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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 2009/10. 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, 2010.

Njuguna Ndung'u

Governor

PREFACE

The world economy declined by 0.6 percent in 2009 compared with 3 percent growth in 2008. The decline occurred in the context of the global financial crisis in the last quarter of 2008 that transformed into economic recession in 2009. The global financial crisis had adversely impacted consumer and business confidence. According to countries categorized in terms of level of economic development, the decline in global output reflected in a decline for advanced economies and a sharp reduction for emerging and developing economies. Going forward the world economy is projected to recover to about 4.5 percent growth in 2010 on account of stronger output performance in the first half of the year. The robust performance reflects an annualized growth rate of over 5 percent recorded in the first quarter of 2010.

On the domestic scene, gross domestic output (GDP) recovered to 2.6 percent growth in 2009 from 1.6 percent growth in 2008. The recovery remained fragile compared to 7 percent growth in 2007 and was driven by the services sectors including tourism, transport and communications and building and construction, and a modest improvement in agriculture. The growth momentum is projected to accelerate in 2010, largely impacted by good weather (that began towards the end of 2009 through June 2010) and from the fiscal stimulus spending and accommodative monetary policy that targets to support private sector activities. During the first quarter of 2010 real GDP growth was robust at 4.4 percent. The real GDP growth is projected to accelerate to 4.5 percent in 2010.

Available economic indicators underscore stable macroeconomic conditions during fiscal year 2009/10.

- The Central Bank of Kenya focused monetary policy during fiscal year 2009/10 towards providing low and stable inflation. Inflation declined gradually during the year on account of good weather conditions and lower crude oil prices compared with the pre-crisis (1988) levels. The twelve month inflation declined from 8.6 percent in June 2009 to 3.5 percent in June 2010. Similarly, the annual average overall inflation declined from 15.1 percent to 5.4 percent over the same period.
- Money supply targets were generally exceeded consistent with the monetary stimulus provided by the Central Bank of Kenya. Following an accommodative monetary policy guided by reduction in the policy rate the banking sector increased credit to the Government and private sectors. While the borrowing programme for Government was achieved credit expansion to the private sector was below both the previous year's growth rate and the target growth for the year to June 2010.
- All short term interest rates declined during the year following a 100 basis points reduction in the Central Bank of Kenya policy rate, the Central Bank Rate (CBR). In particular, the reduction in the Treasury bills interest rates enabled Government continued access of domestic funds at a lower cost. Interest rates on longer dated Government Treasury bonds also declined which enabled Government to finance infrastructure projects from domestic sources at low cost. Average lending rates on bank credit to the private sector declined but by less than proportionately to the short term rates, thereby leading to wider spread.
- The Kenya shilling depreciated by 4.1 percent in the year to June 2010 to Ksh 81 to the US Dollar from Ksh 77.9 to the US Dollar in June 2009. The depreciation reflected developments

in the international currency market, and in particular the effect of the Greek debt crisis. In the East African Community, the Kenya Shilling strengthened marginally against the Tanzania and Uganda Shillings.

The Government pursued prudent fiscal policy consistent with the prevailing economic conditions. While tax revenues fell short of target on account of slower than envisaged expansion in economic activity, Government expenditures were within targets on account of slower absorption rates especially with respect to foreign financed projects. Meanwhile, the share of development expenditure in the total Government expenditure increased consistent with Government's objective of allocating more resources to infrastructure development in order to lay the foundation for high economic growth as underlined under Vision 2030. The Government pursued a debt management strategy to access domestic credit at minimal cost and to support development of a well functioning domestic financial market. While public debt stock increased by 16.2 percent to Ksh 1225.1 billion in the year to June 2010, its share in GDP increased marginally to 49.5 percent. The domestic component of the public debt stock dominated, with its share in GDP increasing from 23.1 percent in June 2009 to 26.6 percent in June 2010.

The balance of payments outturn improved from an overall deficit of US $ 422 million in the year to June 2009 to surplus of US £ 276 million in the year to June 2010. The improvement was largely in the current account and in particular the net inflow from non-factor services (mainly tourism, transport and financial services). The Central Bank of Kenya increased its holding of foreign exchange reserves to about the statutory minimum of 4 months imports of goods and non factor services (at 3.9 months in June 2010 from 3.6 percent by June 2009). The sources of foreign exchange reserves have included the Special Allocation of SDR by the IMF in August and September 2009 and purchases from the interbank market for the purpose of reserves accumulation.

The banking sector was stable and maintained capital and liquidity ratios above the minimum statutory requirements. The consolidated position for all commercial banks and non bank financial institutions, reflect 41.9 percent increase in profitability in the year to June 2010. Credit risk declined with non-performing loans down by 7.9 percent, while the ratio of gross non-performing loans to total loans improved. The overall performance for commercial banks and non bank financial institutions was rated strong during the year. However, the Central Bank of Kenya recorded a loss of KSh 1,639 million (inclusive of foreign currency translation losses amounting to KSh 1,247 million occasioned by appreciation of the Kenya Shilling against hard currencies during part of the financial year relative to the exchange rates at the end of last financial year). This is in comparison to a profit of KSh 23,229 million in 2009 (that was also inclusive of foreign currency translation gain of KSh 13,462 million and proceeds amounting to KSh 3,141 million from sale of the former Grand Regency Hotel). This subdued performance over the previous year is also attributed to decline in interest rates for the Bank's USA Dollar, Sterling Pounds and Euro term deposits, from an average of more than 2 percent in 2009 to an average of under 0.5 percent in 2010 owing to the ongoing World economic turbulence. This drop in interest rates contributed substantially to a 65 percent fall in interest income in the year under review.

UTANGULIZI

Uchumi wa dunia uliporomoka kwa asilimia 0.6 mwaka 2009 ikilinganishwa na kiwango cha ukuaji cha asilimia 3 mwaka 2008. Kuporomoka kwa uchumi huo kulitokea na mtikisiko wa fedha katika robo ya mwisho wa mwaka 2008 ambao ulisababisha mdororo wa uchumi katika mwaka 2009. Hali hii iliathiri ununuzi na imani katika uwekezaji.

Kwa mjibu wa orodha ya nchi zilizo katika kiwango cha maendeleo ya uchumi, kuporomoka huko kwa uzalishaji duniani, kuliathiri mataifa yaliostawi kiuchumi na hata kudhoofisha uchumi wa nchi zenye uchumi unaoimarika. Makadirio ya hivi sasa yanaonyesha kuwa uchumi wa dunia utastawi kwa asilimia 4.5 katika mwaka 2010 kutokana na kuongezeka kwa shughuli za uzalishaji katika kipindi cha kwanza cha mwaka huu. Ukuaji huo wa kasi unaonyesha kuwa uchumi wa dunia ulikuwa kwa asilimia zaidi 5 katika robo ya kwanza ya mwaka 2010.

Hapa nchini, pato la ndani ya nchi liliongezeka kwa asilimia 2.6 mwaka 2009 kutoka asilimia 1.6 mwaka 2008. Hata hivyo ukuaji wa uchumi umesalia kuyumba ikilinganishwa na ukuaji wa asilimia 7 wa mawaka 2007 uliosababishwa na ukuaji wa sekta za huduma ikiwemo utalii, uchukuzi na mawasiliano, ujenzi, pia sekta ya kilimo iliimarika kwa kwa kiwango cha kuridhisha. Kiwango cha ukuaji huu kinatarajiwa kuendelea kuongezeka mwaka 2010 kutokana na hali nzuri ya hali ya hewa (iliyoanza kushuhudiwa mwishoni mwa mwaka 2009 hadi Juni 2010), na kutokana na nyongeza ya fedha ambazo serikali imeongeza na pia sera za usimamizi wa matumizi ya fedha ambazo zililenga kusaidia shughuli za sekta binafsi nchini. Katika kipindi cha robo ya kwanza ya mwaka 2010 ukuaji wa pato la ndani ulikuwa wa kasi kwa kiwango cha asilimia 4.4. Pato hilo linakadiriwa kuongezeka hadi asilimia 4.5 mwaka 2010.

Vigezo vya uchumi vinavyoashiria kuimarika kwa hali ya uchumi mdogo katika mwaka wa fedha wa 20009/2010 ni vifuatavyo:

- Benki Kuu ya Kenya ililenga kupunguza kiwango cha mfumko wa bei chini ya sera yake ya matumizi ya fedha ya mwaka 2009/10. Mfumko wa bei ulipungua kwa kadri katika kipindi hiki kutokana na hali nzuri ya hewa na kupungua kwa bei ya mafuta ghafi ikilinganishwa na kipindi kilichopita kabla ya mtikisiko wa uchumi (1988). Kiwango cha mfumko wa bei cha miezi 12 kilipungua kutoka asilimia 8.6 mwezi Juni 2009 hadi asilimia 3.5 mwezi Juni 2010. Wakati huo huo kiwango cha wastani cha mfumko wa bei kilipungua kutoka asilimia 15.1 hadi asilimia 5.4 katika kipindi hicho hicho.

- Kwa ujumla malengo ya usambazaji wa fedha yalizidi kiwango kilichotarajiwa kutokana na fedha za ziada zilizotolewa na Benki Kuu ya Kenya. Kufuatia sera za pamoja za fedha, sekta ya benki iliweza kutoa mikopo zaidi kwa serikali na sekta ya kibinafsi. Huku mpango wa serikali wa kuazima pesa ukifanikiwa, nafasi za kukopa pesa kwa sekta binafsi zilipungua katika kipindi cha ukuaji kilichopita na malengo ya ukuaji wa uchumi ya mwaka hadi Juni 2010.

- Viwango vya riba vya muda mfupi vilipungua katika kipindi hiki kufuatia hatua ya Benki Kuu kuvipunguza kwa pointi 100 chini ya sera yake ya viwango vya riba (CBR). Kwa ujumla kushuka kwa viwango vya riba vya hawala za serikali kuliiwezesha serikali kuendelea kupata fedha za ndani kwa thamani ndogo. Viwango vya riba kwa hawala za serikali za muda mrefu pia vilishuka hali iliyoiwezesha serikali kudhamini miradi ya miundo mbinu ndani ya nchini kwa gharama ya chini. Viwango vya mikopo ya wastani kwa sekta ya binafsi ilipungua hata hivyo havikuwiana na viwango muda mfupi na hivyo kusababisha utumiaji zaidi.

- Sarafu ya Kenya ilishuka kwa thamani ya asilimia 4.1 katika kipindi cha mwaka hadi Juni 2010 na kuuzwa kwa shilingi 81 kwa dola ya kimarekani ikilinganishwa na kipindi kama hicho kuanzia Juni 2009 ambapo iliuzwa kwa shilingi 77.9 kwa dola ya kimarekani. Kudorora kwa thamni ya sarafu ya Kenya kulionyesha matukio katika soko la sarafu la kimataifa, hasa athari za msuko suko wa kifedha uliotokana na deni kubwa la Ugiriki. Katika Jumuiya ya Afrika ya Mashariki , sarafu ya kenya iliimarika dhidi sarafu za Tanzania na Uganda.

Serikali ilifuata mwongozo wa umakini katika sera yake ya kifedha kuambatana na hali ya uchumi kwa wakati huo. Huku mapato ya kodi yakipungua chini ya kiwango kilichotarajiwa kutoka na kukua polepole kwa shughuli za kiuchumi, matumizi ya serikali hayakuzidi mapendekezo ya bajeti ya serikali hususan kwa kuzingatia viwango vya ufadhili wa miradi kutoka mataifa ya kigeni. Wakati huo huo, pesa zilizotengwa kwa ajili ya shughuli za miradi ya maendeleo katika matumizi ya jumla ya serikali ziliongezeka sawia na malengo ya serikali ya kuteng rasilimali zaidi kwa ujenzi wa miundo mbinu ili kuweka msingi kwa ajili ya ukuaji wa juu wa uchumi chini ya ruwaza ya 2030 (vision 2030). Serikali iliweka mfumo bora wa kusimamia madeni ili kuweza kupata mikopo ya ndani kwa gharama ya chini hatua ambayo ingewezesha utendaji bora wa soko la ndani la fedha. Huku malimbikizo ya madeni ya umma yakiongezeka kwa asilimia 16.2 hadi shilingi bilioni 1,225.1 katika kipindi cha mwaka hadi Juni 2010, kiwango cha madeni hayi katika pato la ndani kiliongezeka kwa asilimia 49.5. Sehemu ya deni la umma ilidhihirika huku pato lake la ndani likiongezeka kutoka asilimia 23.1 katika kipindi cha mwaka hadi Juni 2009 hadi asilimia 26.6 katika kipindi hadi Juni 2010.

Salio la malipo liliimarika kutoka hasara ya dola za kimarekani 422 katika kipindi cha mwaka hadi Juni 2009 ikilinganishwa na malipo ya ziada ya dola za kimarekani 276 katika kipindi cha mwaka hadi Juni 2010. Haya yamedhihirika katika matumizi ya muda hususan kutokana na mapato ya jumla yaliotokana na sekta kama vile utalii, uchukuzi na huduma za fedha. Benki Kuu ya Kenya iliongeza akiba yake ya pesa za kigeni hadi kipindi cha miezi minne kwa bidhaa zinazoingizwa ndani ya nchi kwa kipindi cha asilimia 3.9 Juni 2010 kutoka kwa asilimia 3.6 Juni 2009.

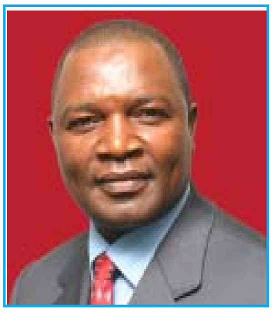
Vianzo vya akiba ya pesa za kigeni vimejumuisha pesa zilizotengwa kwa SDR na shirika la fedha duniani, IMF mnamo mwezi Agosti na Septemba 2009 na ununuaji kutoka benki moja hadi nyingine kwa nia ya kuweka akiba.

Sekta ya benki ilisalia kuwa imara na kuweza kuthibiti viwango vya pesa zinazoingia na kutoka kama kuambatana na masharti. Kwa ujumla mashirika yote ya fedha na benki yaliweza kupata ongezeko la faida la asilimia 41.9 katika kipindi hadi Juni 2010. Hasara kutokana na mikopo isiyolipiwa ilipungua kwa asilimia 7.9, huku kiwango cha mikopo isiyolipiwa ikilinganishwa na mikopo inayoombwa kuimarika. Kutokana na haya mashirika ya fedha na benki yaliweza kuimarisha utendaji kazi wao katika kipindi hiki cha uchumi.

Hata hivyo Benki Kuu ilipata hasara ya shilingi milioni 1,639 (hii ikijumuisha hasara ya mauzo ya fedha za kigeni za thamani ya shilingi 1,247 kutokana na kuimaraka kwa thamani ya sarafu ya Kenya dhidi ya sarafu za kigeni katika kipindi hiki cha uchumi ikilinganishwa na kipindi sawa na hicho katika mwaka wa uchumi uliotangulia). Katika kipindi hicho cha mwaka 2009 Benki Kuu iliweza kupata faida ya shilingi milioni 23,229 (zikijumuisha faida ya shilingi milioni 13,462 ikiwa ni sehemu ya mauzo ya pesa za kigeni na pia fadia iliyotokana na mauzo ya iliyokuwa Hoteli ya Grand Regency kwa thamni ya shilingi milioni 3,141).

Hasara ya mwaka 2010 pia ilitokana na kupungua kwa viwango vya riba vinavyowekwa na Benki katika akaunti za dola ya Kimarekani, Pauni ya Uingereza na Euro kutoka kiwango cha asilimia zaidi ya 2 mwaka 2009 hadi 0.5 mwaka 2010 hali iliyosababishwa na msukosuko wa kiuchumi ilyokumba dunia. Kupungua huku kwa viwango vya riba kulichangia pakubwa kushuka kwa asilimia 65 ya mapato yanayotokana na riba katika kipindi cha uchumi cha mwaka 2010.

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. NYANJUA
Director, Department of Estates, Supplies and Transport

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

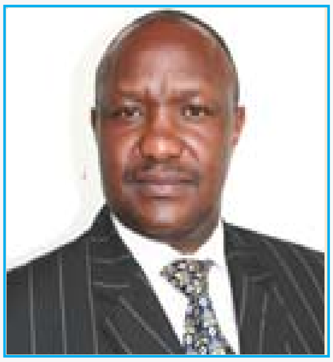
SENIOR MANAGEMENT

MR. GERALD A. NYAOMA
Director, Banking &
National Payment Systems

MR. JACKSON M. KITILI
Director, Monetary Operations
and Debt Management

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

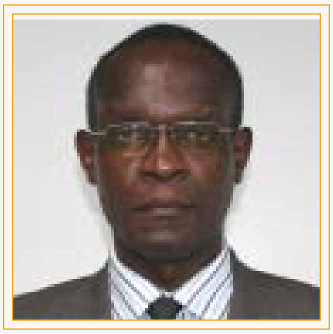
MEMBERS OF THE MONETARY POLICY COMMITTEE

Prof. Njuguna Ndung'u
Governor, Chairman

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

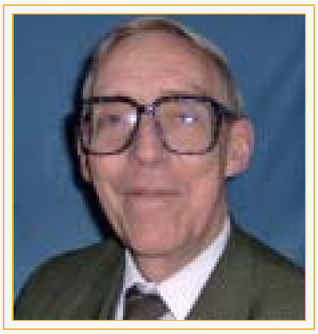
Mr. Joseph K. Kinyua
PS, Treasury
Treasury Representative

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

NEW APPOINTMENTS TO MANAGEMENT

The following new appointments to the Central Bank Senior Management Team were effected during the year under review:

Appointed	Position	Date
Fredrick Parshoyio K. Pere	Director, Bank Supervision	26.08.2009
Cassian Jumma Nyanjwa	Director, Dept of Estates, Supplies &Transport	26.08.2009

The following member of the Central Bank Senior Management Team retired during the year:

Retired

Daniel Macharia Chege - Director, KSMS Business Development and Conferencing.

Launch of Performance Management and Appraisal System (PMAS)

The Bank launched the new Performance Management and Appraisal System on July 1, 2009 following a series of sensitization workshops for Management, appraisers and all members of staff.

Heads of Department PMAS Sign-Off and Commencement of the Cascading Process

The Governor formally signed–off the Performance Management Appraisal System (PMAS) tools for all Heads of Department on April 8, 2010 to mark the official roll-out of the PMAS cascading process in the Bank. This process will focus efforts by all members of staff towards realizing Departmental strategic objectives and by extension, achievement of the Bank's overall strategic objectives and mandates.

CBK Inter-Branches Games

The Bank held its annual Inter-Branches games in Kisumu August 6-8, 2009. The main purpose of this event is to enhance teamwork, sharing of ideas and information and to promote healthy living through sports activities.

Nairobi International Trade Fair (NITF)

In a bid to promote public understanding of it's functions the Bank participated in 2009 Nairobi International Trade Fair held September 28 – October 4, 2009. The theme of the Trade Fair was "*Driving Agri-Business in Attaining Food Efficiency and Vision 2030*".

Kenya Public Service Celebrations Week

The Bank participated in the 2009 Public Service Week celebrations held between October 13-15, 2009 at the KICC grounds. The theme of the event was "*Modernizing Public Service towards realisation of Kenya Vision 2030*". The event was held in all districts in the country and involved ministries, government departments and state corporations. The focus for the Central Bank of Kenya included educating and interaction with members of the public through discussions, exhibitions of products and services, entertainment and distribution of the Bank's service charter and publications to enable the public understand better how the Bank serves them.

CBK Departmental Retreats

The Bank organised Departmental retreats with a view to building solid teams, managing change and enhancing Human Resources Development for effective teamwork and cohesion which is essential to harness and channel the combined staff efforts towards achievement of the Bank's mandate.

The CBK Post Service Medical Scheme (PSMS)

The PSMS Organizing Committee charged with the responsibility of establishing the Scheme has so far achieved the following milestones with the assistance of an actuary:

- Finalized model rules to guide the Proposed Scheme;
- Determined a contribution rate applicable to all members of staff; and
- Designed an Administrative/Governance structure for the Proposed Scheme.

The Committee recently conducted a poll via the intranet, inviting members of staff to choose whether or not they would wish to register in the Proposed Scheme.

Enhanced General Staff Clinic Performance

The Bank reviewed operating hours for the Head Office, Staff Clinic from 8.00 a.m. to 8.00 p.m. Mondays to Fridays and from 8.00 a.m. to 1.00 p.m. Saturdays effective March 1, 2010 to enable staff and their families access medical services after normal working hours, thereby optimizing the utilization of the medical facilities.

To improve on service delivery, the Clinic adopted the Annual Procurement Plan in compliance with the Public Procurement Act. The Bank procured a dental x-ray unit and a mini- vidas analyser for the laboratory and expanded the Clinic's drugs' store.

The Clinic further adopted the Medinous Clinic Management System from May 2010 in line with SIMBA Project.

1. WORLD ECONOMY

The International Monetary Fund's July 2010 update of the World Economic Outlook shows that the global economy declined by 0.6 percent in 2009 compared with 3 percent growth in 2008 (Table 1.1).

Fiscal stimulus measures particularly in the advanced economies were instrumental in stemming the slowdown in real GDP growth in 2009. Private demand remained subdued and did not recover to pre-crisis levels. Weak labor markets and tight credit conditions continued to put a drag on private consumption. In Europe, economic performance was not balanced as fiscal imbalances in some of the smaller European countries posed a challenge. Emerging and developing economies grew by 2.5 percent in 2009 compared with 6.1 percent in 2008. The 2.5 percent growth in emerging and developing economies was not uniform. Resilient domestic demand in Asian economies led to better economic performance compared with other countries in the region. GDP growth in Sub-Saharan Africa moderated to 2.1 percent in 2009 from 5.5 percent in 2008. Economic performance in oil exporting countries was affected by the decline in international oil prices. Growth in some of the countries in the region was also affected through the trade channel.

