk
  - Market risk:
    - Interest risk
    - Foreign currency exchange risk
  - Liquidity risk
- Non financial risks include:
  - Operational risk
  - Human resource risk
  - Legal risk
  - Reputation risk

(i) Financial risks

Credit risk

During its financial operations, the Bank is exposed to credit risk, defined as the probability of a complete or partial failure of counterparty to fulfil its obligations arising from a financial transaction. The credit risk basically originates from the investments made of deposit placements, if on their maturity the depository bank is unable to pay.

The management of the credit risk that the Bank is exposed to during the foreign exchange reserve management is based on the principle of minimizing default probabilities of the counterparties and the financial loss in case of default. The choice of depository banks for deposit placements is a crucial consideration in credit and sovereign risk management. Currently, the Bank's choice of depository banks is confined to the top 200 international banks that meet the set eligibility criteria of financial soundness on long-term credit rating, short-term credit rating, composite rating and capital adequacy. The current active approved depository banks holding the Bank's deposits number twenty one (21) and their performance is reviewed periodically, based on performance ratings provided by international rating agency, Fitch IBCA. Deposit placement limits are allocated to individual banks based on their financial strength, and no individual bank holds more than 10% of the entire deposit portfolio.

To minimize the sovereign risk exposure, the eligible banks are distributed among 10 countries under the following set criteria; long-term credit rating of A+, short-term credit rating of F1, composite rating of B and BIS capital adequacy ratio of 8%.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Credit risk - continued

Analysis of staff loans and advances, Due from Government loan and Government overdraft):

	2011 KShs million	2010 KShs million
Individually impaired:		
Staff loans	42	49
Banks in liquidation	3,706	3,766
	3,748	3,815
Allowance for impairment	(3,725)	(3,784)
	23	**31**
Loans past due but not impaired:		
Past due upto 30 days	32,380	33,102
Past due 31 – 60 days	-	-
Past due 61 – 90 days	-	-
Past due 91 – 150 days	-	-
	32,380	**33,102**
Loans neither past due nor impaired:		
Staff loans and advances	3,175	2,752
Overnight lending to commercial banks	19,873	-
IMF on let to the Goverment	-	241
Goverment Overdraft	7,571	17,649
	30,619	**20,642**

The Bank undertakes its operations in the Republic of Kenya. An analysis of the Bank's assets and liabilities by geographical area is given below: The banks exposure to credit risk is analysed as follows:

	2011 KShs Millions	2010 KShs Millions
Assets		
Republic of Kenya	79,331	65,748
United Kingdom	75,503	189,088
Rest of Europe	82,717	2,310
United states of America	209,025	116,243
Rest of the World	40	533
	446,616	**373,922**
Liabilities		
Republic of Kenya	**446,616**	**373,922**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest 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.

As at 30 June 2011	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings		362,655	334	-	5,846	368,835
	0.21-1.18%					
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	2,731	-	2,731
Items in the course of collection	-	-	-	-	409	409
Advances to Banks	-	49	-	-	-	49
Loans and advances	3%	19,984	333	10,325	-	30,642
Other assets	-	-	-	-	5,385	5,385
Property, plant and equipment	-	-	-	-	2,849	2,849
Prepaid leasehold land	-	-	-	-	268	268
Intangible assets	-	-	-	-	1,171	1,171
Retirement benefit asset	-	-	-	-	1,897	1,897
Due from Government of Kenya	3%	1,271	1,110	29,999	-	32,380
Total assets		**383,959**	**1,777**	**43,055**	**17,825**	**446,616**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk - continued

As at 30 June 2011		3 months	Between	Over 1 year	Non-interest	Total
		or less	3-12 months		bearing	
	Interest rate	KShs million	KShs million	KShs million	KShs million	KShs million
Liabilities and equity						
Currency in circulation		-	-	-	147,718	147,718
	-					
Deposits	-	-	-	-	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829
Other liabilities	-	-	-	-	9,447	9,447
Provisions	-	-	-	-	98	98
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	69,091	69,091
Total liabilities and equity		**-**	**-**	**-**	**446,616**	**446,616**
Interest sensitivity gap 2011		**383,959**	**1,777**	**43,055**	**-428,791**	**-**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