TABLE 1.1: ACTUAL, PROJECTED OUTPUT OF SELECTED COUNTRIES/ REGIONS 2008 - 2011

Country/Region	2008	2009	2010	2011
Global Output	3.0	-0.6	4.6	4.3
Advanced Economies	0.5	-3.2	2.6	2.4
USA	0.4	-2.4	3.3	2.9
Euro Zone	0.6	-4.1	1.0	1.3
UK	0.5	-4.7	1.2	2.1
Emerging and Developing Economies	6.1	2.5	6.8	6.4
Developing Asia	7.7	6.9	9.2	8.5
China	9.6	8.7	10.5	9.6
India	7.3	5.7	9.4	8.4
Brazil	5.1	-0.2	7.1	4.2
SSA	5.5	2.1	5.0	5.9

Source: IMF World Economic Outlook, April/July 2010

Outlook for 2010 and 2011

Financial stability continues to be a major concern although the potential for financial stress spilling over into real activity is somewhat limited. There are, however, concerns that stress in the financial sector in the advanced economies could spill over into other countries through financial and trade channels.

The recovery of global output is projected to gain momentum in 2010 and 2011. Output in advanced economies is expected to grow by 2.6 percent in 2010 and 2011. High levels of public debt, unemployment and constrained growth in credit in some of these countries pose a challenge to the recovery process. In 2011, output growth in emerging and developing economies is expected at 6.5 percent. Asia leads the recovery in growth driven by strong exports and private domestic demand. Private fixed investment has gained momentum due to higher capacity utilization and low cost of capital. China and India are forecast to grow by 10.5 percent and 9.5 percent in 2010 and by 9.5 percent and 8.5 percent in 2011, respectively. Sub-Saharan Africa is expected to grow by 5 percent and 5.9 percent in 2010 and 2011, respectively.

Capital Flows

Net Capital Flows to Developing Countries

Capital flows to developing countries were constrained by developments in international capital markets. Net capital flows to developing countries declined by 38.9 percent in 2008 to US$ 707 billion from US$ 1,158 billion in 2007. The decline was in private flows which affected all regions in varying degree with the exception of Middle East and North Africa (Table 1.2).

Net Private Capital flows to Developing Countries

TABLE 1.2: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES 2005-2008 (US $ BILLION)

	2005	2006	2007	2008*
Total	**570**	**739**	**1158**	**707**
By region:				
East Asia and Pacific	187	206	281	203
Europe and Central Asia	192	311	472	251
Latin America and the Caribbean	113	85	216	128
Middle East and North Africa	19	25	21	23
South Asia	25	72	113	66
Sub-Saharan Africa	33	40	55	36

* Estimate

Source: Global Development Finance (2009)

Net private capital flows comprise of foreign direct investment and portfolio investment. Net Foreign Direct Investment (FDI) flows to developing countries increased by 12.1 percent in 2008 to US$ 583 billion from US$ 520 billion in 2007 and accounted for about 80 percent of net private capital flows (Table 1.3). FDI investors typically take a long term outlook and therefore FDI related flows are more resilient to shocks than other types of capital flows.

TABLE 1.3: NET FDI INFLOWS TO DEVELOPING COUNTRIES 2005 TO 2008 (US$ Billion)

	2005	2006	2007	2008*
Net private and official flows	**498.7**	**668.3**	**1157.7**	**727.3**
of which:				
Net equity flows	347.2	462.7	658.6	599.0
FDI flows	279.1	358.4	520.0	583.0
Portfolio flows	68.1	104.3	138.6	15.7
Net debt flows	151.5	205.6	499.1	128.3
Official	-71.0	-70.9	0.2	20.4
Private	222.5	276.5	498.9	107.9

* Estimate

Source: Global Development Finance (2009)

Net portfolio equity flows to developing countries decreased from US$ 139 billion in 2007 to US$ 16 billion in 2008. This reflected divestiture by international investors from riskier assets to securities perceived to be safer. Net debt flows to the private sector also declined by 78.4 percent in 2008.

Remittances to Developing Countries

Remittance flows to developing countries remained resilient compared to private capital flows. Remittance transfers through official channels to developing countries declined from US$ 336 billion in 2008 to US$ 316 billion in 2009, by 5.9 percent (Table 1.4) compared with 37.2 percent decline for private capital flows (Table 1.3). Remittance flows to Latin America and the Caribbean region, Eastern Europe and Central Asia, Middle East and North Africa were estimated to have declined by 12 percent, 21 percent and 8 percent, respectively, in 2009. Remittances to Sub-Saharan Africa and South Asia declined by a modest 3 percent and 5 percent, respectively. An analysis by the World Bank shows that the diversity of migration destinations increases the resilience of remittances. Exchange rate movements also induce consumption-investment motives for remittances.

TABLE 1.4: REMITTANCE FLOWS TO DEVELOPING COUNTRIES: 2002-2009 (US$ billion)

	2006	2007	2008	2009*
East Asia & Pacific	58	71	86	86
Europe & Central Asia	37	51	58	46
Latin America & the Caribbean	59	63	64	57
Middle East & North Africa	26	32	35	32
South Asia	43	54	72	75
Sub-Saharan Africa	***13***	***19***	***21***	***21***
Total	**235**	**290**	**336**	**316**

* Estimate

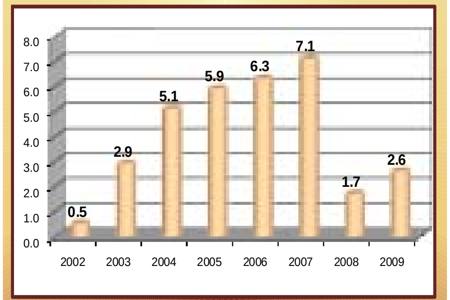
Source: World Bank

DOMESTIC ECONOMY - OVERVIEW

Real GDP for 2009 amounted to Ksh 1.39 trillion or 2.6 percent growth compared to Ksh 1.35 trillion in 2008. The performance by sectors was, however, mixed. The services sectors continued to drive economic growth in 2009 with the tourism sector, the transport and communication sector and the building and construction sector recording the most significant growth rates at 42.8 percent, 6.4 percent and 14.1 percent, respectively. Despite agriculture remaining a major contributor to GDP in 2009 at 24.4 percent, it expanded marginally from -4.1 percent in 2008 to -2.6 percent in 2009, owing to the persistent drought in 2009.

The growth momentum was sustained in the first quarter of 2010 with 4.4 percent growth compared with 5.6 percent growth in the first quarter of 2009. The continuing recovery is attributed to, among other factors, the rainfall experienced towards the end of 2009 through 2010, which impacted positively on agriculture and electricity generation. Agriculture, for example, grew by 4.6 percent in the first quarter of 2010 compared with a decline of 1.1 percent experienced in the first quarter of 2009. Other sectors which expanded during the first quarter of 2010 included the manufacturing sector, the mining and quarrying sector, the wholesale and retail sector and the financial intermediation sector which grew respectively by 7.8 percent, 9.0 percent, 3.7 percent and 11.9 percent.

CHART 2A: REAL GDP GROWTH RATES, 2002 - 2009 (%)



Sources: Economic Survey & Central Bank of Kenya

The economy grew by 2.6 percent in 2009 compared with a revised growth of 1.6 percent in 2008 (Chart 2A). The recovery was weak in 2009 compared with the 7.0 percent growth in 2007, but modest compared with the drop to a 5 year low performance in 2008. Tourism, which was most affected bounced back in 2009 recording a growth rate of 42.8 percent from a decline of 36.1 percent in 2008. Similarly, agriculture recovered in 2009 despite the drought, with the margin of decline improving from -4.1 percent in 2008 to -2.6 percent. In the first quarter of 2010, the economy grew by 4.4 percent, a slower pace compared with a growth of 5.6 percent in the first quarter of 2009. This slower growth was largely attributed to over-reliance on the costly thermal- generated electricity among other reasons, which was reflected by a decline of 2.1 percent in the electricity and water supply sector due to drought in 2009. Growth during the quarter was driven by agriculture, mining and quarrying, manufacturing, wholesale and retail and the financial sectors which expanded by 4.6 percent, 9.0 percent, 7.8 percent, 3.7 percent and 11.9 percent, respectively, compared with -1.1 percent, -11.9 percent, 5.0 percent, -2.6 percent and 2.1 percent in the first quarter of 2008. Total output during the first quarter of 2010 amounted to Ksh 356.6 billion.

TABLE 2.1: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES

MAIN SECTORS	Share in 2009 Nominal GDP (%)	Share in 2009 Real GDP (%)	2004	2005	2006	2007	2008	*2009
Agriculture and Forestry	24.4	21.50	280,518	299,798	312,926	320,423	307,356	299,449
Fishing	0.40	0.41	5,246	5,751	6,249	6,181	5,363	5,761
Mining	0.50	0.44	5,195	5,334	5,554	6,272	6,453	6,179
Manufacturing	9.50	9.91	110,544	115,699	122,953	130,673	135,291	138,003
Electricity and water supply	2.40	2.20	27,877	27,862	27,492	30,002	31,617	30,631
Wholesale and retail trade, repairs	10.00	10.06	100,486	106,095	118,361	131,754	138,051	140,096
Hotels & Restaurants	1.70	1.36	13,741	15,572	17,895	20,814	13,298	18,993
Construction	4.40	3.58	32,932	35,401	37,648	40,405	43,735	49,893
Transport, Storage & Communications	9.80	12.36	112,260	122,316	136,306	156,845	161,699	172,096
Financial intermediation	5.70	3.88	42,657	45,030	47,170	50,306	51,659	54,043
Real estate, renting and business services	5.10	5.43	63,740	65,882	68,446	70,860	73,503	75,674
Public administration and defense	4.50	3.29	47,062	46,460	45,722	44,791	45,080	45,804
Education	6.00	5.95	72,435	72,963	73,152	76,220	80,732	82,912
Health and social work	2.70	2.26	26,408	27,249	28,146	29,053	30,106	31,428
Other community, social and personal services	3.60	3.81	44,514	45,829	47,815	49,419	50,841	53,103
Private households with employed persons	0.40	0.31	3,932	4,011	4,091	4,173	4,256	4,342
Less : Financial services indirectly measured	-1.20	-0.92	-10,800	-11,261	-11,835	-12,174	-10,484	-12,762
All industries at basic 2001 prices	90.10	85.84	978,746	1,029,991	1,088,091	1,156,017	1,168,556	1,195,645
Taxes less subsidies on products	9.90	14.16	130,795	145,143	161,367	180,855	189,083	197,187
Real GDP at 2001 market prices	100.00	100.00	1,109,541	1,175,134	1,249,458	1,336,872	1,357,639	1,392,832
GDP at Mkt Prices			1,109,541	1,175,134	1,249,458	1,336,872	1,357,639	1,392,832
Overall GDP Deflator			115	120	130	137	153	163

Growth Rates in percent

	Share in 2009 Nominal	Share in Real GDP in 2009 (%)	2004	2005	2006	2007	2008	*2009
Agriculture and Forestry	24.4	21.50	1.6	6.9	4.4	2.4	(4.1)	(2.6)
Fishing	0.40	0.41	10.1	9.6	8.7	-1.1	(13.2)	7.4
Mining & Quarrying	0.50	0.44	-0.3	2.7	4.1	12.9	2.9	(4.2)
Manufacturing	9.50	9.91	4.5	4.7	6.3	6.3	3.5	2.0
Electricity and water supply	2.40	2.20	3.0	-0.1	-1.3	9.1	5.4	(3.1)
Wholesale and retail trade, repairs	10.00	10.06	8.5	5.6	11.6	11.3	4.8	1.5
Hotels & Restaurants	1.70	1.36	38.8	13.3	14.9	16.3	(36.1)	42.8
Building & Construction	4.40	3.58	4.4	7.5	6.3	7.3	8.2	14.1
Transport & Communications	9.80	12.36	7.0	9.0	11.4	15.1	3.1	6.4
Financial intermediation	5.70	3.88	1.4	5.6	4.8	6.6	2.7	4.6
Real estate, renting and business services	5.10	5.43	3.0	3.4	3.9	3.5	3.7	3.0
Public administration and defense	4.50	3.29	0.2	-1.3	-1.6	-2.0	0.6	1.6
Education	6.00	5.95	2.0	0.7	0.3	4.2	5.9	2.7
Health and social work	2.70	2.26	3.8	3.2	3.3	3.2	3.6	4.4
Other community, social and personal services	3.60	3.81	3.7	3.0	4.3	3.4	2.9	4.4
Private households with employed persons	0.40	0.31	2.0	2.0	2.0	2.0	2.0	2.0
Less : Financial services indirectly measured	-1.20	-0.92	4.7	4.3	5.1	2.9	(13.9)	21.7
Total GDP at basic 2001 prices	90.10	85.84	3.9	5.2	5.6	6.2	1.1	2.3
Taxes less subsidies on products	9.90	14.16	14.8	11.0	11.2	12.1	4.5	4.3
Real GDP at 2001 market prices	100.00	100.00	5.1	5.9	6.3	7.0	1.6	2.6

* Provisional

Sources: Economic Survey 2010

AGRICULTURE

Agriculture's contribution to GDP increased from 23.4 percent in 2008 to 24.4 percent in 2009 (Table 2.1). However, the sector's performance declined in 2009 with a smaller margin of 2.6 percent compared with -4.1 percent in 2008. Reflecting the good rainfall from the end of 2009 through early 2010, agriculture's performance improved to 4.6 percent growth in January - March 2010 quarter compared with -1.1 percent in the same quarter in 2009. Despite the overall increase in agricultural output, the sector still recorded mixed performances across activities with some cash crops performing better than others on account of rainfall distribution.

TABLE 2.2: 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
Tea						
Output (MT)	321,440	295,791	375,226	328,216	327,713	387,922
Output Growth %	0.19%	-8.07%	25.24%	-11.89%	-0.15%	18.37%
Horticulture						
Output (MT)	167,371	186,356	218,848	281,039	245,618	248,664
Output Growth %	-1.28%	11.34%	17.44%	28.42%	-12.60%	1.24%
Coffee						
Output (MT)	51,136	47,995	50,899	39,842	53,701	34,651
Output Growth %	-9.77%	-7.14%	12.58%	-30.82%	34.78%	-35.47%
Sugarcane						
Output (MT)	4,751,432	4,953,329	4,953,167	5,228,645	5,355,771	5,382,888
Output Growth %	3.73%	8.52%	0.88%	2.83%	2.43%	0.51%

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

The amount of processed tea increased by 18.4 percent in July-June 2009/10 over 2008/09 period following rainfall experienced in the east and west Rift Valley tea growing regions at the end of 2009 and early 2010, which, under normal circumstances are dry months (Table 2.2).

Coffee output, on the other hand declined by 35.5 percent in July-June 2009/10 as a result of climatic changes marked by severe drought in 2009 and unpredictable rainfall patterns in the coffee growing areas in 2010, which made crop management and disease control difficult and costly to farmers.

Despite the shocks experienced by the horticultural industry in 2009/10, including flight cancellations due to the volcanic ash eruptions in Iceland (which adversely affected air transportation) in March/April 2010, horticultural exports increased marginally by 1.2 percent in 2009/10 compared with a volume of 245,618 metric tonnes in 2008/09.

In the sugar sector, cane deliveries increased marginally by 0.5 percent from 5,355,771 metric tones in 2008/09 to 5,382,888 metric tonnes in 2009/10.

MANUFACTURING

The contribution of manufacturing sector to GDP fell marginally from 9.8 percent in 2008 to 9.5 percent in 2009. In the first quarter of 2010, however, total manufacturing output increased by 7.8 percent from Ksh 33,553 million to Ksh 36,164 million, thereby increasing the sector's share in real GDP to 10.1 percent during the quarter. It was the highest first quarter growth in manufacturing sector since 2001.

Production of selected manufactured goods during the year 2009/10 was varied with that of milk and cement recording the highest growth rates at 27.2 percent and 12.1 percent, respectively. Cigarette production, on the other hand, declined in 2009/10 by 17.6 percent from 14,995,064 milles produced in 2008/09 to 12, 357,719 milles. Production of processed sugar, soda ash and beer declined respectively by 6.1 percent, 0.7 percent and 12.0 percent in 2009/10 to a volume of 504,063.3 metric tonnes, 442,238 metric tonnes and 389.7 million litres, respectively, in 2009/2010 (Table 2.3).

TABLE 2.3: PRODUCTION OF SELECTED MANUFACTURED GOODS

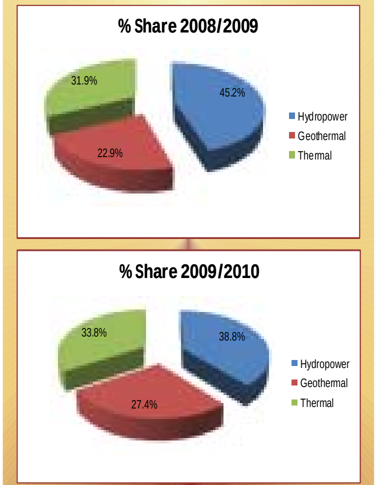
PRODUCT	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10
Processed Sugar						
Output (MT)	507,306	504,589	474,944	530,129.00	536,893.33	504,063.34
Output Growth %	*-3.35%*	*-0.54%*	*-5.88%*	*11.62%*	*1.28%*	*-6.11%*
Cement Production						
Output (MT)	1,975,464	2,104,918	2,370,982.00	2,633,494.00	3,123,473.00	3,500,202.00
Output Growth %	*22.86%*	*6.55%*	*12.64%*	*11.07%*	*18.61%*	*12.06%*
Soda Ash						
Output (MT)	357,521	364,760	385,756	439,958	445,220	442,238
Output Growth %	*1.30%*	*2.02%*	*5.76%*	*14.05%*	*1.20%*	*-0.67%*
Milk						
Output ('000 litres)	284,144	351,609	402,009	397,209	390,910	497,122
Output Growth %	*17.19%*	*23.74%*	*14.33%*	*-1.19%*	*-1.59%*	*27.17%*
Beer						
Output ('000 litres)	257,124	278,905	328,345	381,164	442,877	389,700
Output Growth %	*19.13%*	*8.47%*	*17.73%*	*16.09%*	*16.19%*	*-12.01%*
Cigarettes						
Output (Number of sticks)	10,052,423	12,048,634	13,280,558	15,075,078	14,995,064	12,357,719
Output Growth %	*21.28%*	*19.86%*	*10.22%*	*13.51%*	*-0.53%*	*-17.59%*

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

ENERGY SECTOR DEVELOPMENTS

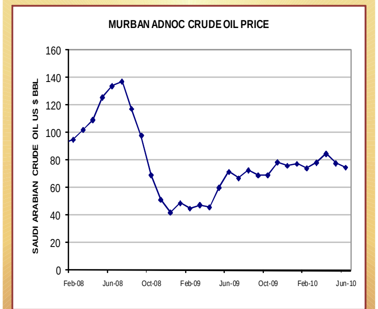
Total electricity generation for the year 2009/10 amounted to 5,556.2 million kilowatt hours compared with 5,544.34 million kilowatt hours in 2008/09, a 0.2 percent increase. This was an improvement from the decline in energy generation over the two preceding years owing to inadequate rainfall for several successive seasons. Total generation in 2009/2010 comprised 38.8 percent, 27.4 percent and 33.8 percent of hydro-power, geo-thermal and thermal generated electricity, respectively (Table 2.4 and Chart 2B).

CHART 2B: PERCENTAGE SHARE OF ELECTRICITY SOURCES



Source: Kenya Power & Lighting Co.

CHART 2C: SAUDI ARABIAN CRUDE OIL



Source: Ministry of Energy

TABLE 2.4: PERFORMANCE OF ENERGY SUB-SECTORS

	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Electricity Supply (Generation)						
Output (KWH Millions)	5,246.20	5,654.00	6,097.20	6,066.60	5,544.34	5,556.19
Growth %	*7.9%*	*7.8%*	*7.9%*	*-0.5%*	*-8.6%*	*0.2%*
Of which:						
Hydro-power Generation (KWH Millions)	2,867.80	3,025.30	3,300.10	3,488.10	2,849.10	2,154.93
Growth (%)	*-12.0%*	*5.5%*	*9.1%*	*5.7%*	*-18.3%*	*-24.4%*
Geo-Thermal Generation (KWH Millions)	1,034.30	1,003.40	1,014.90	1,020.50	1,179.00	1,524.39
Growth (%)	*31.3%*	*-3.0%*	*1.1%*	*0.6%*	*15.5%*	*29.3%*
Thermal (KWH Millions)	1,344.00	1,625.30	1,782.90	1,558.00	1,516.33	1,876.87
Growth (%)	*64.5%*	*20.9%*	*9.7%*	*-12.6%*	*-2.7%*	*23.8%*
Consumption of electricity (KWH Millions)	4,351.40	4,605.70	4,965.70	5,242.90	5,328.00	5,616.90
Growth %	*7.0%*	*5.8%*	*7.8%*	*5.6%*	*1.6%*	*5.4%*
Consumption of Fuels (Metric Tonnes)	2,549	2,742	3,002	2,939	2,916	3,212
Growth %	*13.2%*	*7.6%*	*9.5%*	*-2.1%*	*-0.8%*	*10.2%*

Sources: Kenya National Bureau of Statistics

International crude oil prices edged up gradually, but remained fairly stable in 2009/10 compared with the sharp movements in 2008/09 following adverse effect of global financial crisis in the last quarter of 2008 (Chart 2C). The price of murban adnoc crude oil imported to Kenya fell from a peak of US$ 134.0 per barrel in June 2008 to US$ 42.1 per barrel in December 2008, before increasing to US$ 71.7 per barrel in June 2009 and further to US$ 77.9 per barrel in June 2010.

BUILDING AND CONSTRUCTION

Key indicators in the building and construction industry recorded improved performance in July-June 2009/10 compared with the same period in 2008/09. The cement consumption increased from 2,440,148 metric tonnes to 2,864,126 metric tonnes in July-June 2009/10, an increase of 17.4 percent which was mainly driven by public works in particular, road construction.

TRANSPORT AND COMMUNICATION

Transport

The transport sector thrived in July-June 2009/10 reflecting increased economic activity during the year and more stable international crude oil prices, compared with the same period 2008/09. Cargo handled through the port of Mombasa increased by 8.7 percent, from 17,534,495 metric tonnes in July-June 2008/2009 to 19,064,028 metric tonnes in July-June 2009/10, while Kenya Pipeline throughput grew by 6.3 percent, during the same period (Table 2.5).

Telecommunications

In the telecommunications sector, excise duty on airtime grew by 8.6 percent from Ksh 6,630 million in 2008/09 to Ksh 7,203 million in 2009/10.

TABLE 2.5: PERFORMANCE OF TRANSPORT AND COMMUNICATION SUB-SECTORS

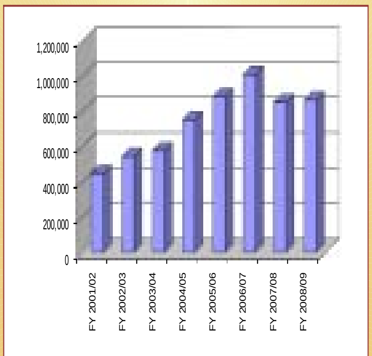
Activity	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10
Cargo by KPA *						
Output (MT)	13,284,921	13,524,051	15,198,435	16,290,399	17,534,007	19,064,028
Output Growth %	*6.23%*	*1.28%*	*12.38%*	*7.18%*	*7.64%*	*8.73%*
Throughput by Kenya Pipeline						
Output ('000 litres Equivalent)	3,459,298	3,627,232	3,963,076	3,873,855	4,058,727	4,314,488
Output Growth %	*11.83%*	*4.85%*	*9.26%*	*-2.25%*	*4.77%*	*6.30%*
Excise duty on Airtime						
Output (Ksh Million)	2,982	3,963	5,360	6,397	6,630	7,203
Growth %	*32.74%*	*35.41%*	*35.28%*	*16.49%*	*3.64%*	*8.64%*

* Provisional

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

TOURISM

CHART 2D: TOURIST ARRIVALS



Source: Kenya Tourist Board

In 2009/10, tourism bounced back from the after effects of the post election crisis to record a growth of 18.3 percent compared with 1.6 percent growth in 2008/09. Cruise ships arrivals, however, declined during the period by 98.2 percent following cancellations as a result of insecurity caused by Somali pirates off the Kenyan coast. Arrivals via Jomo Kenyatta International Airport (JKIA) and Moi International Airport, Mombasa (MIAM) increased during the period by 18.6 percent and 28.4 percent, respectively (Table 2.6).

TABLE 2.6: TOURIST ARRIVALS BY POINT OF ENTRY

	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09	FY 2009/10
Cruise ships	5,615	6,161	5,849	3,531	15,518	287
Output Growth %	*172.18%*	*9.72%*	*-5.06%*	*-39.63%*	*339.48%*	*-98.15%*
JKIA	553,437	637,545	731,252	667,640	691,244	819,843
Output Growth %	*33.98%*	*15.20%*	*14.70%*	*-8.70%*	*3.54%*	*18.60%*
MIAM	194,572	243,425	273,877	179,285	156,991	201,611
Output Growth %	*20.62%*	*25.11%*	*12.50%*	*-34.54%*	*-12.43%*	*28.42%*
Total	753,624	884,728	1,010,978	850,456	863,753	1,021,741
Output Growth %	*30.74%*	*17.40%*	*14.28%*	*-19.40%*	*1.56%*	*18.29%*

FY - Fiscal year
Source: Kenya Tourist Board

USE OF AVAILABLE RESOURCES

Total resources available to the economy measured in gross national disposable income stabilised at 108.5 percent of GDP in 2009, compared with 108.6 percent in 2008.

TABLE 2.7: USE OF RESOURCES (KSH MILLION)

	2003	2004	2005	2006	2007	2008	2009
Gross national disposable income	1,192,664	1,345,167	1,503,497	1,747,455	1,962,234	2,235,571	2,446,311
Net current transfers	67,609	80,856	95,868	129,916	143,152	161,265	177,667
Gross national income	1,125,055	1,264,311	1,407,629	1,617,539	1,819,082	2,074,306	2,268,644
Net factor income payments (Y(f))	-6,728	-10,017	-8,194 -	5,053 -	9,706	15,989	13,065
Gross domestic product (at market prices)	1,131,783	1,274,328	1,415,823	1,622,592	1,828,788	2,058,317	2,255,579
Total Consumption (C)	1,078,028	1,190,029	1,313,504	1,507,742	1,711,595	1,914,549	2,194,505
Government consumption - C(g)	205,207	227,596	246,056	285,056	327,918	346,769	369,741
Private consumption - C(p)	872,821	962,433	1,067,448	1,222,686	1,383,677	1,567,780	1,824,764
Gross domestic investment (I)	186,542	217,742	239,446	291,209	348,850	403,502	456,771
Gross fixed capital formation	179,254	207,196	264,728	309,592	355,090	409,597	456,771
Increase/Decrease in stocks	7,288	10,546	-25,282	-18,383	-6,240	-6,095	
Exports of goods and nfs (X)	270,118	335,743	395,208	439,906	490,987	584,504	575,253
Imports of goods and nfs (M)	-339,301	-435,844	-523,970	-613,856	-691,220	-879,821	-861,788
Discrepancy	-63,604	-33,342	-8,365	-2,409	-31,424	35,583	-109,162
GDP deflator (2001=100)	107.21	114.85	120.48	129.86	136.80	151.61	161.94
Real GDP	1,055,658	1,109,541	1,175,133	1,249,459	1,336,874	1,357,640	1,392,832
Real GDP growth (annual in %)	2.90%	5.10%	5.90%	6.30%	7.10%	1.60%	2.60%
Gross National savings	114,636	155,138	189,993	239,713	250,639	321,022	251,806
Gross Domestic Savings	47,027	74,282	94,125	109,797	107,487	159,757	74,139
Total National Balance(S-I)	-71,906	-62,604	-49,453	-51,496	-98,211	-82,480	-204,965
CAB (X-M+Y(f)+TR(f))	-8,302	-29,262	-41,088	-49,087	-66,787	-118,063	-95,803
Discrepancy	-63,604	-33,342	-8,365	-2,409	-31,424	35,583	-109,162
CAB + DISCREPANCY	-71,906	-62,604	-49,453	-51,496	-98,211	-82,480	-204,965
Kenya - National Accounts							
In shares of GDP	2003	2004	2005	2006	2007	2008	2009
Gross national disposable income	105.38%	105.56%	106.19%	107.70%	107.30%	108.61%	108.46%
Net current transfers (T R(f))	5.97%	6.34%	6.77%	8.01%	7.83%	7.83%	7.88%
Gross national income	99.41%	99.21%	99.42%	99.69%	99.47%	100.78%	100.58%
Net factor income payments (Y(f))	-0.59%	-0.79%	-0.58%	-0.31%	-0.53%	0.78%	0.58%
Gross domestic product (GDP)							
Gross Domestic Product (expend)							
Total Consumption ©	95.25%	93.38%	92.77%	92.92%	93.59%	93.02%	97.29%
Government consumption - C(g)	18.13%	17.86%	17.38%	17.57%	17.93%	16.85%	16.39%
Private consumption - C(p)	77.12%	75.52%	75.39%	75.35%	75.66%	76.17%	80.90%
Gross domestic investment (I)	16.48%	17.09%	16.91%	17.95%	19.08%	19.60%	20.25%
Gross fixed capital formation	15.84%	16.26%	18.70%	19.08%	19.42%	19.90%	20.25%
Increase/Decrease in stocks	0.64%	0.83%	-1.79%	-1.13%	-0.34%	-0.30%	0.00%
Exports of goods and services (X)	23.87%	26.35%	27.91%	27.11%	26.85%	28.40%	25.50%
Imports of Goods and services (M)	-29.98%	-34.20%	-37.01%	-37.83%	-37.80%	-42.74%	-38.21%
Gross National savings	10.13%	12.17%	13.42%	14.77%	13.71%	15.60%	11.16%
Gross Domestic Savings	4.16%	5.83%	6.65%	6.77%	5.88%	7.76%	3.29%
Total National Balance(S-I)	-6.4%	-4.9%	-3.5%	-3.2%	-5.4%	-4.0%	-9.1%
Trade Balance (TB=X-M)	-6.1%	-7.9%	-9.1%	-10.7%	-10.9%	-14.3%	-12.7%
CAB (X-M+Y(f)+TR(f))	-0.7%	-2.3%	-2.9%	-3.0%	-3.7%	-5.7%	-4.2%
CAB + DISCREPANCY	-6.4%	-6.9%	-6.9%	-6.9%	-6.9%	93.1%	93.1%

Source: Economic Survey, 2009

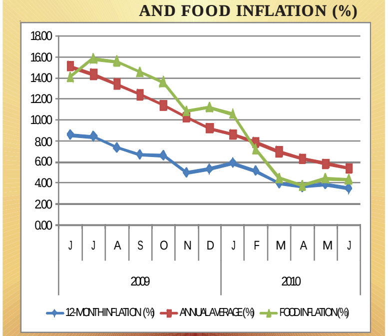
Total consumption as a share of available resources increased from 93 percent in 2008 to 97 percent in 2009. This was mainly driven by increase in private consumption which increased from 76.2 percent in 2008 to 81 percent in 2009. The share of the Government consumption remained fairly stable. Gross Domestic Investment increased marginally from 19.6 percent in 2008 to 20.3 percent in 2009. Exports of goods and services declined sharply from 28.4 percent to 25.5 percent in similar period, mainly explained by slow demand for Kenya's export in the world market. Imports of goods and services also declined from 42.7 percent to 38.2 percent in the same period mainly as a result of reduced payments on oil imports.

Gross natural savings declined from 15.6 percent in 2008 to 11.2 percent in 2009. The lowest since 2004. Savings-Investment balance worsened from a deficit of 4.0 percent in 2008 to a deficit of 9.1 percent in 2009, the highest since 2003. Trade balance improved from a peak of 14.3 percent deficit in 2008 to 12.7 percent deficit in 2009 on account of reduced payments for oil imports.

MONETARY POLICY MANAGMENT
3. INFLATION

The 12-month overall inflation maintained a general downward trend throughout the year, declining from 8.6 percent in June 2009 to 3.5 percent in June 2010 (Table 3.1 and Chart 3A). The decline was attributed largely to declining food prices following the rainfall experienced in the country towards the end of 2009 and early 2010 which ensured sufficient supply and lower prices of both seasonal and non-seasonal food items. During the period, food inflation declined from 14.1 percent in June 2009 to 4.4 percent in June 2010. Food accounts for 36.0 percent weight in the CPI basket. Similarly, the average annual inflation declined from 15.1 percent in June 2009 to 5.4 percent in June 2010.

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



Source:Kenya National Bureau of Statistics

TABLE 3.1: MONTH-ON-MONTH OVERALL AND UNDERLYING INFLATION (%)

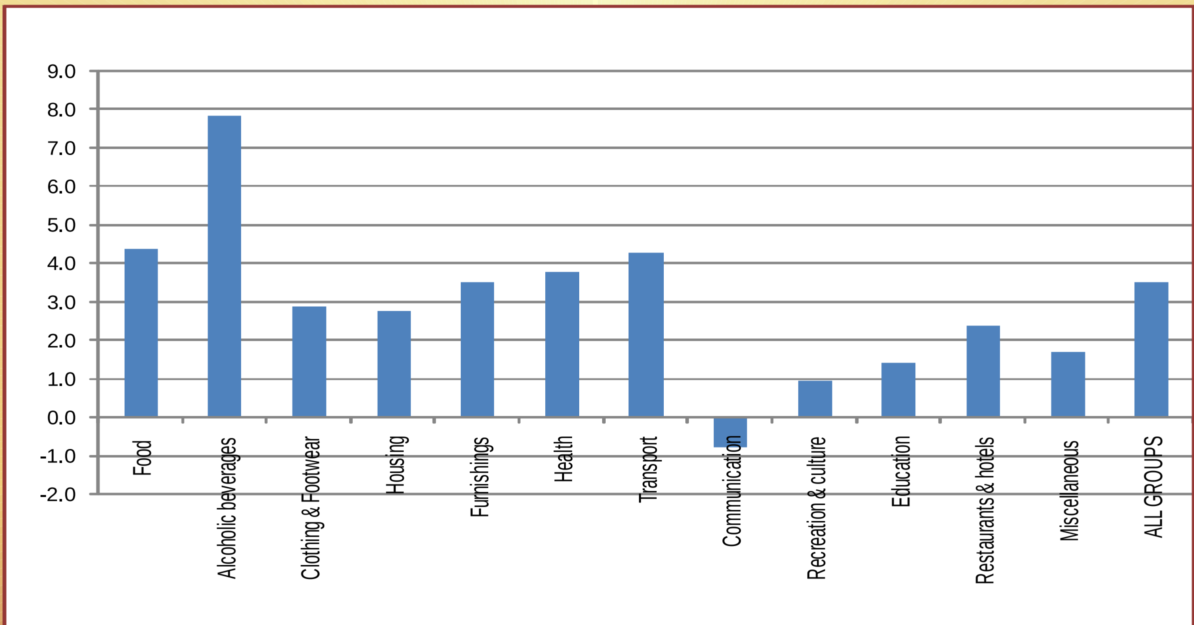
	2009							2010					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
12-Month overall	8.60	8.44	7.36	6.74	6.62	5.00	5.32	5.95	5.18	3.97	3.65	3.88	3.49
Annual average	15.11	14.35	13.42	12.41	11.42	10.24	9.24	8.64	7.88	7.03	6.32	5.85	5.43

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

Inflation by Category of Goods and Services

The categories of goods and services and their respective 12-month inflation rates are presented in Chart 3B.

CHART 3B: 12-MONTH INFLATION RATES FOR GOODS AND SERVICES - JUNE 2010



Source: Kenya National Bureau

As shown in Chart 3B, the alcoholic beverages, tobacco and narcotics basket experienced the highest inflation equivalent to 7.8 percent, followed by the food and transport baskets at 4.4 percent and 4.3 percent, respectively. During the same period prices in the communications basket experienced 0.8 percent reduction following declining prices of airtime brought about by competition among the various service providers in the market. The 12- month inflation for the clothing and footwear basket, health, recreation and culture, education and restaurants and hotels was at 2.9 percent, 3.8 percent, 0.9 percent, 1.4 percent and 2.4 percent, respectively, in June 2010.

Inflation Outlook

Since availability of food is a key of inflation, it is expected that inflation will be predicted on food prices in 2010/11. Other factors which might impact inflation in 2010/11 is international price of oil and the extent to which exchange rate is affectedby turbulence in Europe and the occurrence of double dip recession which might lead investors turn to the US$ as a safe haven. Depending on the realization of these factors, we expect inflation in 2010/11 to remain around 5%.

4. MONEY AND CREDIT DEVELOPMENTS

Monetary Policy for Fiscal Year 2009/10

The Central Bank of Kenya implemented an accommodative monetary policy directed at achieving and maintaining low inflation but also to support growth in a recovery from the worst economic performance since 2003. Inflation as measured by the GDP deflator was projected to decline from 12.1 percent in June 2009 to 10.1 percent in June 2010. Accordingly, the Central Bank of Kenya set out the optimal path for both reserve money and money supply expansion consistent with the achievement of price stability. Money supply, M3, and reserve money were targeted to grow by 16.5 percent and 13.4 percent, respectively, in the year to June 2010 (Table 4.1). To support economic recovery, the Monetary Policy Committee (MPC) of Central Bank of Kenya reduced the Central Bank Rate (CBR) by 125 basis points between July 2009 and June 2010 to signal to the banks to lower lending rates for the private sector. The Monetary Policy Committee also lowered the cash reserve requirements (CRR) on deposits held with commercial banks to 4.5 percent in July 2009 from 5.0 percent previously in order to enhance capacity to provide bank credit especially to the private sector. The revision of the CRR led a downward revision of the bank reserves target and reserve money target.

The direction of the CBR was to guide money market participants on the direction of short-term interest rates. The monetary policy committee emphasized on lowering interest rates in order to enhance credit extension to the private sector. To implement monetary policy the Bank relied on open market operations (OMOs) using repurchase order agreement securities (REPOs) and purchases of foreign exchange from the interbank market. The Monetary Policy Committee also lowered the reserve requirements down to 4.5 percent in July 2009 from 5.0 percent to enhance capacity of commercial banks in providing credit to the private sector.

TABLE 4.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2009/10 MONETARY PROGRAMME

	Jun'09	Sep'09	Dec'09	Mar'10	Jun'10
Reserve money (Ksh million)	163.6	164.7	174.5	175.9	181.4
NFA of CBK (Ksh million)	208.8	216.1	232.9	247.9	262.5
Memo:					
Annual change in reserve money	7.0	7.9	6.7	13.2	13.4
Annual change in extended broad money (M3)	15.0	16.5	15.0	18.2	16.5
Real GDP growth					3.1
GDP Deflator					10.1

Source: Central Bank of Kenya

Monetary Policy Implementation

The Central Bank of Kenya implemented monetary policy in an economy whose performance had declined sharply due to both domestic and external shocks in 2008 and 2009. The Central Bank of Kenya relied on open market operations (OMO) to operationalise adjustment in the CBR.

Open market operations were the primary instrument for implementing monetary policy during the year. The Central Bank of Kenya thereby stabilised interbank liquidity by providing reverse repos to banks, and through the purchases of foreign exchange from the interbank market in its endeavour to build the level of foreign exchange reserves to the statutory 4-months of import cover.

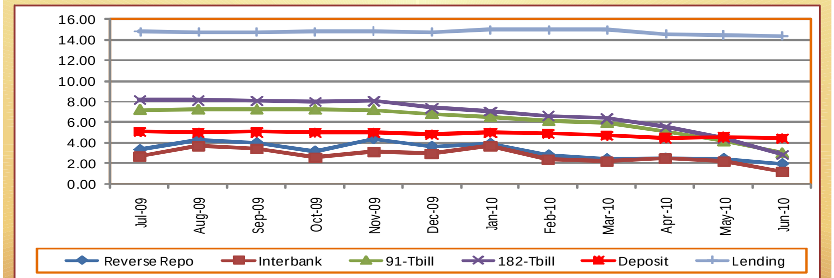
The reverse from repos activity was more pronounced in December 2009, and March through May 2010 following accumulation of high level of Government deposits at the Central Bank of Kenya that led to tight market conditions. The largest injection of liquidity through reverse repos totaling Ksh 72.3 billion was in April 2010. The second largest injection of liquidity through reverse repos was in December 2009 at Ksh 56 billion. Government deposits at the Central Bank of Kenya had peaked at Ksh 80 billion in part due to part tax collection, but mainly from the proceeds of the infrastructure bond floated in December 2009.

In January through May 2010 the government run down its deposits at the Central Bank of Kenya but at a pace slower than envisaged because of administrative constraints in implementing the fiscal stimulus programme. Following the resolution of the constraints to fiscal spending in April the Government accelerated payments out of its deposits at the Central Bank of Kenya from end May. This fits in with the seasonal end year pattern in the fiscal cycle.

As a result of the fiscal shocks, commercial banks accumulated high excess reserves but were unable to lend them out, hence reserve money expanded faster than envisaged at the start of financial year 2009/10. Efforts by the Central Bank of Kenya to encourage expansion 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 (that is the repo rate, the interbank rate and the 91-day and 182-day Treasury bill rates) positively reflected the monetary policy conditions and trended downwards during the financial year. But commercial bank lending rates declined marginally from 14.79 percent in June 2009 to 14.39 percent in June 2010 (Chart 4A), mainly due to perceived risks in the economy. The increase was attributed to higher risk perception by commercial banks.

The Central Bank of Kenya also adjusted the reserve money programme in July 2009 to reflect the lower CRR but maintained the broad money target unchanged to underscore the need for banks to expand credit to the private sector.

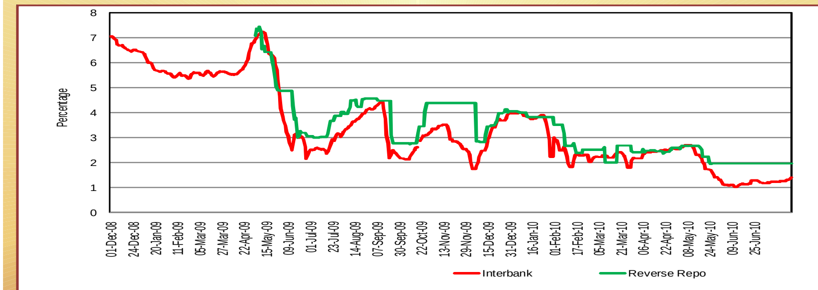
CHART 4A: INTEREST RATES JULY 2009- JUNE 2010 IN PERCENT



Source: Central Bank of Kenya

Short term interest rates remained low for most of the year and trended in the direction of the CBR (Chart 4B). Efficiency in the money market improved with enhanced utilisation of the horizontal repo - a monetary policy instrument launched in Septermber 2008 to re-distribute liquidity among commercial banks. However, some degree of skewness in the liquidity distribution remained due to lack of credit lines for some banks. Consequently, some banks resulted to borrowing from the Central Bank of Kenya overnight window. To cater for the skewness of liquidity in the market as well as the resultant shortfall of liquidity created by an accumulation of government deposits the Central Bank of Kenya provided reverse repo to banks that were short of liquidity.