As at 30 June 2010	**Interest rate**	**3 months or less** KShs million	**Between 3-12 months** KShs million	**Over 1 year** KShs million	**Non-interest bearing** KShs million	**Total** KShs million
Assets						
Balances due from banking institutions and gold holdings	0.36-0.54%	277,283	348	-	7,051	284,682
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	26,272	-	26,272
Items in the course of collection	-	-	-	-	316	316
Advances to Banks	-	31	-	-	-	31
Loans and advances	3%	74	241	20,359	-	20,674
Other assets	-	-	-	-	4,802	4,802
Property, plant and equipment	-	-	-	-	1,024	1,024
Prepaid leasehold land	-	-	-	-	272	272
Intangible assets	-	-	-	-	853	853
Retirement benefit asset	-	-	-	-	1,894	1,894
Due from Government of Kenya	3%	883	1,110	31,109	-	33,102
Total assets		**278,271**	**1,699**	**77,740**	**16,212**	**373,922**
Liabilities and equity						
Currency in circulation	-	-	-	-	125,024	125,024
Deposits	-	-	-	-	143,228	143,228
Amounts due to International Monetary Fund	-	-	-	-	63,276	63,276
Other liabilities	-	-	-	-	9,474	9,474
Provisions	-	-	-	-	113	113
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	30,166	30,166
Total liabilities and equity		**-**	**-**	**-**	**373,922**	**373,922**
Interest sensitivity gap 2010		**278,271**	**1,699**	**77,740**	**-357,710**	**-**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Sensitivity analysis on interest rate risk

The Bank uses models to assess the impact of possible changes in market risks. These risks include interest rate risk and foreign exchange risk.

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. The Bank bases its analysis on the interest sensitivity gap (Note 31(c). The sensitivity computations assume that financial assets maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	2011 KShs million	**2010 KShs million**
Effect on profit before tax of a +10% change in interest rates	621	324
Effect on profit before tax of a -10% change in interest rates	(621)	(324)

Foreign currency exchange rate risk

Foreign currency exchange rate risk signifies the probability of incurring a loss stemming from adverse market movements, usually in interest rates, currency exchange rates and asset prices.

For the purpose of managing foreign currency exchange rate risk, the Bank holds a diversified portfolio that spreads over the major world currencies with the following features; stability, widely traded, international acceptability and offering the best range of investment instruments. Guided by these features and the need to minimize transaction costs in external payments, the Bank invests its reserves in four key international currencies, namely, US dollar (USD), British pound (GBP), Euro (EUR) and the Swiss Franc (CHF).

The distribution of these currencies in the portfolio is subject to review from time to time. However, to allow for flexibility in portfolio management, the mix benchmarks are allowed +5% within the following ranges:

USD: 40 - 50%
GDP: 25 - 35%
EUR: 20 - 30%
CHF: 0 - 5%

The net foreign currency position of the Bank as of 30 June 2011 and 2010 is summarized below. The table presented below provides the Bank's assets, and liabilities, at carrying amounts, categorized by currency.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

The various currencies to which the Bank is exposed at 30 June 2011 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	167,589	95,438	105,643	-	-	92	368,762
Special Drawing Rights	-	-	-	2,731	-	-	2,731
Gold holdings	-	-	-	-	76	-	76
Total assets	167,589	95,438	105,643	2,731	76	92	371,569
Liabilities							
Balances due to IMF	-	-	-	81,829	-	-	81,829
Commissions for EEC Development Fund	-	-	-	-	-	-	-
Local Banks forex settlements	3,698	501	930	-	-	-	5,129
Local bank guarantees	339	-	-	-	-	-	339
Bonds pending payables	1,536	-	-	-	-	-	1,536
Forex bureaux deposits	192	-	-	-	-	-	192
Total liabilities	5,765	501	930	81,829	-	-	89,025
Net statement of financial position at 30 June 2011	**161,824**	**94,937**	**104,713**	**-79,098**	**76**	**92**	**282,544**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued
The various currencies to which the Bank is exposed at 30 June 2010 are summarised below (all expressed in KShs million):