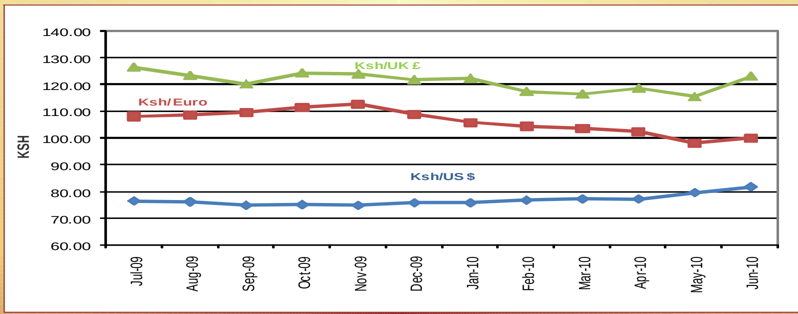
CHART 4B: REPO AND INTERBANK RATES DEC 2008 TO JUN 2010



Source: Central Bank of Kenya

The Central Bank of Kenya continued to purchase foreign exchange from commercial banks to build-up its reserves guided by foreign exchange cash flow plan throughout the fiscal year. However, the tempo was somewhat reduced during the last quarter when the shilling depreciated weighed down by the Euro Zone woes arising from the Greek debt crisis. The Central Bank of Kenya, therefore, took a cautious strategy when accessing the market to minimise the pressure in the foreign exchange market (Chart 4C).

CHART 4C: SELECTED KSH NOMINAL EXCHANGE RATES JUL 2009 TO JUN 2010



Source: Central Bank of Kenya

Money Supply

Money supply, M3, growth at 26.2 percent in the year to June 2010 exceeded the 13.0 percent increase in a corresponding period in 2009 and the projected 16.5 percent growth for the year to June 2010. The expansion in money supply in June 2010 was supported by increases in net domestic assets (NDA) and net foreign assets (NFA) of the Banking system (Table 4.2).

TABLE 4.2: PERFORMANCE OF MONETARY AGGREGATES JUNE 2009 - JUNE 2010(Percent)

	RM		M3	
	Act.	Targ.	Act.	Targ.
2009				
Jun	5.6	7.0	13.0	15.0
Jul	2.9	5.8	14.4	15.0
Aug	1.3	7.2	15.0	15.8
Sep	5.2	7.9	14.8	16.5
Oct	3.8	6.0	13.9	14.7
Nov	5.4	4.9	14.9	15.1
Dec	9.1	6.7	16.0	15.0
2010				
Jan	17.7	13.7	19.2	17.0
Feb	15.4	15.4	20.5	17.7
Mar	14.2	13.2	22.3	18.2
Apr	16.1	16.2	20.9	16.6
May	21.0	11.9	24.9	17.7
Jun	32.1	13.4	26.3	16.5

Source: Central Bank of Kenya

The NDA grew by 34.8 percent in the year to June 2010 compared with 24.2 percent a year earlier on account of credit provision to government and private sectors. The NFA of the banking system also increased by 4.2 percent in the twelve months to June 2010 compared with a decline by 8.0 percent in a corresponding period in 2009. For the second consecutive year the increase 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 2008 Act	Jun 2009 Act	Jun 2010 Act	Annual % Change 2008/09	Annual % Change 2009/10
1.0 Liabilities					
Money Supply					
Money supply, M2 1/	840.7	950.2	1198.9	13.0	26.2
Money supply, M3 2/	716.0	812.1	1033.7	13.4	27.3
Overall Liquidity, L 3/	391.8	400.7	511.6	2.3	27.7
2.0 Assets (2.1+2.2) 4/	83.6	87.3	101.3	4.5	16.0
2.1 Net foreign assets 5 /	291.3	268.0	279.3	-8.0	4.2
Central Bank	202.6	208.8	241.9	3.1	15.8
Banking Institutions	88.7	59.2	37.4	-33.3	-36.8
2.2 Net domestic assets (2.21+2.22)	549.4	682.3	919.7	24.2	34.8
2.21 Domestic Credit (2.210+2.211)	701.8	864.2	1086.7	23.1	25.8
2.210 Government (net)	133.4	173.9	277.7	30.3	59.7
2.211 Private sector and other public sector	568.3	690.3	809.1	21.5	17.2
2.22 Other assets net	-152.4	-181.9	-167.1	19.4	-8.2
Memorandum Item:					
Reserve Money 6/	152.9	159.9	210.3	4.6	31.5

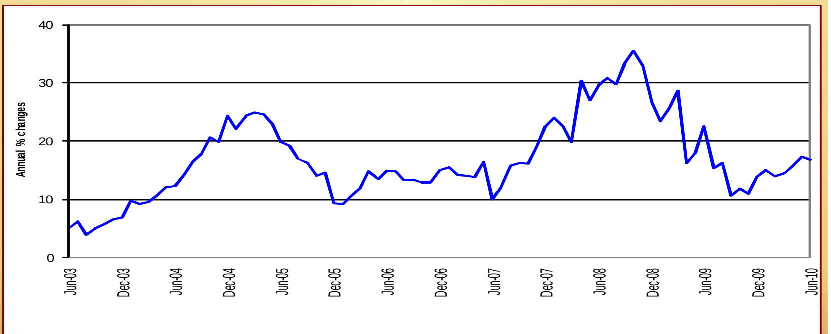
1/ Broad money, M2, comprises M1 and call, 7-days, savings & time deposits as well as certificates of deposits held by the private sector & parastatals with NBFIs. M2 excludes deposits of both the central & local Government with NBFIs, and all cross deposits of both commercial banks and NBFIs.
2/ Broad money, M3, comprises M2 plus foreign currency deposits held by residents with banking institutions.
3/ Overall liquidity L, comprises M3 plus non-bank holdings of government securities.
4/ NFA valued at constant exchange rate of Ksh 78.95 to the US $ (September 30th, 2001)
5/ Reserve money comprises currency in circulation & commercial banks balances held with the Central Bank.

Source: Central Bank of Kenya

Domestic Credit

Domestic credit grew by 25.8 percent in the year to June 2010 compared with 23.1 percent in a similar period in 2009 and the projected 22.1 percent growth in the year to June 2010. Growth in net credit to Government accelerated to 59.7 percent in the year to June 2010 from 30.3 percent in the corresponding period in 2009. While the private sector accounted for the largest share of bank credit during the year, the rate of credit uptake by the sector decelerated to 16.8 percent from 22.5 percent in the year to 2009 (Table 4.4). The rate of credit growth to the private sector is still below the pre-crisis level in 2008 (Chart 4D).

CHART 4D: ANNUAL PERCENTAGE CHANGES IN PRIVATE SECTOR CREDIT



Source: Central Bank of Kenya

The incremental credit to the private sector was allocated as follows: real estate (33.3 percent), private households (29.3 percent), Trade (26.8 percent), manufacturing (10.8 percent), transport and communication (10.3 percent), consumer durables (6.6 percent), Agriculture (6.4 percent) and finance and insurance (3.3 percent) (Table 4.4).

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

	2009 Jun		2010 Jun		Annual Change	
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)
1. Credit to other public sector	**6.3**	**0.9**	**9.9**	**1.2**	**3.5**	**56.1**
Local government	-4.2	-0.6	-4.5	-0.6	-0.2	5.3
Parastatals	10.5	1.5	14.3	1.8	3.8	35.7
2. Credit to private sector	**684.0**	**99.1**	**799.2**	**98.8**	**115.2**	**16.8**
Agriculture	31.3	4.5	38.6	4.8	7.4	23.6
Manufacturing	86.3	12.5	98.8	12.2	12.5	14.5
Trade	99.6	14.4	130.4	16.1	30.8	31.0
Building and construction	40.0	5.8	31.1	3.8	-8.9	-22.3
Transport & communications	54.6	7.9	66.4	8.2	11.8	21.7
Finance & insurance	19.9	2.9	23.7	2.9	3.8	19.2
Real estate	43.3	6.3	81.7	10.1	38.4	88.6
Mining and quarrying	21.3	3.1	16.3	2.0	-5.0	-23.5
Private households	84.3	12.2	118.0	14.6	33.7	40.0
Consumer durables	42.8	6.2	50.4	6.2	7.6	17.8
Business services	78.1	11.3	74.9	9.3	-3.2	-4.1
Other activities	82.6	12.0	68.8	8.5	-13.8	-16.7
3. TOTAL (1+2) *	**690.3**	**100.0**	**809.1**	**100.0**	**118.7**	**72.9**

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

Source: Central Bank of Kenya

Reserve Money

Reserve money, which comprises currency in circulation and commercial banks deposits at the Central Bank of Kenya, increased by 31.5 percent to Ksh 210.3 billion in June 2010 from Ksh 159.9 billion in June 2009. As shown in Table 5.5, the increase in reserve money reflected 50.1 percent growth in bank reserves and 16.0 percent increase in currency outside banks. At Ksh 210.3 billion in June 2010, reserve money was Ksh 28.9 billion above target.

The sources of reserve money in the twelve months to June 2009 were increases in the net foreign assets (NFA) and net domestic assets of the Central Bank of Kenya. NFA of the Central Bank of Kenya rose by 15.8 percent to Ksh 241.9 billion in the year to June 2010 reflecting purchases of foreign exchange from domestic banks to boost the level of gross reserves.

The NDA of the Central Bank of Kenya improved by 35.3 percent to Ksh -31.6 billion in the year to June 2010, from Ksh -48.8 billion in the previous year. The increase in NDA was reflected in lending to government and commercial banks (Table 4.5).

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

	2008 June	2009 June	2010 June	Change (%) 2008/09	2009/10	2010 June Target	Deviation
1. Net Foreign Assets	202.6	208.8	241.9	3.1	15.8	239.2	2.7
2. Net Domestic Assets	-49.6	-48.8	-31.6	-1.6	-35.3	-57.8	26.2
2.1 Government Borrowing (net)	-27.7	-23.5	7.5	-14.9	-131.7	-20.3	27.7
2.2 Advances & Discounts	7.0	17.5	2.8	151.4	-84.0	1.6	1.2
2.3 Other Domestic Assets (net)	-28.9	-42.8	-41.9	47.9	-2.1	-41.7	-0.2
3. Reserve Money	152.9	159.9	210.3	4.6	31.5	181.4	28.9
3.1 Currency outside banks	83.6	87.3	101.3	4.5	16.0	110.6	-9.3
3.2 Bank reserves	69.3	72.6	109.0	4.7	50.1	70.8	38.1

Source: Central Bank of Kenya

Outlook

Over the next twelve months to June 2011, the Bank will target 17.3 percent expansion in money supply, M3, and 2.5 percent contraction in reserve money (Table 4.6). The projected decline in reserve money during the year to June 2010 reflects a re-adjustment to correct for the surge in bank reserves in May and June 2010. The liquidity supply in the Monetary Programme will support economic recovery from 3.6 percent growth in June 2009 to 5.1 percent in June 2010. The Bank will continue to use open market operations to realign reserve money to target as well as short-term interest rates to support this growth forecast.

TABLE 4.6: MONETARY PROGRAMME FOR 2010/11

	Jun-10 Est	Jun-11 Proj.
Ksh Billion		
Reserve Money	210.3	205.9
Net Foreign assets	241.9	289.8
Money Supply (M3)	1,198.9	1,405.9
Net Foreign assets	279.3	365.8
Annual Growth Rates		
Money Suppy (M3)	26.3	17.3
Reserve Money	32.1	-2.1
Real GDP	3.6	5.1
GDP deflator	8.8	6.7
Months of import cover	3.9	4.2

Source: Central Bank of Kenya

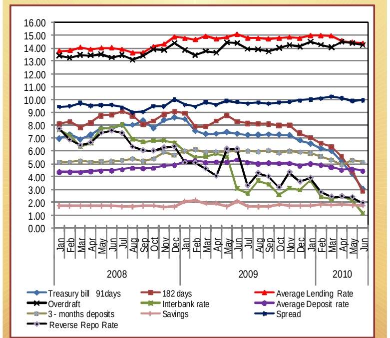
Central Bank Rate (CBR)

In July 2009 the Monetary Policy Committee reduced the Central Bank Rate (CBR) by 25 basis points to 7.75 percent to encourage banks to lower lending rates. The CBR was lowered further by 75 basis points in November 2009 to 7.0 percent and by 25 basis points in March 2010 to 6.75 percent. The Monetary Policy Committee lowered the CBR to signal to the market easing of monetary policy with the direction of the CBR to guide money market participants on the direction of short-term interest rates.

Short-Term Rates

The short-term rates trended downwards in the fiscal year 2009/10 (Table 5.1 and Chart 5A) following the reduction of the CBR. The 91-day Treasury bill rate declined by 418 basis points from 7.24 percent in July 2009 to 3.06 percent in June 2010. The 182-day Treasury bill rate declined by 528 basis points from 8.14 percent in July 2009 to 2.86 percent in June 2010. The interbank rate trended downwards shedding 154 basis points from 2.69 percent in July 2009 to 1.15 percent in June 2010. The decline in the interbank rate was a reflection of increased liquidity in the economy.

CHART 5A: INTEREST RATES



Source: Central Bank of Kenya

Lending Rates

Average lending rates declined marginally (by 4 basis points) in the fiscal year 2009/10 from 14.79 percent in July 2009 to 14.39 percent in June 2010. The decline in overall lending rate was reflected in the 1-5 years loans category in both the corporate and personal loans. The slight decline in interest rates was mainly attributed to the push by Central Bank to have commercial banks lower their rates. However, commercial banks cited perceived risk and high cost of funds as reasons why they were not ready to significantly reduce their lending rates.

TABLE 5.1: INTEREST RATES (%)

	2009						2010					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91-day	7.24	7.25	7.29	7.26	7.22	6.82	6.56	6.19	5.98	5.17	4.21	3.06
Treasury bill 182-day	8.14	8.12	8.09	7.98	8.03	7.38	7.02	6.61	6.34	5.58	4.41	2.86
Average Lending Rate	14.79	14.76	14.74	14.78	14.85	14.76	14.98	14.98	14.96	14.58	14.46	14.39
Overdraft	13.94	13.90	13.76	14.03	14.24	14.13	14.48	14.25	14.06	14.50	14.38	14.23
Interbank rate	2.69	3.68	3.38	2.57	3.11	2.95	3.69	2.39	2.22	2.46	2.16	1.15
Average Deposit rate	5.09	5.00	5.05	5.03	5.04	4.84	5.00	4.89	4.74	4.49	4.58	4.45
3 - months deposits	5.98	5.93	6.05	5.83	5.98	5.90	5.81	5.57	5.28	4.90	5.26	5.11
Savings	1.67	1.65	1.65	1.85	1.71	1.73	1.75	1.81	1.81	1.85	1.76	1.75
Spread	9.70	9.76	9.69	9.75	9.81	9.92	9.98	10.08	10.22	10.10	9.88	9.94

Source: Central Bank of Kenya

Deposit Rates

Average deposit rates declined by 64 basis points from 5.09 percent in July 2009 to 4.85 percent in June 2010. The decline in the deposit rates, though reflected in all categories/maturities of deposits, was more pronounced in the 0-3 month's deposits and over 3 months deposits categories. The deposit rate on demand deposits declined from 1.36 percent in July 2009 to 0.97 percent in June 2010. The savings deposits also declined from 1.67 percent in July 2009 to 1.55 percent in June 2010.

The decline in the overall deposit interest rate in June 2010 was much higher than the increase in overall lending rate. Consequently, the interest rate spread rose from 9.70 percent in July 2009 to 9.94 in June 2010. Chart 5A and Table 5.1 percent show the movement in interest rates during the period.

Interest Rates Outlook

Interest rates are expected to remain low and stable in both the short and medium term, consistent with expected stability in most of the macroeconomic fundamentals. The Central Bank of Kenya 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

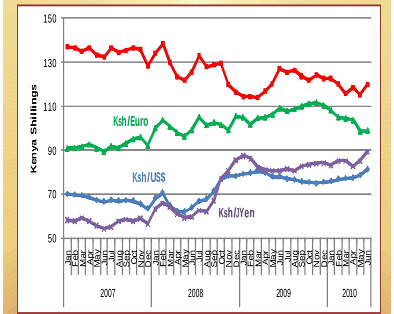
The Kenya Shilling Exchange Rates

The Kenya shilling depicted mixed performance against major world currencies in fiscal year 2009/10 (Table 6.1 and Chart 6A). The shilling depreciated against the US dollar by 4.1 percent between June 2009 and June 2010 to exchange at an average of Ksh 81.0 per US dollar in June 2010 compared with Ksh 77.9 per US dollar in June 2009.

The weakening of the Kenya shilling mainly reflects developments in international currency market, largely influenced by the effect of the Greek Debt Crisis on the Euro. The strengthening of the US dollar against the Sterling Pound and the Euro in the international market fuelled the weakening of the shilling against the US dollar. The shilling appreciated against the Sterling Pound and the Euro to exchange at Ksh 119.6 per Sterling Pound and Ksh 99.0 per Euro in June 2010 compared with Ksh 127.2 per Sterling Pound and, Ksh 109.0 per Euro in June 2009.

Against African currencies, the Kenya shilling gained against the Uganda shilling and the Tanzania shilling by 1.6 percent and 1.1 percent in the fiscal year 2009/2010 to exchange at Ush 27.9 per Kenya shilling and Tsh 18.0 per Kenya shilling in June 2010. The Kenya shilling however depreciated against the South African Rand by 9.9 percent to exchange at Ksh 10.6 per Rand in June 2010 compared with at Ksh 9.6 per Rand in June 2009.

CHART 6A: KENYA SHILLING EXCHANGE RATES



Source: Central Bank of Kenya

TABLE 6.1: KENYA SHILLING EXCHANGE RATES

	2007			2008			2009			2010		% Change
	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Jun-09 to Jun-10
Kshs/US$	69.9	66.6	63.3	68.1	63.8	78.0	78.9	77.9	75.4	75.8	81.0	4.1 [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	-6.0 [a]
Kshs/Euro	90.9	89.3	92.2	100.2	99.2	105.0	105.0	109.0	110.3	108.3	99.0	-9.2 [a]
Kshs/Yen	58.1	54.3	56.5	63.2	59.6	85.4	87.4	80.6	84.1	83.1	89.2	10.6 [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	9.9 [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	1.6 [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	1.1 [a]

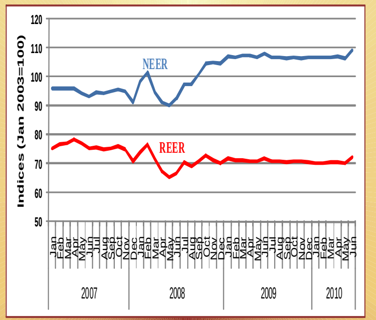
*Currency per Kenya shilling

[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

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) and the real effective exchange rate index (REER) which are a measure of external competitiveness were stable between June 2009 and June 2010 (Chart 6B).

Outlook for the Kenya Shilling

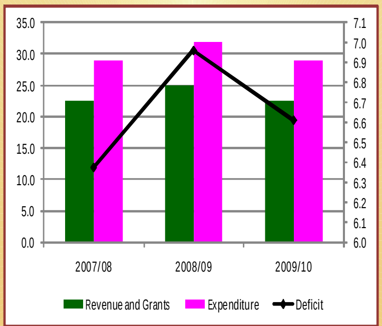
The Kenya shilling is expected to remain stable as impacts from the international financial crisis dwindle. However, demand for foreign currency is likely to be strong in the next fiscal year consistent with expectations for higher remittances, receipts from exports and the inflows of long term capital.

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

7. GOVERNMENT BUDGETARY OPERATIONS

Government budgetary operations in the fiscal year 2009/10 raised the budget deficit on commitment basis by 75.7 percent to Ksh 157.8 billion or 6.2 percent of GDP compared with Ksh 89.8 billion (3.8 percent of GDP) in a similar period in the fiscal year 2008/09. In addition, Government receipts fell below the target by Ksh 17.6 billion for the period, following missed targets on non-tax revenue and Appropriation-in-Aid (A-in-A). The deficit was well within the revised budget target of Ksh 172.3 billion or 6.8 percent of GDP for the fiscal year (Table 7.1and Chart 7A).

CHART 7A: GOVERNMENT BUDGET PERFORMANCE



Sources: Central Bank of Kenya and Treasury

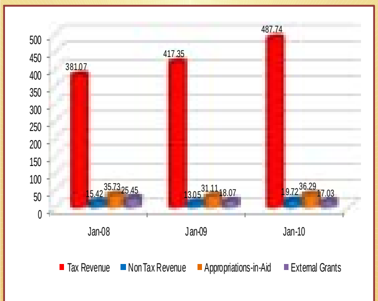
TABLE 7.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS

	FY 2007/2008	FY 2008/2009	FY 2009/2010		
	Actual	Actual	Prov	Target	Over(+) /below (-) target
1. REVENUE	**457.7**	**506.0**	**560.8**	**619.5**	**58.7**
Revenue	432.2	487.9	543.8	588.3	44.5
Tax Revenue	381.1	417.4	487.7	517.9	30.1
Non Tax Revenue	15.4	13.0	19.7	22.9	3.2
Appropriations-in-Aid	35.7	31.1	36.3	47.5	11.2
External Grants	25.4	18.1	17.0	31.2	14.2
2. EXPENSES	**534.8**	**595.7**	**718.6**	**791.8**	**73.2**
Recurrent Expenditure	403.4	435.5	519.8	536.4	16.6
Development Expenditure	131.5	160.2	198.8	255.4	56.6
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-77.2**	**-89.8**	**-157.8**	**-172.3**	**-14.5**
Deficit on a commitment basis as a % of GDP	-4.5	-3.8%	-6.2%	-6.8%	
4. ADJUSTMENT TO CASH BASIS	**9.3**	**-27.3**	**-9.0**	**0.0**	**9.0**
5. DEFICIT ON A CASH BASIS	**-67.9**	**-117.0**	**-166.8**	**-172.3**	**-5.5**
Deficit on a cash basis as a % of GDP	-4.0	-5.0%	-6.6%	-6.8%	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**-7.9**	**0.0**	**-3.2**	**0.0**	**3.2**
7. FINANCING	**59.9**	**117.0**	**163.7**	**172.2**	**8.5**
Domestic (Net)	-13.9	75.9	152.5	124.0	-28.5
External (Net)	6.3	41.1	11.1	48.2	37.1
Capital Receipts (privatisation)	67.5	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0

Sources: Treasury and Central Bank of Kenya

Government Revenue

CHART 7B: COMPOSITION OF REVENUE



Sources: Central Bank of Kenya and Treasury

Government revenue (including grants) increased by 10.8 percent to Ksh 560.8 billion in the fiscal year 2009/10 compared with Ksh 506.0 billion in a similar period in the fiscal year 2008/09 (Chart 7B). But as a percentage of GDP, the revenue and grants increased marginally from 22.6 percent to 22.7 percent during the period. Despite the improved revenue performance in the fiscal year 2009/10, the targets were missed by 9.5 percent. The shortfall was mainly attributed to decline of the corporate taxes, VAT and other taxes attributed to slower-than-envisaged expansion in economic activities.

Cumulative tax revenue collection in the year to June 2010 was Ksh 543.8 billion, or 10.3 percent above Ksh 487.9 billion collected in a similar period of fiscal year 2008/09. The tax revenue was, however, below the target by Ksh 44.5 billion for the period. Appropriation-in-Aid (A-I-A) increased by Ksh 5.2 billion and non-tax revenue by Ksh 6.7 billion. External grants, however, declined by Ksh 1.3 billion.

Expenditure and Net Lending

CHART 7C: GOVERNMENT EXPENDITURE

Sources: Central Bank of Kenya and Treasury

As shown in Chart 7C, Government expenditure and net lending increased by 20.6 percent, from Ksh 595.7 billion in the fiscal year 2008/09 to Ksh 718.6 billion in the fiscal year 2009/10. This increase reflected a growth of 19.3 percent and 24.1 percent in recurrent and development expenditures, respectively.

The recurrent expenditure increased by Ksh 84.3 billion, from Ksh 435.5 billion in the fiscal year 2008/09 to Ksh 519.8 billion in the fiscal year 2009/10. This was attributed to increases of Ksh 18.3 billion in wages and salaries, interest payments of Ksh 11.7 billion and Ksh 54.3 billion in other expenses. Recurrent expenditure was Ksh 16.6 billion below target. Development expenditure increased from Ksh 160.2 billion to Ksh 198.8 billion in the period reflecting increased expenditure on infrastructure development. The development expenditure were Ksh 56.6 billon or 22.2 percent below target. The lower than target performance was attributed to slower absorption rates especially with respect to the externally financed projects. But the percentage of development expenditure in total expenditure increased from 26.9 percent in the fiscal year 2008/09 to 27.7 percent in a similar period in the fiscal year in 2009/10, while that of recurrent expenditure declined from 73.1 percent to 72.3 percent. This development is in line with the Government fiscal policy objective of allocating more resources towards infrastructure development in order to create an environment conducive to doing business and promote investment to achieve and sustain high economic growth in line with the Vision 2030.

Financing

During the 2009/10 fiscal year, budgetary operations of the Government resulted in a financing requirement of Ksh 163.7

billion which was 39.9 percent above Ksh 117.0 billion deficit in a similar period of 2008/09 (Table 7.2). The financing requirement was wholly to finance the budget deficit. The Government sourced the requisite funds through net domestic borrowing amounting to 131.1 billion, net external debt borrowing of Ksh 11.9 billion and a draw down of Government deposit at the Central Bank of Ksh 20.7 billion.

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

I. FINANCING REQUIREMENTS	2006/07	2007/08	2008/09	2009/10
1. Budget deficit	37.0	58.0	83.5	163.7
2. External debt reduction	1.7	-	-	-
3. Domestic debt reduction	5.6	6.2	6.3	-
3.1 Central Bank (incl. items in transit)	5.6	-	6.3	-
3.2 Commercial banks (net of deposits)	-	6.2	-	-
3.3 Non-bank sources	-	-	-	-
4. Increase in GoK deposits at CBK	-	26.4	-	-
TOTAL	44.3	90.7	89.8	163.7
II. FINANCING SOURCES	2006/07	2007/08	2008/09	2009/10
1. Budget surplus	-	-	-	0.0
2. External debt increase	-	4.4	11.6	11.9
3. Increase in domestic debt	22.2	18.8	72.4	131.1
3.1 Central Bank	-	9.3	-	9.8
3.2 Commercial banks	7.3	-	43.6	91.6
3.3 Non-bank sources	14.9	9.5	28.8	29.7
4. Reduction in GoK deposits at CBK	18.1	-	3.3	20.7
5. Refinancing costs	4.0	67.5	2.5	-
TOTAL	44.3	90.7	89.8	163.7

Source: Treasury and Central Bank of Kenya

Outlook for the fiscal year 2010/11

In the budget estimates for the fiscal year 2010/11, Government revenue excluding external grants is estimated at Ksh 689.6 billion (24.9 percent of GDP), while external grants are estimated at Ksh 40.4 billion (1.5 percent of GDP). Government expenditure is estimated at Ksh 918.0 billion or 33.1 percent of GDP. The main components of expenditure include Ksh 592.5 billion (21.3 percent of GDP) in recurrent expenditure and Ksh 323.6 billion or 11.7 percent of GDP in development expenditure.

The overall budget deficit including grants is therefore estimated at Ksh 188.0 billion (6.8 percent of GDP) in 2010/11. The deficit will be financed through net external borrowing of Ksh 82.7 billion (3.0 percent of GDP) and net domestic borrowing of Ksh 105.3 billion (3.8 percent of GDP)

8. PUBLIC DEBT

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.

Kenya's public and publicly guaranteed debt increased by 16.2 percent in the fiscal year 2008/09 to Ksh 1225.1 billion in June 2010 from Ksh 1053.8 billion in June 2009 (Table 8.1). The increase in the overall Government debt stock comprised Ksh 141.1 billion in domestic debt and Ksh 28.0 billion in external debt. The percentage of domestic debt in total debt increased from 49.2 percent to 53.8 percent during the period while the proportion of external debt decreased from 50.8 percent to 46.2 percent. As a percentage of GDP, overall public debt stock increased from 47.0 percent to 49.5 percent during the period (Table 8.1). The proportion of external debt in GDP declined from 24.0 percent to 22.8 percent, while the proportion of domestic debt increased from 23.1 percent of GDP to 26.6 percent.

TABLE 8.1 (a) : PUBLIC DEBT (KSH BN)

	June 2008		June 2009*		June 2010**	
	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT						
Securitised debt	**427.2**	**99.2**	**511.6**	**98.7**	**640.6**	**97.1**
Treasury Bills	111.3	25.8	150.1	**29.0**	191.3	**29.0**
Of which Repo Treasury bills	34.4	8.0	33.3	**6.4**	32.2	**4.9**
Treasury Bonds	315.2	73.2	360.7	**69.6**	448.6	**68.0**
Government Stocks	0.8	0.2	0.8	**0.1**	0.8	**0.1**
Non Securitised debt	**3.4**	**0.8**	**6.9**	**1.3**	**19.0**	**2.9**
Overdraft/Advances	0.4	0.1	5.1	**1.0**	17.6	**2.7**
others	3.0	0.7	1.8	**0.3**	1.3	**0.2**
TOTAL DOMESTIC DEBT	**430.6**	**100.0**	**518.5**	**100.0**	**659.6**	**100.0**
(as a % of GDP	21.2		23.1		26.6	
(as a % of Total Debt	50.1		49.2		53.8	
EXTERNAL DEBT**						
Bilateral	153.2	34.8	185.9	34.6	196.3	34.7
Multilateral	268.2	61.0	327.6	61.0	348.6	61.7
Comm. Banks	0.0	0.0	0.0	0.0	0.0	0.0
Export Credit	18.5	4.2	23.8	4.4	20.5	3.6
TOTAL EXTERNAL DEBT	**440.0**	**100.0**	**537.4**	**100.0**	**565.5**	**100.0**
(as a % of GDP	21.6		24.0		22.8	
(as a % of Total Debt	50.5		50.8		46.2	
TOTAL PUBLIC DEBT	**870.6**		**1053.8**		**1,225.1**	
(as a % of GDP)	42.8		47.0		49.5	

* External debt stock Revised
** Provisional

Sources: Central Bank of Kenya and Treasury

Regional Public Debt Comparison

The public debt to GDP ratio in Kenya has evolved over time. In 2001 it stood at 62.4 percent declining to 43.5 percent in 2007. The decline in the debt to GDP ratio during this period was on account of prudent economic management of the economy. However, following the financial crisis that started in the United States of America, governments across the globe embarked on mitigating the effects of the crisis by implementing fiscal stimulus packages. Kenya was no exception, as higher budget deficit was programmed during the FY 2009/10 largely to finance the fiscal stimulus programme. This development saw the debt to GDP ratio raise from 43.5 percent in 2007 to 49.5 percent in June 2009.

TABLE 8.1(b): REGIONAL COMPARISON OF PUBLIC DEBT TO GDP: 2001-2009

	2001	2005	2007	2009
Kenya	62.4	55.6	43.5	47.0
Uganda	63.1	48.8	14.8	-
Tanzania	70.6	68.1	45.1	38.3
benin	59.1	45.8	24.5	26.2
Burkina Faso	71.4	41.5	-	-
Côte d'Ivoire	118.1	79.3	72.5	63.8
Guinea Bissau	405.0	264.0	172.0	161.0
Mali	90.0	68.0	19.4	25.7
Niger	96.3	66.4	-	-
Senegal	70.6	48.0	24.1	32.1
Togo	135.6	94.2	61.0	52.1

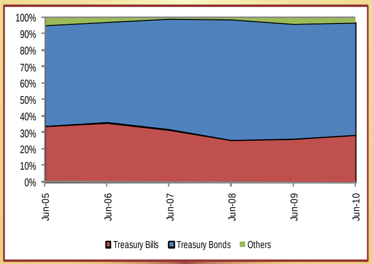
Source: UNECA, IMF, EAC

Other countries in the region also experienced increasing debt-GDP ratio during the period 2007- 2009: Senegal from 24.1 percent in 2007 to 32.1 percent in 2009 and Mali from 19.4 percent to 25.4 percent during the same period. It may be observed that the debt to GDP ratio has been on the declining trend during the period 2001-2009. The countries that registered declining ratios was a result of massive debt forgiveness under the Highly Indebted Poor Countries initiative.

Public Domestic Debt

Total domestic debt increased by 27.2 percent or Ksh 141.1 billion during the fiscal year 2009/10 from Ksh 518.5 billion in June 2009 to Ksh 659.6 billion in June 2010. The rise in domestic debt during the period comprised largely increases of Ksh 41.3 billion in Treasury bills (excluding Repos) and Ksh 87.9 billion in Treasury bonds. Government overdraft at Central Bank of Kenya which is the main component of other domestic debt, increased from Ksh 5.1 billion in June 2009 to Ksh 17.6 billion in June 2010. The percentage of Treasury bonds in total domestic debt declined from 72.7 percent in June 2008 to 69.6 percent in June 2009, while Treasury bills increased from 17.7 percent of total domestic debt to 22.5 percent during the period (Chart 8A). Outstanding Treasury bonds increased from Ksh 315.2 billion in June 2008 to Ksh 360.7 billion in June 2009.

CHART 8A:COMPOSITION OF GOVERNMENT DOMESTIC DEBT

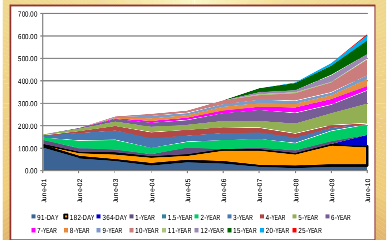


Sources: Central Bank of Kenya and Treasury

The increase in the stock of Treasury bonds during the period partly comprised Ksh 18.5 billion proceeds of the first ever infrastructure bond issued by the Government to raise funds for infrastructure projects. Treasury bills (including Repos) increased from Ksh 111.3 billion to Ksh 137.8 billion during the period.

Reflecting the rise in the stock of Treasury bonds, the average maturity of domestic debt (by period to maturity) increased from 3 years and 9 months in June 2008 to 4 years and 3 months in June 2010. These developments are consistent with 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. The 25-year bond issued in June 2010 was oversubscribed by 260 percent, indicating a potentially big demand for such bonds by investors and the vibrancy in the bond market. The Government made significant progress in issuing long-term instruments during the fiscal year 2009/10 (Chart 8B). The 5-year Treasury bond, however, accounted for the largest proportion of outstanding Government securities during the period, increasing from 11.1 percent in June 2009 to 14.2 percent in June 2010. The percentage of Treasury bonds with maturities of between 10-years and 25-years increased to 30 percent during the year ending June 2010 up from 27 percent in June 2009 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. Treasury bills holdings by commercial banks increased from 54.2 percent in June 2009 to 70.0 percent in June 2010. Commercial banks holdings of Treasury bonds decreased marginally from 48.8 percent to 46.6 percent during the period. The continued re-opening of bond issues to add to their liquidity and support for bond trading was a resounding success during the year. The infrastructure bonds issued during the year were popular in the bond market due to their attractive features like tax exemptions.

CHART 8C: INTEREST PAYMENTS ON

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

Holders	Jun-08		Jun-09		Jun-10	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	69.4	62.4	108.0	78.3	167.2	87.4
Central Bank*	43.0	38.6	33.3	24.2	33.2	17.4
Comm. Banks	26.4	23.7	74.6	54.2	133.8	70.0
NBFIs	0.0	0.0	0.0	0.0	0.2	0.1
Insurance Companies	17.0	15.3	17.0	12.4	8.4	4.4
Parastatals	7.2	6.4	2.3	1.7	1.9	1.0
of which NSSF	0.1	0.0	0.0	0.0	0.0	0.0
Building Societies	1.1	0.9	0.0	0.0	0.0	0.0
Others	16.7	15.0	10.5	7.6	13.8	7.2
Total	**111.3**	**100.0**	**137.8**	**100.0**	**191.3**	**100.0**

* Includes Repo Treasury bills

Source: Central Bank of Kenya

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

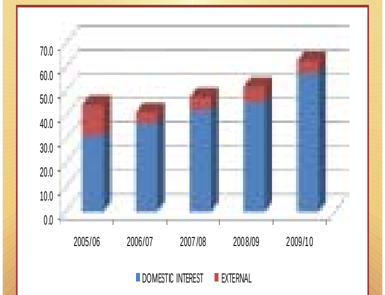
Holders	Jun-08		Jun-09		Jun-10	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	156.8	49.8	176.8	49.0	211.7	47.2
Central Bank	0.0	0.0	0.0	0.0	0.0	0.0
Comm. Banks	156.1	49.5	176.0	48.8	208.9	46.6
NBFIs	0.7	0.2	0.8	0.2	2.8	0.6
Insurance Companies	31.9	10.1	38.3	10.6	53.8	12.0
Parastatals	29.5	9.4	31.4	8.7	38.0	8.5
of which NSSF	11.3	3.6	15.8	4.4	20.1	4.5
Building Societies	0.9	0.3	0.5	0.1	0.4	0.1
Others	96.0	30.5	113.8	31.5	124.7	27.8
Total	**315.2**	**100.0**	**360.7**	**100.0**	**448.6**	**100.0**

Source: Central Bank of Kenya

Domestic Debt Service

Cumulative Government expenditure on interest and other charges on domestic debt increased from Ksh 45.5 billion in the fiscal year 2008/09 to Ksh 57.4 billion in the fiscal year 2009/10 (Chart 8C). Interest on domestic debt as a percentage of ordinary Government revenue increased from 10.1 percent to 10.6 percent during the period following a higher rate of growth in interest payments.

CHART 8C: INTEREST PAYMENTS ON PUBLIC DEBT



Public and Publicly Guaranteed External Debt

Kenya's external debt increased by 5.2 percent, from Ksh 537.4 billion (US$ 6.9 billion) in June 2009 to Ksh 565.5 billion (US$ 7.0 billion) in June 2010 following the weakening of the Kenya shilling against the Euro, the dollar and the sterling Pound (Table 8.1). The increase in external debt comprised external loans disbursement of Ksh 29.2 billion and revaluation loss of Ksh 18.6 billion which more than offset repayment of Ksh 26.2 billion.

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

The percentage of external debt owed to multilateral corporations (including loans from the IMF) increased from 61.0 percent in June 2009 to 61.7 percent in June 2010, while that owed bilateral creditors increased from 34.6 percent to 34.7 percent (Table 8.4 and Charts 8D and 8E). The percentage of external debt contracted through export credits decreased from 4.3 percent in June 2009 to 3.6 percent in June 2010. The percentage of external debt held in US dollars, Euro and Japanese Yen increased from 27.9 percent, 32.5 percent and 25.5 percent in June 2009, respectively, to 27.5 percent, 33.1 percent and 26.0 percent in June 2010. However, the external debt proportion held in Sterling Pounds and other currencies including SDRs decreased from 5.8 percent and 8.3 percent to 5.7 percent and 7.6 percent, respectively, during the period.

TABLE 8.4: DISTRIBUTION OF EXTERNAL PUBLIC DEBT

	Jun-08	%	Jun-09	%	Jun-10	%
Bilateral	153.2	34.8	185.9	34.6	196.3	34.7
Multilateral	268.2	61.0	327.6	61.0	348.6	61.7
Commercial loans	0.0	0.0	0.0	0.0	0.0	0.0
Export Credit	18.5	4.2	23.8	4.4	20.5	3.6
Total	440.0	100.0	535.3	100.0	565.5	100.0

Sources: Central Bank of Kenya and Treasury

CHART 8D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2010

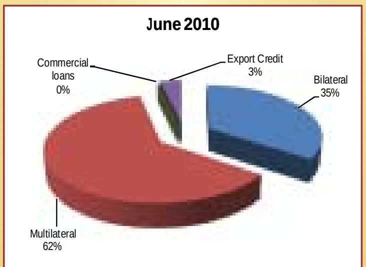
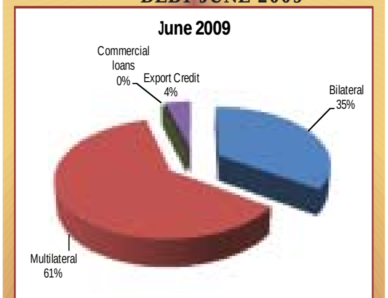


CHART 8E: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2009



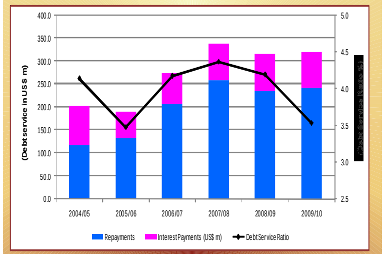
Sources: Central Bank of Kenya and

External Debt Service

External debt service increased from Ksh 24.3 billion or 5.0 percent of ordinary revenue to Ksh 26.2 billion or 4.8 percent of ordinary revenue following the weakening of the shilling against the major currencies. The external debt service in the period comprised Ksh 19.7 billion in principal repayments and Ksh 6.4 billion in interest payments.

The debt service ratio, which is the ratio of external debt service payments to export earnings of goods and services, decreased from 4.4 percent in the fiscal year 2007/08 to 3.5 percent in the fiscal year 2008/09. As shown in Chart 8F, the debt service ratio has generally 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.

CHART8F: EXTERNAL DEBT SERVICE AND DEBT SERVICE RATIO



Sources: Central Bank of Kenya and

Prospects for Fiscal Year 2010/11

In the budget estimates for 2010/11, Government domestic borrowing is projected at Ksh 105.3 billion (3.8 percent of GDP), while external borrowing is estimated at Ksh 82.7 billion (3.0 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 as a percentage of GDP.

9. BALANCE OF PAYMENTS

Overview

Kenya's balance of payments developments in 2009 were mainly influenced by events in the global economy. While world output declined by 0.6 percent in 2009, it rebounded in the first quarter of 2010 to grow at an annualized rate of 5 percent. 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. On the balance, the current account deficit narrowed by US$ 627 million in 2009/10 from US$ 2,296 million in 2008/09. Kenya's balance of payments position improved from a deficit of US$ 422 million during the fiscal year 2008/09 to a surplus of US$ 276 million during the fiscal year 2009/10 (Table 9.1).