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	137,412	76,279	70,388	-	-	542	284,621
Special Drawing Rights	-	-	-	26,272	-	-	26,272
Gold holdings	-	-	-	-	57	-	57
Total assets	137,412	76,279	70,388	26,272	57	542	310,950
Liabilities							
Amounts due to IMF	-	-	-	63,276	-	-	63,276
Commissions for EEC Development Fund	-	-	-	-	-	-	-
Local Banks forex settlements	2,900	328	441	-	-	-	3,669
Local bank guarantees	488	-	-	-	-	-	488
Bonds pending payable	1,026	-	-	-	-	-	1,026
Forex bureaux deposits	180	-	-	-	-	-	180
Total liabilities	4,594	328	441	63,276	-	-	68,639
Net statement of financial position at 30 June 2010	**132,818**	**75,951**	**69,947**	**-37,004**	**57**	**542**	**242,311**

Sensitivity analysis on currency risk
Currency risk is the risk of loss resulting from changes in exchange rates. The Bank bases its analysis on the interest sensitivity gap (Note 30). The Bank has assets and liabilities in various currencies; however, the most significant exposure arises from assets denominated in the US dollar, GBP and Euro currencies. The following table demonstrates the sensitivity to reasonably possible change in the KShs/ US dollar exchange rate, with all other variables held constant, of the Bank's profit earned.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

	2011 KShs million	2010 KShs million
Effect on profit before tax of a +7% change in exchange rates	19,778	16,962
Effect on profit before tax of a -7% change in exchange rates	(19,778)	(16,962)

Liquidity risk

Liquidity risk is defined as not having sufficient cash to meet the commitments that are due or being compelled to convert assets into cash at a price lower than their fair value. The choice of the types of instruments to invest the reserves in is part of liquidity risk management. The available instruments are governed by Section 26 of the Central Bank of Kenya Act which specifies the eligible instruments in which the Bank can invest its reserves including; gold, demand or time deposits and convertible and marketable securities of or, guaranteed by foreign governments or international financial institutions.

In order to manage liquidity risk, the Bank invests its surplus reserves in time deposits with maturities concentrated in short-term maturity span of one to three months. The portfolio is structured in such a manner that a mix of deposits matures every week to ensure availability of funds to meet scheduled government and the Bank's obligations.

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2011 to the contractual maturity date.

	On	Due within	Due between	Due between	Due after	
	demand	3 months	3-12 months	1-5yrs	5 years	Total
LIABILITIES	**KShs million**	**KShs million**	**KShs million**	**KShs million**	**KShs million**	**KShs million**
Currency in circulation	-		-		147,718	147,718
Deposits	129,946	-	5,846		-	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829
Other liabilities	-	-	9,447		-	9,447
Provisions		-	98	-	-	98
Dividends payable	-	980	1,661	-	-	2,641
TOTAL LIABILITIES	129,946	980	17,052	-	229,547	377,525
Liquidity gap 2011	**-129,946**	**-980**	**-17,052**	**-**	**-229,547**	**-377,525**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2010 to the contractual maturity date.

	On	Due within	Due between	Due between	Due after	
	Demand	3 months	3-12 months	1-5yrs	5 years	Total
LIABILITIES	KShs million	KShs million	KShs million	KShs million	KShs million	KShs million
Currency in circulation			-	-	125,024	125,024
Deposits	136,177		7,051	-	-	143,228
Amounts due to International Monetary Fund			241	1,535	61,500	63,276
Other liabilities		-	9,474	-	-	9,474
Provisions		-	113	-	-	113
Dividends payable	-	-	2,641	-	-	2,641
TOTAL LIABILITIES	136,177	-	19,520	1,535	186,524	343,756
Liquidity gap 2010	**-136,177**	**-**	**-19,520**	**-1,535**	**-186,524**	**-343,756**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Non-financial risks

Operational risk
Operational risk is the risk of loss due to human or system errors, incompatibility or failure of internal business processes, or external events. The Bank seeks to minimize losses from operational risk by establishing effective internal control systems which prevent or detect all errors and situations which might cause loss through failure of people or processes in such a way that losses are avoided or reduced to the minimum possible extent. The Bank has assigned the responsibility for managing operational risks to the management of the departments.
The assessment of risks in terms of their effects and probabilities of occurrence and the adequacy, effectiveness and efficiency of the controls established to mitigate the risks is done vide audits and risk assessments conducted by the Internal Audit and Risk Management Department(IARM).

Human Resource risk
The particular nature of the activities of the Bank necessitates specialized knowledge in many areas.

The Bank ensures that there is an adequate knowledge base for all specialized job requirements by investing significantly in human resource development in terms of capacity building and practical exposure. The Bank also organizes workshops, seminars, conferences and job attachments to its staff as an effort to improve its human resource requirements.

Legal risk
Legal risks arise from any uncertainty of enforceability, whether through legal or judicial processes, of the obligations of the Bank's clients and counter parties. These are the risks that the Bank may not be complying fully with the relevant laws and legislations. The Bank aims at minimizing such uncertainties through continuous consultations with all relevant parties.
In mitigating these types of the risks, the Bank ensures that all business agreements are subjected to extensive legal reviews before contracting.

Reputation risk
The concern about reputation flows from the fact that the Bank is a public institution with important responsibilities for stability in the value of money, the soundness and efficiency of the financial system and the issue of currency (notes and coins). All of these matters have direct impact on all citizens and the credibility and the reputation of the Bank is an important factor in the successful fulfilment of these responsibilities.

In managing this risk, the Bank adheres to the best practices and applies principles of sound corporate governance. It also ensures that all key staff has a clear understanding of the appropriate processes in respect of the best practice and principles of good corporate governance.

The Bank therefore, sets out policies and guidelines that govern sound functional operations within the Bank. The performance of these policies and guidelines are periodically reported to different levels of the Bank's Management for Control and Compliance Monitoring.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

32 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 liabilities approximate their respective carrying amounts. Fair values are based on discounted cash flows using a discount rate based on the borrowing rate that directors expect would be available to the Bank at the reporting date.

The table below sets out the carrying amounts of each class of financial assets and liabilities, and their fair values:

30 June 2011:	**Held for trading KShs million**	**Held-to-maturity KShs million**	**Loans and receivables KShs million**	**Available-for-sale KShs million**	**Other amortised cost KShs million**	**Total carrying amount KShs million**	**Fair value KShs million**
Assets							
Balances due from banking institutions and Gold holdings	37,734	316,967	14,134	-	-	368,835	368,835
Funds held at International Monetary Fund	-	-	2,731	-	-	2,731	2,731
Items in the course of collection	-	-	409	-	-	409	409
Advances to Banks	-	-	49	-	-	49	49
Loans and advances	-	-	30,642	-	-	30,642	30,642
Other assets	-	-	-	-	5,385	5,385	5,385
Due from Government of Kenya	-	-	32,380	-	-	32,380	32,380
Total assets	**37,734**	**316,967**	**80,345**	**-**	**5,385**	**440,431**	**440,431**
Liabilities							
Currency in circulation	-	-	-	-	147,718	147,718	147,718
Deposits	-	-	-	-	135,792	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829	81,829
Other liabilities and provisions	-	-	-	-	9,545	9,545	9,545
Total liabilities	**-**	**-**	**-**	**-**	**374,884**	**374,884**	**374,884**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

32 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES (Continued)