TABLE 9.1: BALANCE OF PAYMENTS (US $ M)

ITEM	Year to Jun 2009*	Year to June 2010* Q1 Jul-Sep	Q2 Oct-Dec	Q3 Jan-Mar	Q4 Apr-Jun	Year to Jun 2010*	Absolute Change
1. OVERALL BALANCE	-422	176	147	-101	54	276	698
2. CURRENT ACCOUNT	-2,296	-485	-287	164	-20	-627	1,669
2.1 Goods	-6,281	-1,380	-1,763	-1,413	-1,690	-6,246	35
Exports (fob)	4,642	1,172	1,188	1,290	1,244	4,894	252
Coffee	179	54	33	47	61	194	15
Tea	877	236	263	340	287	1,127	250
Horticulture	668	165	188	187	175	715	47
Oil products	87	34	22	20	23	99	12
Manufactured Goods	570	131	151	145	143	570	0
Raw Materials	247	45	50	74	50	219	-28
Re-exports	281	102	63	79	81	325	44
Other	1,732	405	418	399	423	1,645	-88
Imports (cif)	10,923	2,552	2,950	2,703	2,934	11,139	217
Oil	2,556	565	692	612	763	2,632	77
Chemicals	1,384	315	348	384	380	1,427	43
Manufactured Goods	1,477	352	435	390	448	1,625	149
Machinery & Transport Equipment	3,151	772	829	761	849	3,212	61
Other	2,356	548	646	556	493	2,243	-113
2.2 Services	3,985	895	1,476	1,578	1,670	5,618	1,634
Non-factor services (net)	1,933	388	793	1,042	1,054	3,277	1,345
of which tourism	677	170	244	267	264	945	268
Income (net)	-66	-33	-7	16	15	-9	57
of which official interest	-97	-20	-22	-17	-14	-73	24
Current Transfers	2,118	540	689	519	601	2,350	232
Private (net)	1,859	461	610	524	606	2,201	342
Public (net)	259	79	79	-5	-5	148	-110
3. CAPITAL & FINANCIAL ACCOUNT	1,874	660	434	-265	74	903	-971
3.1 Capital Tranfers (net)	247	45	82	19	34	180	-67
3.2 Financial Account	1,627	615	352	-284	40	723	-904
Official, medium & long-term	119	-41	66	88	70	182	63
Inflows	361	36	111	164	99	409	48
Outflows	-242	-77	-45	-76	-29	-227	15
Private, medium & long-term (net)	485	147	449	-357	201	440	-45
Commercial Banks (net)	472	155	468	-371	191	443	-30
Other private medium & long-term (net)	12	-8	-19	14	10	-3	-15
Short-term (net) incl. errors & omissions	1,023	509	-163	-15	-231	100	-922
memo:							
Gross Reserves	4,822	5,235	5,064	5,188	5,009	5,009	188
Official	3,219	3,708	3,847	3,745	3,799	3,799	579
*imports cover***	*3*	*4*	*4*	*4*	*4*	*4*	1
*imports cover****	*4*	*4*	*4*	*4*	*4*	*4*	0
Commercial Banks	1,602	1,527	1,217	1,443	1,211	1,211	-391

* Provisional

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

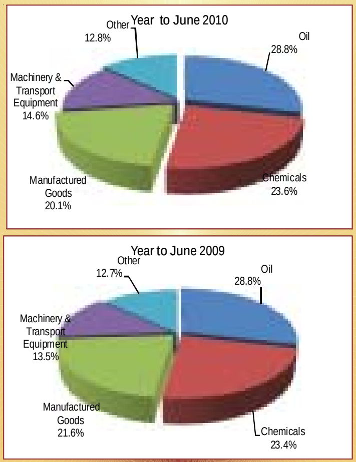
*** Based on 36 months average of imports of goods and non-factor services

Source: Central Bank of Kenya

Trade in Goods and Services

Merchandise Account

CHART 9A: COMPOSITION OF KENYA'S IMPORTS



Sources: Central Bank of Kenya

Kenya's trade deficit improved from US$ 6,281 million during the fiscal year 2008/09 to US$ 6,246 million in 2009/10. Imported goods increased by 2 percent to US$ 11,139 million reflecting increased spending on machinery and transport equipment, chemicals, and oil. The value of merchandise exported increased by 5.4 percent to US$ 4,894 million.

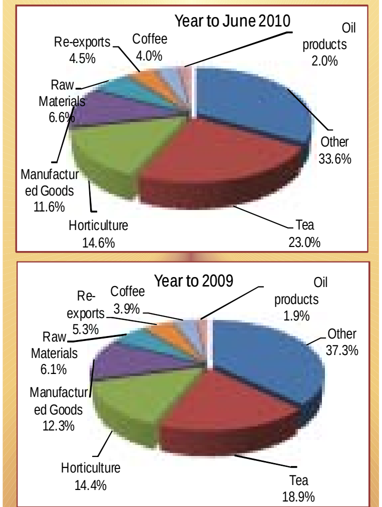
Imports

The value of Kenya's imports of commodities rose to US$ 11,139 million during the fiscal year 2009/10 from US$ 10,923 million in the fiscal year 2008/09.

Oil imports which accounted for 25 percent of total imports increased from US$ 2,556 million to US$ 2,632 million in the period. Imports of machinery and transport equipment accounted for 29 percent of the import bill and increased from US$ 3,151 million to US$ 3,212 million (Chart 9A).

Exports

CHART 9B: COMPOSITION OF KENYA'S EXPORTS



Sources: Central Bank of Kenya

The value of goods exported increased by 5.4 percent from US$ 4,642 million in the fiscal year 2008/09 to US$ 4,894 million during the fiscal year 2009/10. The improvement in export performance mainly came from tea exports which increased by 28 percent. Improved commodity prices in the international markets and domestic production led to this favorable development. The index of non-fuel primary commodities increased by 18 percent between June 2009 and June 2010. Tea accounts for about 20 percent of Kenya's exports of goods. Receipts from horticultural exports also increased from US$ 668 million to US$ 715 million, partly reflecting improved recovery of the global economy in the first quarter of 2010 than previously expected. Horticulture accounted for 15 percent of Kenya's good exports in the fiscal year 2009/10 (Chart 9B).

Services, Income and Current Transfer Account

The surplus on the services account improved by US$ 4,532 million in the fiscal year 2009/10 compared with US$ 3,985 million in fiscal year 2008/09. The services account is composed of non-factor services, income and current transfers.

Earnings from non-factor services which mainly include tourism transport and financial services increased by 22 percent from US$ 1,933 million to US$ 2,352 million in the fiscal year 2009/10. This reflected improved inflows from foreigners travelling to Kenya which recovered by 8.7 percent from US$ 677 million in the fiscal year 2008/09 to US$ 736 million in 2009/10. Similarly, net receipts from transportation services increased from US$ 170 million to US$ 489 million.

Net receipts on the current transfer account increased from US$ 2,118 million to US$ 2,175 million in 2009/10, an increase of 2.7 percent. Remittance transfers which proved resilient to adverse global shocks rose by 7.6 percent.

The income account improved to an inflow of US$ 4 million in fiscal year 2009/10 compared with an outflow of US$ 66 million fiscal year 2008/09. Policy rate cuts reflecting an accommodative monetary and fiscal policy environment in the world economy have lowered interest payments on both official and private foreign debt.

Capital and Financial Flows

The surplus on the capital and financial account improved from US$ 1,874 million in the fiscal year 2008/09 to US$ 2,305 million in the fiscal year 2009/10.

Capital flows to the Government comprising project grants declined from US$ 247 million to US$ 180 million in the fiscal year 2009/10. However, medium and long-term flows to Government improved from US$ 119 million to US$ 531 million reflecting project loans in the fiscal year 2009/10 and 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 amounted to US$ 32 million in 2009/10 compared with US$ 12 million in 2008/09. The Banking sector reduced its deposits held abroad by US$ 443 million in 2009/10 compared with US$ 472 million in 2008/09.

Net short term financial inflows, including errors and omissions in recorded transactions, were US$ 1,119 million in the fiscal year 2009/10 compared with US$ 1,023 million in 2008/09.

Direction of Trade

As shown in Table 9.2, the main destination countries for Kenya's merchandise exports in the fiscal year 2009/2010 were Uganda (12.3 percent), United Kingdom (11.0 percent), Tanzania (8.2 percent), the Netherlands (7.1 percent), Pakistan (4.5 percent), United States of America (4.4 percent), Egypt (4.3 percent), Sudan (4.0 percent), Somalia (3.4 percent), and the Democratic Republic of Congo (3.1 percent). Overall, African countries absorbed 45.9 percent of Kenya's merchandise exports.

TABLE 9.2: KENYA'S EXPORTS: MAIN DESTINATION COUNTRIES (US$ M)

Destination Country	Fiscal Years			Proportion (%)		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
Uganda	571	601	601	12.3	13.0	12.3
Tanzania	367	407	402	7.9	8.8	8.2
Egypt	157	185	212	3.4	4.0	4.3
Sudan	200	169	196	4.3	3.7	4.0
Somalia	179	148	167	3.8	3.2	3.4
DRC	130	148	150	2.8	3.2	3.1
Rwanda	100	134	134	2.2	2.9	2.7
Others	394	406	385	8.5	8.8	7.9
Total Africa	2,098	2,200	2,247	45.1	47.4	45.9
United Kingdom	520	486	539	11.2	10.5	11.0
Netherlands	372	337	349	8.0	7.3	7.1
USA	283	271	214	6.1	5.8	4.4
Pakistan	169	202	218	3.6	4.4	4.5
United Arab Emirates	151	92	208	3.2	2.0	4.3
Germany	94	89	95	2.0	1.9	1.9
India	97	83	87	2.1	1.8	1.8
Afghanistan	53	68	157	1.1	1.5	3.2
Others	812	815	779	17.5	17.6	15.9
Total Exports	4,648	4,642	4,894	100.0	100.0	100.0

Source: Central Bank of Kenya

On the other hand, Kenya sourced most of her imports from the United Arab Emirates (14.1 percent), India (11.0 percent), China (10.2 percent), South Africa (7.5 percent), Japan (6.2 percent), United States of America (5.1 percent), United Kingdom (4.5 percent), Saudi Arabia (3.9 percent), Germany (2.8 percent) and Singapore (2.7 percent) (Table 9.3).

TABLE 9.3: KENYA'S IMPORTS: MAIN SOURCE COUNTRIES (US$ M)

Source Country	Fiscal Years			Fiscal Years		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
South Africa	597	815	833	5.9	7.5	7.5
Egypt	144	134	172	1.4	1.2	1.5
Others	426	348	394	4.2	3.2	3.5
Total Africa	**1,166**	**1,296**	**1,400**	**11.6**	**11.9**	**12.6**
India	1,069	1,186	1,221	10.6	10.9	11.0
United Arab Emirates	1,600	1,201	1,566	15.9	11.0	14.1
China	817	940	1,140	8.1	8.6	10.2
Japan	653	614	686	6.5	5.6	6.2
USA	393	494	572	3.9	4.5	5.1
United Kingdom	409	421	497	4.1	3.9	4.5
Singapore	194	417	302	1.9	3.8	2.7
Germany	351	354	308	3.5	3.2	2.8
Saudi Arabia	289	375	434	2.9	3.4	3.9
Indonesia	335	278	295	3.3	2.5	2.7
Netherlands	162	230	212	1.6	2.1	1.9
France	246	232	195	2.4	2.1	1.7
Bahrain	101	209	82	1.0	1.9	0.7
Italy	188	184	165	1.9	1.7	1.5
Others	2,101	2,491	2,065	20.8	22.8	18.5
Total Imports	**10,076**	**10,923**	**11,139**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Kenya

Kenya's Trade Structure

The proportion of Kenya's total trade with Asia declined to 44.2 percent in 2009 compared with 47.2 percent in 2008. The proportion of trade with European countries and America, however, rose to 24.0 percent and 7.4 percent in 2009 compared with 23.8 percent and 5.9 percent in 2008, respectively (Table 9.4).

TABLE 9.4: KENYA'S TRADE STRUCTURE

	Total Trade in Billions of Kenya Shillings							Proportion (%)						
	2003	2004	2005	2006	2007	2008	2009*	2003	2004	2005	2006	2007	2008	2009*
Europe	134.2	159.5	172.5	206.9	220.4	265.0	272.2	28.9	27.5	24.5	26.8	25.1	23.8	24.0
Western Europe	127.0	151.9	165.8	194.5	207.2	241.5	242.3	27.3	26.2	23.6	25.2	23.6	21.7	21.4
European Union	119.0	143.9	155.7	180.2	193.7	222.4	229.0	25.6	24.8	22.1	23.3	22.0	19.9	20.2
Others	8.0	7.9	10.1	14.3	13.5	19.2	13.4	1.7	1.4	1.4	1.8	1.5	1.7	1.2
Eastern Europe	7.2	7.6	6.7	12.4	13.1	23.4	29.9	1.5	1.3	1.0	1.6	1.5	2.1	2.6
America	22.1	30.5	65.1	53.8	76.0	65.6	83.8	4.7	5.3	9.3	7.0	8.6	5.9	7.4
U.S.A	17.2	18.9	54.6	45.1	63.7	48.1	67.5	3.7	3.3	7.8	5.8	7.2	4.3	6.0
Others	4.9	11.6	10.5	8.8	12.2	12.3	16.3	1.0	2.0	1.5	1.1	1.4	1.1	1.4
Africa	122.0	154.3	183.5	171.9	196.0	248.5	267.4	26.2	26.6	26.1	22.3	22.3	22.3	23.6
E.A.Community	56.4	67.2	78.3	59.1	77.0	96.5	103.0	12.1	11.6	11.1	7.7	8.8	8.7	9.1
Tanzania	16.0	19.9	23.1	22.8	29.0	36.5	37.9	3.4	3.4	3.3	3.0	3.3	3.3	3.3
Uganda	31.7	38.1	44.1	28.8	39.5	47.5	50.7	6.8	6.6	6.3	3.7	4.5	4.3	4.5
Comesa[a]	33.2	42.1	49.8	56.7	66.8	79.6	72.7	7.1	7.3	7.1	7.3	7.6	7.1	6.4
Other Countries	32.4	45.0	55.4	56.1	52.2	72.4	91.7	7.0	7.8	7.9	7.3	5.9	6.5	8.1
Asia	174.4	219.1	257.6	324.2	380.3	526.0	501.4	37.5	37.8	36.6	42.0	43.2	47.2	44.2
Middle East	82.0	107.7	116.8	129.5	143.6	199.8	168.2	17.6	18.6	16.6	16.8	16.3	17.9	14.8
Far East	92.3	111.4	140.8	194.7	236.7	326.2	333.2	19.9	19.2	20.0	25.2	26.9	29.2	29.4
Australia & Oceanic	2.5	2.1	2.5	3.8	3.1	2.5	5.3	0.5	0.4	0.4	0.5	0.4	0.2	0.5
All other Countries N.E.S	9.9	13.9	22.3	11.8	3.9	3.4	3.0	2.1	2.4	3.2	1.5	0.4	0.3	0.3
Grand Total	**465.0**	**579.4**	**703.5**	**772.5**	**879.7**	**1115.6**	**1133.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

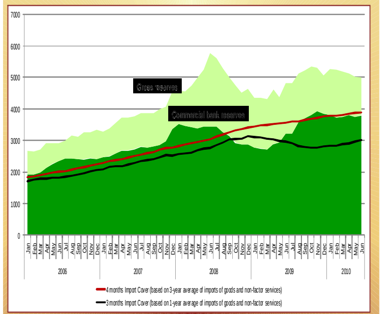
*Provisional

[a] Excluding member countries Uganda, Rwanda & Burundi

Source: Economic Survey, 2008

There was increased trade with Asia mainly United Arab Emirates and Pakistan (Economic Survey 2009). Much of the trade between Kenya and European countries was with the Western Europe. Trade with African countries rose to 23.6 percent with the trade concentrated in the EAC and COMESA regions.

CHART 9C: FOREIGN EXCHANGE RESERVES



Source: Central Bank of Kenya

Foreign Exchange Reserves

Gross foreign assets of the banking system increased from US$ 4,822 million at the end of June 2009 to US$ 5,007 million at end of June 2010 (Chart 9C). At the institutional level, the share of the Central Bank of Kenya in gross foreign assets increased from 66.7 percent to 75.9 percent over the same period.

In value terms, the official foreign exchange reserves held by the Central Bank of Kenya increased from US$ 3,219 million (3.6 months of import cover. The months of import is expressed in terms of the moving average of imports of goods and non factor services over the last 36 months (3 years)) at the end of June 2009 to US$ 3,799 million (3.9 months of import cover) at the end of June 2010. The improvement in gross official foreign exchange reserves reflected domestic interbank purchases by the Central Bank of Kenya to enhance import cover.

Foreign exchange assets of commercial banks declined from US$ 1,602 million at the end of June 2009 to US$ 1,211 million at end of June 2010, reflecting relatively higher returns from holding domestic assets. Most of the foreign assets are held as balances with banks abroad amounting to 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$ 2,140 million at the end of June 2010 compared with US$ 1,912 million at the end of June 2009.

10. BANKING SECTOR DEVELOPMENTS

Overview

During the period ended June 30, 2010, the Kenyan banking sector maintained higher capital and liquidity ratios in relation to the minimum statutory requirements. Non-performing loans were low in relation to gross loans. The total shareholders' funds, deposits and assets expanded by 25.6 percent, 27.8 percent and 22.6 percent, respectively. Liquidity was considered strong, with the average ratio of liquid assets to total deposit liabilities at 45.1 percent, well above the statutory minimum requirement of 20 percent. The overall performance of the banking sector was rated strong in June 2010.

Structure of the Banking Sector

As at June 30, 2010, the Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company and 127 foreign exchange bureaus. The sector witnessed an increase in the branch network from 930 branches in June 2009 to 1,017 in June 2010 representing a growth of 9.4 percent. One deposit taking microfinance institution, the Kenya Women Finance Trust was issued with a license during the period under review.

Structure of the Balance Sheet

Total assets of the banking sector rose by 22.6 percent from Ksh 1,263.4 billion in June 2009 to Ksh 1,548.4 billion as at June 2010. The major components of the assets comprised net advances, Government securities and placements accounting for 51.0 percent, 25.0 percent and 7.0 percent, respectively. Deposits expanded by 27.8 percent from Ksh 954.1 billion to Ksh 1,219.5 billion in June 2010. The growth in deposits, retained profits and capital injections supported the growth in the asset base.

TABLE 10.1: BALANCE SHEET (KSH MILLION)

	Jun-10	Jun-09	% Change
Cash	29,641	24,848	19%
Balances at CBK	89,860	55,064	63%
Placements	102,614	122,392	-16%
Govt. securities	392,702	257,923	52%
Other Investments	36,439	20,500	78%
Loans & Advances	786,591	668,580	18%
Foreign Assets	3,744	2,219	69%
Other assets	106,817	111,938	-5%
Total Assets	**1,548,408**	**1,263,464**	**23%**
Deposits	1,219,531	954,162	28%
Foreign Liabilities	22,500	22,441	0%
Other liabilities	84,038	109,843	-23%
Capital & Reserves	222,339	177,018	26%
Total Liabilities and Shareholders' Funds	**1,548,408**	**1,263,464**	**23%**

Source: Central Bank of Kenya

Non–Performing Loans

Non-performing loans (NPLs) declined by 7.9 percent from Ksh 66.8 billion in June 2009 to Ksh 61.5 billion as at the end of June 2010. Similarly, the ratio of gross non-performing loans to gross loans improved from 9.4 percent in June 2009 to 7.4 percent in June 2010, largely due to enhanced credit underwriting standards applied by financial institutions.

Deposit Liabilities

Total deposits, which form a major component of the banking sector funding increased by 27.8 percent from Ksh 954.2 billion at end of June 2009 to Ksh 1,219.5 billion as at end of June 2010. The growth in deposits was partly supported by aggressive marketing campaigns adopted by financial institutions, branch network expansion and inflows from exports.

Capital and Reserves

Capital and reserves of the banking sector increased by 25.6 percent from Ksh 177.0 billion in June 2009 to Ksh 222.3 billion in June 2010. The total capital of the Banking Sector, which comprises core and supplementary capital, expanded by 16.6 percent from Ksh 163.9 billion in June 2009 to Ksh 191.1 billion. Similarly, core capital grew by 17.1 percent from Ksh 145.8 billion in June 2009 to Ksh 170.7 billion in June 2010. The growth was attributed to fresh capital injection and retention of profits. However, total capital to risk weighted assets ratio decreased marginally from 19.8 percent in June 2009 to 19.6 percent in

June 2010, occasioned by a higher growth in risk assets compared to growth in capital.

Profitability

During the period ending June 30, 2010, the banking sector pre-tax profits increased by 41.9 percent from Ksh 24.6 billion in June 2009 to Ksh 34.9 billion in June 2010. Total income rose by 24.1 percent from Ksh 81.8 billion in June 2009 to Ksh 101.5 billion in June 2010. Interest on advances at Ksh 50.6 billion accounted for 50 percent of total income. The staff costs constituted 34 percent of total expenses. Similarly, return on assets increased from 3.1 percent in June 2009 to 3.5 percent in June 2010, occasioned by a higher growth in profits compared with growth in assets.

TABLE 10.2: BANKING INDUSTRY PROFITS (KSH BILLION)

Item	Jun-10	Jun-09	% Change
Total income	101.5	81.8	24%
Expenses before provisions	62.6	54.0	16%
Profit before provisions	38.9	27.8	40%
Provision for bad debts	4.0	3.2	25%
Profit before tax	**34.9**	**24.6**	42%

Source: Central Bank of Kenya

Outlook for the Banking Sector

The banking sector growth momentum is expected to continue into fiscal year 2010/11 as financial institutions spread their presence in the East African region and embrace ICT-banking. Introduction of Credit Reference Bureaus and Agent Banking are some of the emerging developments that will be critical in the banking sector development.

11. OTHER BANKING SECTOR DEVELOPMENTS

The Central Bank of Kenya continued to foster support for financial access and financial inclusion as a regulator of the banking sector and in partnership with other regulators in the financial sector both at the national and regional levels. In this regard, the regulatory environment was strengthened, new institutions created and new initiatives to improve financial access adopted. The banking sector continued to reap the benefits of enhanced competition among banking institutions. In particular, the stiff competition resulted in new innovative products in the market, flexible banking hours, wider reach in terms of delivery of banking services and competitive pricing of banking services. In its role as an agent of development, the Central Bank of Kenya pursued monetary and financial policies to provide the requisite environment for the growth of the financial sector, encourage provision of banking services to the majority of the population at affordable cost and enhance the safety and soundness of the financial system.

The Proceeds of Crime and Anti-Money Laundering Act 2009

The Proceeds of Crime and Anti-Money Laundering Act, 2009 was passed by Parliament and assented to by His Excellency the President on December 31, 2009. The Deputy Prime Minister and Minister for Finance Hon. Uhuru Kenyatta gazetted 28, June, 2010 as the commencement date for the Proceeds of Crime and Anti-Money Laundering Act, 2009. The Act will strengthen the country's anti-money laundering legal framework. It criminalizes money laundering, provides for elaborate criminal and civil restraint, seizure and forfeiture procedures. It requires reporting institutions to file reports on suspicious activities; verify their customers' identities and establish and maintain customer records and internal reporting procedures. The Act also establishes a financial reporting centre to receive, analyze and disseminate suspicious transaction reports and an asset recovery centre to undertake proceedings on asset forfeiture and manage assets recovered under the Act.

Reducing the Cost of Financial Services

Cognizant of the need to lower the cost of financial services in order to increase access, the Central Bank of Kenya supported the establishment of new institutions and new initiatives and commenced creation of additional currency centres.

Microfinance Institutions

Since the Microfinance Act and related regulations came into effect in May 2008, the Central Bank of Kenya has licensed two deposit taking microfinance institutions. Faulu Kenya Ltd was the first to be licensed in May 2009. In March 2010, The Kenya Women Finance Trust Deposit Taking Microfinance Ltd became the second deposit-taking microfinance institution to be licensed. The Central Bank of Kenya has so far approved thirty four (34) microfinance business names, which is the first step in the licensing process.

Agent Banking

The Banking Act was amended through the Finance Act, 2009, to allow banks to conduct banking business through third party agents. Consequently, in May 2010, the Central Bank of Kenya issued guidelines on Agent Banking. The salient features of the Guidelines include:

- Legal entities including natural persons will be permitted to undertake agent banking. Petrol stations, shops, chemists, telecommunication companies and sole proprietors are some of the envisaged legal entities.
- Agents will provide a wide range of services but excluding customer appraisal and loan approval.
- Electronic transactions like deposit, withdrawal, payment or transfer of funds will be real time.
- One agent will be at liberty to be contracted by more than one institution (non-exclusivity).
- Charges payable by the customers will be fixed by the institutions and not the agents.
- To protect consumers, agents will be required to make minimum disclosures like the name of the institution it is working for, the institution’s logo, services it provides and the authorisation

documents from the institution and the Central Bank of Kenya.

Arising from this development, a number of banks have applied to the Central Bank of Kenya seeking approval to carry out agency banking model. One bank received approval in May 2010 and has already obtained approval for over 4,000 agents.

The introduction of agent banking is intended to enable institutions to provide banking services in a more cost effective way, which is also cheaper to the customers. It is further intended to enhance financial access especially for those people who are currently unbanked.

Credit Reference Bureaus (CRBs)

Following the operationalisation of the Banking (Credit Reference Bureau) Regulations, 2008 (CRB Regulations) in February 2009, the first credit reference bureau, Credit Reference Bureau Africa Limited (CRB Africa) was licensed in February 2010. The Central Bank of Kenya is currently reviewing three other applications that are at various stages of processing.

The Central Bank of Kenya and the Kenya Bankers Association (KBA), through the Joint Task Force (JTF) on operationalisation of credit referencing mechanism, have continued their efforts towards realisation of full implementation of the information sharing mechanism. In August 2009, the JTF, through a project management team (Kenya Credit Information Sharing Initiative – KCISI), oversaw the completion of the data template to be used by the institutions to submit data to the licensed CRBs. The licensed CRBs will then collect, collate and process data received from the banking sector and generate credit reports to be used by lenders

The existing state of information asymmetry between borrowers and banks is a constraint to innovation and financial intermediation. Therefore, credit information sharing will facilitate the development of information capital. Credit information sharing offers an opportunity to promote access to affordable credit to more Kenyans because information symmetry lowers the risk premium and search costs loaded in the cost of credit. In the past, banks have loaded a “risk premium” to borrowers because of lack of information. It is therefore, the Central Bank’s expectation that savings arising from the sharing of credit information shall translate to lower cost of credit and in turn, more Kenyans will be able to access credit from institutions. The information capital will support credit growth and financial development in Kenya in line with Vision 2030.

Currency Centres

The Central Bank of Kenya commence establishment of new currency centres, in addition to the existing branches in order to ensure efficient and cost effective distribution of currency in the country. The first currency centre which was established in December 2009 in Nyeri town in Central Province has resulted in significant reduction in costs of moving cash for commercial banks in the region. The Central Bank of Kenya is keen on opening more centres in other regions in the country.

The Financial Regulators Platform

The regulators in the financial sector sustained collaboration to promote and safeguard development of a vibrant and sound financial sector. The collaboration encompasses sharing of knowledge, network and approaches with regards to market development, tackling challenges and sharing cost of networking and financial infrastructure development.

The regulators platform within the region focuses on among others, joint supervisory and information sharing at the national and regional level. This is being supported by the creation of new institutions such as the credit reference bureaus (CRBs). Credit information sharing facilitates building of information capital so as reduce information asymmetry between banks and their borrowers. This is expected to translate to cheaper credit through lowering of premiums associated with information asymmetries. The agent banking model, a new initiative, is an alternative cheaper delivery channel for financial institutions. This framework allows banks to conduct banking business through third party agents. It is expected to enhance financial access especially for those people who are currently unbanked.

Central Banks within the East African region have signed Memorandum of Understanding (MOUs) to facilitate collaboration in supervision and information sharing in the wake of increasing regional expansion of national commercial banks. The Central Bank of Kenya has also signed MOUs with other domestic financial sector regulators namely the Capital Markets Authority, Retirement Benefits Authority and the Insurance Regulatory Authority.

The financial regulators strategy for developing the financial market shall encompass provision of advice, cultivating partnership, resolving binding constraints and providing space for innovation and above all regulation in their market segments.

1 MODE OF PAYMENTS

1.1 NON-CASH INSTRUMENTS

1.2 KENYA ELECTRONIC PAYMENT AND SETTLEMENT SYSTEM (KEPSS)

Kenya Electronic Payments and Settlement System (KEPSS) moved a volume of 673,368 transactions worth Ksh 16,806 billion in the year to June 30, 2010, representing 142.7 percent increase in volume and 8.8 percent increase in value compared to the period to June 30, 2009. The average amount moved per transaction decreased from Ksh 55.7 million to Ksh 28.8 million, reflecting a decrease of 48.3 percent and signifying increased use of the system by the public for low value payments which in effect dilutes the average value per transaction through the system. The number of transactions moved per day however increased by 137.6 percent in the year to June 30, 2010 to 2,663 transactions compared to 1,121 transactions in the year to June 30, 2009. This increase is attributed to increased awareness of KEPSS as a safe and efficient mode of payment for both high value and time critical payments and low value payments. In addition, this increase is also attributed to the effects of value capping and G-Pay system policies which were implemented with effect from 1 October, 2009 resulting to more than double the daily flows through the KEPSS System. The proportion of Direct payments through KEPSS increased from 94.2 percent to 97.3 percent while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS decreased from 5.8 percent to 2.7 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

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

TABLE 12.2: DIRECT PAYMENT VS. NET SETTLEMENT INSTUCTIONS (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

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 683.25 percent from 9,410 messages in the year to June 30, 2009 to 73,704 messages in the year to June 30, 2010. In the same period, single third party Message Type MT 103 increased by 386.6 percent from 115,443 messages to 561,768 messages. Overall, total third party messages processed through KEPSS increased by 409.0 percent from 124,853 messages to 635,472 messages in the year to June 30, 2010 (Table 12.3). The increase in these messages reflects growing awareness of KEPSS among the public as well as the impact of value capping and G-Pay policies on the KEPSS System.

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

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

1.3 THE AUTOMATED CLEARING HOUSE OPERATIONS

Automated Clearing House (ACH) operated smoothly during the year to June 30, 2010. The ACH Kenya shilling value throughput for the period under review was Ksh 2.3 billion with a volume of 25.0 million transactions for both Debit and Credit instruments. This represents a risk reduction of 50.3 percent and 5.2 percent in value and volume, respectively, compared to Ksh 4.7 billion and 26.4 million transactions in the same period last year as indicated in Table 12.4. This reduction is in tandem with the objective of the value capping policy which sought to remove 60 percent of value and 5 percent of volume, respectively, from the clearing house.

Cheques dominated the non-cash payment instruments accounting for 62.8 percent of total transactions through the Clearing House. In the year to June 2010, the volume of cheques settled through the Nairobi Automated Clearing House was 15.7 million cheques valued at Ksh 1,954 billion, representing a decrease of 15.2 percent from 18.5 million cheques valued at Ksh 3,901 billion in similar period in 2009.

Electronic Funds Transfer (EFT) transactions (credit) based payments decreased by 52.1 percent during this period from Ksh 766 billion to Ksh 367 billion (Table 12.4). However, while the usage of cheques decreased as a result of value capping policy, EFT usage went up by 18.4 percent from 7.9 million EFT's for the year to June 2009 to 9.3 million EFT's for the year to June 2010.

TABLE 12.4: CLEARING HOUSE KSH TRANSACTION TO JUNE 30, 2010

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

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

The ACH continued to witness increased activity in Domestic Foreign Currency Cheque Clearing (DFCCC) transactions in the year to June 30, 2010 compared to the same period last year. The US dollar and the Euro denominated Cheques processed through the clearing house increased by 7.2 percent and 1.7 percent from 282.0 and 9.8 thousand Cheques to 302.4 and 10.0 thousand Cheques, while the GBP denominated Cheques declined by 12.7 percent from 2.9 thousand Cheques to 2.6 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 exchange market followed by the Euro and the Pound, respectively.

TABLE 12.5: DOMESTIC FOREIGN CURRENCY CHEQUE CLEARING TRANSACTIONS TO JUNE 30, 2010

Currency	USD		GBP		EURO	
	Value	Volume	Value	Volume	Value	Volume
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
Growth (percent)	(43.11)		(66.84)		(45.23)	

Source: Central Bank of Kenya, Banking Services Division

1.4 AUTOMATED TELLER MACHINES (ATMS) AND PLASTIC CARD USAGE

The number of Automated Teller Machines (ATMs) in the payment card industry continued to grow, increasing by 21.0 percent from 1,510 ATMs in December 2008 to 1,827 ATMs in December 2009. Growth in ATMs is attributed to commercial banks' business expansion strategies and the need to counter increased competition in the payment card industry.

Amounts dispensed through ATMs in the year to December 2009 increased by 28.0 percent and 61.4 percent from Ksh 396.9 billion to Ksh 5078.0 billion and Ksh 258.3 billion to Ksh 417.0 billion for acquirers and issuers respectively. Correspondingly, withdrawals increased by 19.9 percent and 41.5 percent from 77.9 million withdrawals to 93.4 million withdrawals and 54.7 million withdrawals to 77.4 million withdrawals for acquirers and issuers. Other ATMs dispensed Ksh 18.9 billion in the year to December 2009 with 3.6 million withdrawals (Table 12.6 A).

TABLE 12.6A: AUTOMATED TELLER MACHINE'S USAGE

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Number of ATM machines	107	174	215	324	555	737	1,078	1,510	1,827
Number of transactions (m)									
Acquirers	-	-	-	-	-	-	58.63	77.92	93.43
Issuers	-	-	-	-	-	-	42.08	54.70	77.42
Other	-	-	-	-	-	-	-	3.44	3.56
Value of transactions (bn)									
Acquirers	-	-	-	-	-	-	312.87	396.93	507.99
Issuers	-	-	-	-	-	-	136.44	258.33	417.04
Other	-	-	-	-	-	-	-	18.51	18.93

Source: NPS Survey, 4th quarter 2009

The total number of cards in use rose by 88.6 percent from 2.5 million cards in December 2007 to 4.8 million cards in December 2009. This increase is mainly attributed to debit cards which recorded a growth of 142.1 percent from 1.5 million cards in December 2008 to 3.7 million cards in December 2009.

TABLE 12.6B: NUMBER OF CARDS IN CIRCULATION

	2001	2002	2003	2004	2005	2006	2007	2008	2009
ATM cards	262,100	248,247	266,811	332,015	426,110	829,962	943,359	900,148	985,141
Debit cards	159,498	202,018	330,007	356,989	496,647	750,085	971,449	1,528,866	3,700,646
Credit cards	18,522	18,215	57,146	59,164	69,478	73,238	107,106	107,653	106,842
Charge cards	3,068	3,301	3,693	3,371	3,142	3,769	5,775	5,160	1,682
Total	443,188	471,781	657,657	751,539	995,377	1,657,054	2,027,689	2,541,827	4,794,311

Source: NPS Survey, 4th quarter 2009

1.5 MOBILE PHONE USAGE FOR FUNDS TRANSFER

In March 2010, a third mobile service provider, Essar Telkom launched its mobile money transfer service, Yu bringing to three the number of mobile money transfer services in Kenya's payment sector. Mobile phone money transfer service usage continues to grow among the Kenyan public with the number of transactions increasing by 100.8 percent from 125.1 million transactions in the year to June 30, 2009 to 251.2 million transactions in the year to June 30, 2010. The Bank continues to monitor the developments in this sector in line with the Governments policy of enhancing financial inclusion for the rural poor and the un-banked. Numerous other service providers have approached the Bank seeking permission to roll out mobile money transfer services and the Bank is evaluating such applications on a case by case basis.

Customer base increased by 41.2 percent from 7.4 million customers to 10.4 million customers while the number of agents increased by 197.2 percent from 10,735 to 31,902 in the same period. Of these 31,902 agents, M-Pesa accounted for 59.5 percent, Zap 27.5 percent, and Yu 13.0 percent. Amounts transferred through mobile money transfer services increased by 87.6 percent from Ksh 318.4 billion for the year to June 30, 2009 to Ksh 597.3 percent for the year to June 30, 2010 (Table 12.7).

TABLE 12.7: MOBILE PHONE MONEY TRANSFER

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

Source: Service providers

2 CASH

Currency in circulation increased from Ksh 108.2 billion as at the end of June 2009 to Ksh 125.2 billion as at end of June 2010 reflecting an increase of Ksh 16.9 billion or 15.6 percent from the previous year's issued currency as indicated in Tables 12.8. In weighted terms, bank notes accounted for 96.4 percent of currency in circulation, while the proportion of coins stood at 3.6 percent.

TABLE 12.8: CURRENCY IN CIRCULATION (NOTES & COINS)

	Jun-06		Jun-07		Jun-08		Jun-09		Jun-10	
Item	Ksh bn.	%	Ksh bn.	%	Ksh bn.	%	Ksh bn.	%	Kshs bn.	%
Currency in circulation	76.30	100.00	89.94	100.00	99.89	100.00	108.25	100.00	125.17	100.00
Bank Notes	73.20	95.94	86.45	96.12	96.14	96.25	104.22	96.27	120.72	96.44
Coins	3.10	4.06	3.49	3.88	3.75	3.75	4.04	3.73	4.45	3.56

Source: Central Bank of Kenya, Currency Division

TABLE 12.9: CURRENCY IN CIRCULATION (PIECES)

	Bank notes				Coins		
	2008/2009	2009/2010	%age change		2008/2009	2009/2010	%age change
	Pieces (m)	Pieces (m)			Pieces (m)	Pieces (m)	
1000/=	78.69	90.22	14.7	40/=	1.92	2.25	17.25
500/=	20.86	25.33	21.4	20/=	69.84	75.95	8.75
200/=	31.74	38.21	20.4	10/=	111.34	125.80	12.99
100/=	61.80	70.71	14.4	5/=	151.19	170.60	12.84
50/=	44.39	55.28	24.5	1/=	511.45	539.00	5.39
20/=	10.10	10.05	-0.5	/50=	258.90	272.00	5.06
10/=	12.06	12.00	-0.5	/10=	358.64	360.00	0.38
5/=	5.80	5.80	0.0	/05=	305.12	300.00	(1.68)
	265.44	**307.60**	**15.9**		**1,768.39**	**1,845.60**	**4.4**

Source: Central Bank of Kenya, Currency Division

The number of notes in circulation increased by 15.9 percent from 265 million pieces in the year to June 30, 2009 to 308 million pieces in the year to June 30, 2010. There was notable increase in the usage of Ksh 1,000, Ksh 500, Ksh 200, Ksh 100 and Ksh 50 notes that increased by 14.7 percent, 21.4 percent, 20.4 percent, 14.4 percent and 24.5 percent in the year to June 30, 2010, respectively. Coins in circulation grew by 4.4 percent in the same period from 1,768 million pieces to 1,846 million pieces, with the Ksh 40 coin, Ksh 20 coin, Ksh 10 coin, and Ksh 5 coin increasing by 17.2 percent, 8.7 percent, 13.0 percent, and 12.8 percent, respectively. Public preference for bank notes explains the high proportion of currency in circulation being in Bank notes and 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 4.2 percent from Ksh 283.5 billion as at June 30, 2009 to Ksh 271.5 billion as at June 2010. Similarly withdrawals (i.e. cash outflows) decreased by 1.2 percent from Ksh 291.8 billion to Ksh 288.4 billion in the same period. This reflects a net currency outflow in the year to June 30, 2010 of Ksh 16.9 billion (Table 12.10) .

TABLE 12.10: CURRENCY INFLOWS AND OUTFLOWS (KSHS M)

Inflow by banks	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Bank Notes	196,106	226,747	268,543	283,083	271,257
Coins	713	704	562	376	248
Total	**196,819**	**227,451**	**269,105**	**283,459**	**271,505**
Outflows by banks					
Bank Notes	204,716	239,983	278,236	291,161	287,754
Coins	923	1,077	831	657	658
Total	**205,638**	**241,060**	**279,066**	**291,818**	**288,412**
Net Outflows	**(8,819)**	**(13,609)**	**(9,961)**	**(8,359)**	**(16,907)**

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 54.6 percent from 2,296 counterfeit notes in the year to June 30, 2009 to 1,042 counterfeit notes in the year to June 30, 2010 (Table 12.11). The resultant impact in value terms was a decrease of 63.5 percent in the total value of counterfeit notes from Ksh 1.69 million in the previous year to Ksh 0.62 million in the year to June 30, 2010.

In terms of denomination, there were 485 pieces of Ksh 1,000 or 46.5 percent, 113 pieces of Ksh 500 or 10.8 percent, 297 pieces of Ksh 200 or 28.5 percent, and 143 pieces of Ksh 100 or 13.7 percent of the counterfeit notes, respectively.

TABLE 12.11: COUNTERFEIT NOTES BY DENOMINATION

	Pieces			Proportion
	2007/2008	2008/2009	2009/2010	2008/2009
1000/=	653	1,376	485	46.55
500/=	205	442	113	10.84
200/=	172	411	297	28.50
100/=	94	60	143	13.72
50/=	4	7	4	0.38
20/=	0	0	0	0.00
10/=	0	0	0	0.00
5/=	0	0	0	0.00
Total	**1,128**	**2,296**	**1,042**	**100.00**
	Amounts (KSH)			**Proportion**
	2006/2007	**2007/2008**	**2009/2010**	**2008/2009**
1000/=	653,000	1,376,000	485,000	78.81
500/=	102,500	221,000	56,500	9.18
200/=	34,400	82,200	59,400	9.65
100/=	9,400	6,000	14,300	2.32
50/=	200	350	200	0.03
20/=	0	0	0	0.00
10/=	0	0	0	0.00
5/=	0	0	0	0.00
Total	**799,500**	**1,685,550**	**615,400**	**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 NPS Bill 2010. Once enacted, the Bill will enhance the Bank's oversight powers for non-bank based payment, clearing settlement systems. In order to provide a sound legal basis for the proposed Cheque Truncation, the Bank made recommendations for amendment to the Bills of Exchange Act.

3.2 CONNECTIVITY TO KEPSS

The automation system for Government outward Payments was implemented as scheduled on October 1, 2009. The system has enhanced efficiency in Government payment processing and mitigation of risks associated with cheques issuance and usage for large value financial transactions. Consequently, the Government has since stopped the use of Cheques for processing its outward payments.

3.3 EAST AFRICAN CROSS BORDER PAYMENT SYSTEM

Consultations among the East Africa Countries on 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 are ongoing. The system is aimed at ensuring efficient and safe settlement of intra-regional financial transactions and is expected to go live by the 2^{nd} quarter of financial year 2010/11.

3.4 VALUE CAPPING

In the year to June 30, 2010, the Government, Central Bank of Kenya, and Kenya Bankers Association finalized consultations and implemented value capping policy with effect from October 1, 2009. This policy change was aimed at enhancing safety and efficiency of payment process and instruments by minimizing inherent risks in the Clearing House. Effectively, the policy eliminated 60 percent of value from the Clearing House and more than doubled the volume of transactions through the KEPSS System.

3.5 CHEQUE TRUNCATION PROJECT

Central Bank of Kenya in conjunction with other stakeholders has selected the project vendor and the project manager. The projected is expected to go live effective February 2011. Once implemented, the new system will automate the entire clearing cycle including cheque exchange, settlement, and fating processes and the resultant effect would be the reduction of risks and costs associated with handling of physical cheques among the clearing house members.