30 June 2010:	Held for trading KShs million	Held-to - maturity KShs million	Loans and receivables KShs million	Available-for-sale KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Assets							
Balances due from banking institutions and Gold holdings	33,515	235,459	15,708	-	-	284,682	284,682
Funds held at International Monetary Fund	-	-	26,272	-	-	26,272	26,272
Items in the course of collection	-	-	316	-	-	316	316
Advances to Banks	-	-	31	-	-	31	31
Loans and advances	-	-	20,674	-	-	20,674	20,674
Other assets	-	-	-	-	4,802	4,802	4,802
Due from Government of Kenya	-	-	33,102	-	-	33,102	33,102
Total assets	**33,515**	**235,459**	**96,103**	**-**	**4,802**	**369,879**	**369,879**
Liabilities							
Currency in circulation	-	-	-	-	125,024	125,024	125,024
Deposits	-	-	-	-	143,228	143,228	143,228
Amounts due to International Monetary Fund	-	-	-	-	63,276	63,276	63,276
Other liabilities and provisions	-	-	-	-	9,587	9,587	9,587
Total liabilities	**-**	**-**	**-**	**-**	**341,115**	**341,115**	**341,115**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

32 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES (Continued)

Valuation hierarchy

The valuation hierarchy, and types of instruments classified into each level within that hierarchy, is set out below:

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted prices in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs	Valuation models using significant non-market observable inputs
Types of financial assets:	Actively traded government and other agency securities Listed derivative instruments Listed equities	Corporate and other government bonds and loans Over-the-counter (OTC) derivatives	Highly structured OTC derivatives with unobservable parameters Corporate bonds in illiquid markets
Types of financial liabilities:	Listed derivative instruments	Over-the-counter (OTC) derivatives	Highly structured OTC derivatives with unobservable parameters

The table below shows the classification of financial instruments held at fair value into the valuation hierarchy set out below as at 30 June 2011:

30 June 2011:	Level 1 KShs million	Level 2 KShs million	Level 3 KShs million	Total KShs million
Assets				
Balances due from banking institutions and Gold holdings	368,835	-	-	368,835
Other assets	-	5,381	-	5,381
Total assets	**368,835**	**5,381**	**-**	**374,216**

30 June 2010:	Level 1 KShs million	Level 2 KShs million	Level 3 KShs million	Total KShs million
Assets				
Balances due from banking institutions and Gold holdings	284,682	-	-	284,682
Other assets	-	5,141	-	5,141
Total assets	**284,682**	**5,141**	**-**	**289,823**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011 (continued)

32 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES (Continued)

The effective interest rates for the principal financial assets and liabilities at 30 June 2011 and 2010 were in the following ranges:

	2011	2010
Assets		
Government securities	6.00%	6.64%
Deposits with overseas correspondent banks		
- current accounts		
- term deposits (USD)	0.21%	0.36%
- term deposits (Sterling Pounds)	0.71%	0.48%
- term deposits (Euro)F	1.18%	0.54%
Loans and advances - commercial banks	6.50%	6.50%
- Government of Kenya	3.0%	3.0%
- employees	3.0%	3.0%
Due from Government of Kenya		
Liabilities	0.0%	0.0%
- deposits	0.36%	0.36%

33 CONTINGENCIES

The Bank is party to various legal proceedings with potential liability of KShs 266.5 million as at 30 June 2011 (2010- KShs 496.8 million). Having regard to all circumstances and the legal advice received, the directors are of the opinion that these legal proceedings will not give rise to liabilities.

34 COMMITMENTS

	2011 KShs million	2010 KShs million
Capital: Authorised and not contracted for		
Office furniture	1	1
Office equipment	26	6
Computer equipment	27	3
Computer equipment - SIMBA Software	4	-
Computer equipment - SIMBA Hardware	-	164
Fixtures & fittings	1	-
Motor vehicles	31	4
Others	64	15
	154	**193**

35 OPERATING LEASE COMMITMENTS

AS LESSEE:

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

	2011 KShs million	2010 KShs million
One year	2	2
Between two and five years	9	10
Over five years	174	180
	185	**192**

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

36 IMPACT OF CHANGE IN ACCOUNTING POLICY

During the year, the Bank adopted the requirements of IAS 39 by fair valuing the staff loans and advances granted at low interest rates. The impact of this is presented within the financial statements under the following line items:

	2011 KShs million	2010 KShs million
Other assets – Prepayments and sundry debtors	**2,161**	**2,340**
Other liabilities – Long term employee benefit	**2,161**	**2,340**
Interest income	**179**	**Nil**
Staff costs	**179**	**Nil**

37 TAXES

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.