13. CURRENCY DEVELOPMENTS

I. Currency in Circulation

Currency in Circulation increased by 15.6 percent or Ksh16.9 billion in the year (Table 13.1)

TABLE 13.1: CURRENCY IN CURCULATION

CENTER	CIRCULATION AS AT JUNE 30TH 2009 (Ksh)	CIRCULATION AS AT JUNE 30TH 2010 (Ksh)
Nairobi	145,474,249,721.20	161,274,545,921.00
Mombasa	31,300,703,026.25	33,694,527,926.25
Kisumu	-13,616,518,060.00	-9,439,916,960.00
Eldoret	-54,904,897,324.70	-59,464,089,324.70
Nyeri	0.00	-904,506,000.00
Total	**108,253,537,362.75**	**125,160,561,562.55**

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

The denominations contributing significantly to the expansion in circulation were the Ksh 1000, 50, and 100 bank notes and Ksh 1 and 5 coins.

II. Currency Centres

In an effort to ensure efficient and cost effective distribution of currency in the country, the Bank embarked on establishment of new currency centres in addition to the existing branches. The first currency centre was established in Nyeri in December 2009. This centre serves the larger Mt. Kenya region which has a presence of thirteen Commercial Banks with an extensive network of Branches. There has been a marked reduction in the cost of moving cash on the part of Commercial Banks and an improvement in the cleanliness of banknotes in the region as a result of the centre's establishment. The Bank is keen on opening more centres in future.

III. Improvements in Currency Sorting

In late 2008, the Bank embarked on a clean banknote policy where commercial banks were incorporated in the currency sorting processes. Consequently, in the fiscal year 2009/10, commercial banks invested in currency sorting equipment and established regional sorting centres. Others enlisted the services of Cash in Transit (CIT) firms to carry out this function on their behalf. These efforts have improved the quality of currency in circulation and have also reduced the frequency of commercial banks' visits to the Central Bank of Kenya for cash services since they re-circulate clean currency in the market. The amount of counterfeits getting through the Banking System has also reduced significantly since they are weeded out at the commercial bank level during sorting.

IV Combating Counterfeits

In an effort to ensure that counterfeiting is minimized, the Bank stepped up its public awareness campaigns on security features of banknotes through the participation of the Currency Operations and Branch Administration Department in the Public Service week in Nairobi, Mombasa, Kisumu and Nakuru. The Department also participated in the Nairobi International Trade Fair and the Eldoret National Show. In all these forums, public education on currency security features was extensively carried out. The Department has also started collaborating with other large cash handling institutions in ensuring that their employees are educated on security features of banknotes.

V Licensing Use of Cash Defacement Devices.

The Central Bank of Kenya (Currency Handling) Regulation, 2008, was published on November 21, 2008. The purpose of the regulations was to allow defacement of currency by authorised persons in case of robbery attacks, and also prohibit the use of currency or images of currency notes or coins in any publication without prior written consent from the Central Bank of Kenya. However, owing to the challenges experienced during implementation of the regulations it was found necessary to review them. This was done in the last financial year and the amended regulations were approved and signed by the Governor for publication on July 16, 2010

14. REGIONAL INTEGRATION DEVELOPMENTS

INTRODUCTION

The Central Bank of Kenya participated in a number of regional integration initiatives and programmes, particularly those relating to monetary integration. The Central Bank of Kenya 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 status of macroeconomic convergence and other developments related to monetary cooperation in EAC, COMESA and AACB in 2009.

THE EAC MONETARY CO-OPERATION PROGRAMME

Background Information

To facilitate 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.

The Governors of the Central Banks of the Partner States through the Monetary Affairs Committee (MAC) are mandated to steer aspects of the EAC treaty relating to monetary and financial cooperation. MAC is tasked with the mandate of laying the foundation for a common monetary union, which encompasses 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; Financial Markets Integration; Monetary Union (a common Central Bank and a single currency) in EAC

The original timeline for the achievement of a Monetary Union in East Africa was 2015. However, the 6th Extraordinary

Summit of the Heads of State held in 2007 directed that the EAC monetary union to be fast tracked to 2012. MAC has made progress in monetary policy harmonization and coordination. In particular, MAC has prioritized and budgeted for activities towards the establishment of the East African Monetary Union.

EAC Macroeconomic Convergence Criteria and Progress in 2007

The Governors of EAC Partner States adopted a new set of convergence criteria in May 2007 which were classified into primary criteria, and secondary criteria. The primary criteria are the primary preconditions for convergence, which need to 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.

Partner States were affected by the global economic recession making it difficult to achieve the EAC convergence criteria in 2009. 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. This did not pose a risk to inflation due to the reduction in global demand. Governments in the region also implemented economic stimulus measures to cushion their economies against the adverse effects of the global financial and economic crisis. The region faced a number of challenges in the pursuit of appropriate policy in light of the global financial crisis. Countries in the region with fully

TABLE 14.1: MACROECONOMIC PERFORMANCE AND CONVERGENCE UNDER THE EAC CRITERIA

Criteria	Target level and Date	2004	2005	2006	2007	2008	2009
Budget Deficit (Excl. Grants) / GDP*	< 6% by 2010	1.01	4.71	2.70	5.23	4.81	8.30
Budget Deficit (Incl. Grants) / GDP*	<3% by 2010	0.01	3.39	1.78	3.93	4.01	7.04
2. Inflation rate– annual average	not > 5% per year by 2010	11.80	9.90	6.40	4.30	16.30	9.20
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	3.40	3.20	3.60	4.00	2.80	4.10
GDP Growth Rate At Factor Cost- constant prices***	At least 7% p.a. by 2010	5.10	5.90	6.30	7.00	1.60	2.60
Stable Real exchange rates	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	96.02	85.89	79.18	75.71	70.46	70.97
Current Account Deficit (Excl. Grants) / GDP	Sustainable levels by 2010	-1.30	-1.74	-2.49	-4.44	-7.18	-6.47
Gross National Savings/GDP***	at least 20% by 2010	12.20	13.40	14.80	13.70	15.50	11.10

* 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

liberalized capital account with market determined exchange rates, experienced volatile exchange rates, and dampening of stock market indices.

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

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".

In accordance with the mandate provided in the COMESA Treaty, the Authority of Heads of State and Government of COMESA member countries adopted a Monetary and Fiscal Policies Harmonization Programme in 1992. The Programme aimed to establish a monetary union in 2025 and had four stages. The first stage (1992-1996) entailed consolidation of existing instruments of monetary co-operation and implementation of policy measures aimed at achieving macroeconomic convergence. Progress towards this objective is monitored through observance of set convergence criteria. The next stage (1997-2000) involved introduction of limited currency convertibility and an informal exchange rate union. The third stage (2000-2024), is that of a formal exchange rate union and co-ordination of economic policies by a common monetary institution. The final stage was realization of a full monetary union involving a common currency issued by a common Central Bank by 2025.

The implementation Programme did not proceed as originally envisaged. 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.

In an effort to fast track the attainment of a single monetary zone, the committee of Governors of Central Banks of COMESA also commissioned a study in 2005 which recommended among other things the establishment of a COMESA Monetary Institute (CMI).

The 14th Meeting of the COMESA Committee of Governors of Central Banks held in Mauritius from 26th to 30th October 2009, ratified the decision for the Central Bank of Kenya to host the CMI. 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.

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, particularly the secondary criteria. With regard to primary criteria, the budget deficit (excluding grants) increased to 5.6 percent of GDP in 2009. This performance is due to an accommodative fiscal policy by Government to stimulate the economy after the post election cirsis in January 2008 and global economic recession. The overall average inflation rate declined in 2009 but was above the COMESA target of 5 percent. Kenya's official external reserves at 4.1 months of import cover in 2009, was within the 4 months of import cover COMESA Monetary Harmonization Target.

Kenya met several of the secondary criteria targets. Total domestic revenues to GDP were 21.4 percent for 2009, well within the target of COMESA. The ratio of debt relative to GDP showed a stable trend, an indicator of prudent fiscal and macroeconomic management over the year. Real GDP grew by 2.6 percent in 2009 compared with 1.7 percent in 2008. The economy is showing signs of recovery as the effects of the global economic downturn start to wane out.

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					
		2004	2005	2006	2007	2008	2009
1. Overall budget deficit/GDP ratio (excluding grants)*	< 5 percent	1.01	4.71	2.70	5.23	4.81	8.30
2. Inflation rate– annual average	< 5 per cent	11.80	9.90	6.40	4.30	16.30	9.20
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	3.40	3.20	3.60	4.00	2.80	4.10
Secondary Criteria	**Target Stage I (2005-2010)**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
1. Real GDP growth rate****	> 7 percent	5.10	5.90	6.30	7.00	1.60	2.60
2. Domestic fiscal receipts/GDP ratio*****	= or > 20 percent	21.55	20.49	21.63	22.02	21.77	23.69
3. Current account deficit (excluding grants) as percent of GDP	Sustainable level	-1.40	-1.80	-2.50	-4.40	-7.20	-6.50
4. Achievement and maintenance of domestic investment rate	at least 20 percent	17.10	16.90	18.00	19.10	19.20	23.40
5. Maintenance of real exchange rate stability - REER Index	Achieve and maintain stable exchange rates (REER. Jan	96.02	85.89	79.18	75.71	70.46	70.97

* 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

THE AFRICAN MONETARY COOPERATION PROGRAMME (AMCP)

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. 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, of net more than 3 percent;
- Inflation rate, of not more than 3 percent;
- Minimization of Central Bank financing of budget deficit;
- External Reserves 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 to total tax revenue ratio of not more than 35 percent;
- Maintenance of real exchange rate stability;
- Public investments financed by domestic sources/or tax revenue to GDP ratio equal to or more than 20 percent
- Maintenance of positive real interest rates.

Progress in Implementation of the AMCP

The year 2009 was the first year of the stage III of the AMCP implementation. As shown in Table 14.3, Kenya's performance in the implementation of the AMCP is on track. 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.

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 2004	2005	2006	2007	2008	2009
1. Overall budget deficit/GDP ratio (Excluding grants)*	< 5 percent	1.01	4.71	2.70	5.23	4.81	8.30
2. Inflation rate - Annual Average	< 10 per cent	11.80	9.90	6.40	4.30	16.30	9.20
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	3.40	3.20	3.60	4.00	2.80	4.10
Secondary Criteria	**Target for Stage II (2004-2008)**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
1. Domestic fiscal receipts/GDP ratio****	= or > 20 percent	21.55	20.49	21.63	22.02	21.77	23.69
2. Current account deficit (excluding grants) as a percent of GDP	Sustainable level	-1.40	-1.80	-2.50	-4.40	-7.20	-6.50
3. Achive and maintain domestic investment rate of 20%	= or > 20 percent	17.10	16.90	18.00	19.10	19.20	23.40
4. Maintenance of real exchange rate stability	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	96.02	85.89	79.18	75.71	70.46	70.97

* 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

In 2009, Kenya's 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.

Overall annual average inflation in Kenya of 9.2 percent in 2009 was above the AMCP target of less than 5 percent. Inflation declined in 2009 from 16.3 percent in 2008 attributed to easing of supply constraints in the agricultural sector and improved weather conditions towards the end of 2009. In addition, the revision in the methodology of computing prices indices from the arithmetic mean to the geometric mean resulted in a more representative inflation rate.

Kenya's official external reserves at 4.1 months of import cover in 2009, was below the 6 months of import cover AMCP target. A general increase in the import bill partly offset efforts by the Central Bank to enhance reserve levels through purchases of foreign exchange from the interbank market.

Kenya continues to meet almost all the secondary criteria targets. Domestic fiscal receipt to GDP ratio at 21.4 percent in 2009, met the target of the AMCP. The total wage bill as a proportion of domestic revenue was 31.7 percent which was within the AMCP target of 35 percent.

15. ECONOMIC OUTLOOK

The recent economic recovery, though weak, is projected to strengthen in 2010 with real GDP growth expected at 4.5 percent. The Government will strive to provide an enabling macroeconomic environment to ensure economic gains with minimal inflationary pressure. Both the fiscal stimulus by the Ministry of Finance and the accommodative monetary policy by the Central Bank of Kenya will be continued in 2010 to ensure adequate support to private sector activities that will underpin the economic recovery. Furthermore, the Central Bank of Kenya will pursue measures to enhance efficiency in the money market and enhance uptake of existing money market instruments by commercial banks. This will be geared to improve the transmission of monetary policy impulses from the short end to the long end of the money market as credit supply to the economic agents remain a critical factor in the production process. The Central Bank of Kenya will constantly engage with stakeholders in the money market in communicating its policies and actions in order to elicit predictable behavior

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FOR THE YEAR ENDED 30 JUNE 2010

CENTRAL BANK OF KENYA
BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2010

DIRECTORS

Prof. Njuguna Ndung'u	-	Governor and Chairman
Dr. Hezron Nyangito	-	Deputy Governor and Deputy Chairman
Mr. Joseph K. Kinyua	-	Permanent Secretary - Treasury, Member
Mr. Joseph K. Waiguru	-	Member
Dr. William O. Ogara	-	Member
Mr. Nicholas A. Nesbitt	-	Member
Ms. Agnes Wanjiru	-	Member
Ms. Wanza Kioko	-	Member (Resigned on 8 December 2009)

SENIOR MANAGEMENT

Prof. Njuguna Ndung'u	-	Governor
Dr. Hezron Nyangito	-	Deputy Governor
Mr. Kennedy K. Abuga	-	Director –Governor's Office & Board Secretary
Mr. Aggrey J.K. Bett	-	Director – Finance and IMS Department
Mr. Fredrick Pere	-	Director – Banking Supervision Department (Appointed on 26 August 2009)
Ms Rose Detho	-	Director – Banking Supervision Department (Transferred on 26 August 2009)
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies
Mr. William Nyagaka	-	Director – Internal Audit & Risk Management Department
Mr. Charles Koori	-	Director – Research and Policy Analysis Department
Mr. Casssian J. Nyanjwa	-	Director – Department of Estates, Supplies and Transport (Appointed on 26 August 2009)
Mr. Nicholas B.T. Korir	-	Director – Department of Estates, Supplies and Transport (Transferred on 26 August 2009)
Mr. James T. Lopoyetum	-	Director – Currency Operations and Branch Administration Department
Mr. Gerald Nyaoma	-	Director – Banking Department
Mr. Jackson M. Kitili	-	Director – Monetary Operations & Debt Management Department
Mr. Peter K. Rotich	-	Director - Human Resources and Administration Department

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MAIN LAWYERS

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CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2010

The directors submit their report together with the audited financial statements for the year ended 30 June 2010, 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 as set out on page 78 show that the Bank recorded a loss of KShs 1,639 million (inclusive of foreign currency translation losses amounting to KShs 1,247 million occasioned by appreciation of the Kenya Shilling against hard currencies during part of the financial year). This is in comparison to a profit of KShs 23,229 million in 2009(inclusive of foreign currency translation gain of KShs 13,462 million). This subdued performance over the previous year is mainly due to interest rates for all term deposits that fell from an average of more than 2% in 2009 to an average of under 0.5% in 2010 for USA Dollar, Sterling Pounds and Euros owing to the ongoing World economic turbulence. This drop in interest rates contributed substantially to the 65% fall in interest income from KShs 8,852 million in 2009 to KShs 3,089 million in the year under review. Another main factor that contributed to the fall in net surplus in the year 2010 is the fact that the income for 2009 included an amount of Kshs 3,141 million that related to the sale of the former Grand Regency Hotel. Furthermore, some operating expenses such as staff costs (15% more), depreciation (35% more) and currency printing costs (18% more) registered higher costs all totaling KShs 1,019million over previous year's due to a one off staff remuneration package effected in the year; acquisition of equipment and change in policy on treatment of intangible assets and the need to meet increased demand for cash in the economy. However, the above adverse cost effects were moderated by reduction in expenses associated with conduct of monetary policy that were KShs 332 million lower than the previous year's owing to less need for mop-ups due to tight liquidity prevailing in the economy for most part of the year under review.

3.2 Financial position

The financial position of the Bank is set out in the statement of financial position on page 79. During the year under review, the assets of the Bank increased by KShs 59,865 million (20%). The increase is mainly due to foreign currency reserves that increased by KShs 37,948 million or 10% owing to earnings from the reserves and net purchases to build up reserves. Increasing the assets also are the Special Drawing Rights amounting to SDR 224 million and equivalent to KShs 25,828 million allocated to the Bank by IMF during the year. The other factor that added to the assets is Government borrowing from the Bank that went up by KShs 12,357 million during the year in line with the new borrowing limit that has been raised to KShs 22 billion. Borrowings by commercial banks from the Bank fell significantly by KShs 15 billion owing to relative stability of liquidity in the economy leading to less need by commercial banks to rely on the Bank for day to day liquidity needs for the better part of the financial year.

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
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3.2. Financial position (Continued)

The rise in the assets of the Bank during the year under review was also countered and boosted by minor decreases and increases in balances of other assets.

Correspondingly, liabilities and equity also increased by KShs 59,865million (20%) mainly due to recognition of the above SDRs equivalent to KShs 25,828 million as liabilities owing to IMF. Other significant increases were reported in deposits from commercial banks and currency in circulation by KShs 17,591million or 14% and KShs 16,982 million or 16% respectively. The increase in currency in circulation mirror demand for cash in the economy. Other liabilities also went up significantly by KShs 5,646 million or 381% due to increase in un-cleared (impersonal accounts) effects by KShs 4,421 million and bonds pending payment that increased by KShs 1,026 million (100%). The above increases were moderated by a reduction in Equity by KShs 8,839 million due to payment of dividends to the government amounting to KShs 7,200 million and the net deficit of KShs 1,639 million incurred during the year under review.

4. Dividend

Having regard to the financial results described above where the Bank registered an unrealized loss of KShs 1,639 million and the needs of the shareholder, the Board of Directors recommend payment of KShs 2.0 billion dividend for the year ended 30 June 2010 (2009: KShs 7.2 billion).

5. Directors

The directors who served during the year and up to the date of this report are listed on page 70.

6. Auditors

The auditors, KPMG Kenya, were appointed during the financial year 2009/10 in line with the Public Procurement and Disposal Act, 2005 for a period of three years and are serving their first year in the audit of the year under review.

BY ORDER OF THE BOARD

K. K. Abuga
BOARD SECRETARY

Date: 20th September, 2010

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 78 to 128 which comprise the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors responsibility includes: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances; designing, implementing and maintaining internal controls relevant to the preparation and presentation of these financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

The Directors accept responsibility for the 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 of Kenya 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 its 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 20 September 2010 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 constitute the Governor who is also the Chairman, Deputy Governor, who shall also be the Deputy Chairman, the Permanent Secretary to the Treasury, who is a non-voting member and five Non-Executive Directors. Other than the Permanent Secretary to the Treasury who is ex-officio, all the others are appointed by the President of the Republic of Kenya for terms of four years each and are eligible for reappointment provided that no Governor, Deputy Governor or director shall hold office for more than two terms.

Currently there are four Non-Executive Directors namely Messrs Joseph K. Waiguru, Nicholas A. Nesbitt, William O. Ogara and Ms Agnes Wanjiru who are all serving their first term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

Board meetings

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

Audit Committee

The Audit Committee is chaired by Dr. William O. Ogara and has three other members who are Non-Executive Directors having experience in Accounting, Auditing, Banking, Financial Management and Information Technology. 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;
- 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.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (continued)

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
- Dr. Rose W. Ngugi-external member appointed by Minister for Finance
- Mrs. Sheila S.M.R. M'Mbijjewe-external member appointed by Minister for Finance
- Mr. Wycliffe Mukulu-external member appointed by Minister for Finance
- Mr. Charles Koori- internal member appointed by Governor
- Mr. John K. Birech-internal member appointed by Governor

Human Resources Committee

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

Management Structure

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on page 70. 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.

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial year 2009/10 is disclosed in note 29 (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.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (continued)

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 Bank financial statements of Central Bank of Kenya set out on pages 78 to 128 which comprise the statements of financial position of the Bank at 30 June 2010, and the Bank's statement of comprehensive income, statement of changes in equity of the Bank and cash flow statement of the Bank 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 73, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with 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 2010, and the Bank's 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: 20 September 2010

CENTRAL BANK OF KENYA
STATEMENT COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 KShs'million	2009 KShs'million
Interest income	4	3,089	8,852
Interest expense	5	(91)	(432)
Net interest income		**2,998**	**8,420**
Fee and commission income	6	3,005	3,005
Foreign exchange (loss)/gain	7	(1,247)	13,462
Other operating income	8	984	4,849
Operating income		**5,740**	**29,736**
Operating expenses	9	(7,379)	(6,507)
(Loss)/profit for the year		**(1,639)**	**23,229**
Other comprehensive income		-	-
Total comprehensive income		**(1,639)**	**23,229**

The notes set out on pages 82 to 128 form an integral part of these financial statements.

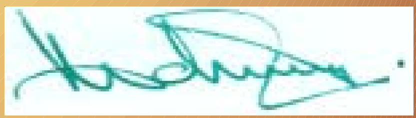
CENTRAL BANK OF KENYA

STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2010

ASSETS	Note	KShs million	KShs million
Balances due from banking institutions and gold holdings	10	284,682	246,734
International Monetary Fund	11	26,272	914
Items in the course of collection	12	316	1,430
Advances to banks	13	31	15,011
Loans and advances	14	20,674	8,317
Other assets	15	2,462	2,870
Retirement benefit asset	16	1,894	1,425
Property and equipment	17	1,024	1,034
Prepaid operating lease rentals	18	272	275
Intangible assets	19	853	378
Due from Government of Kenya	20	33,102	33,329
TOTAL ASSETS		**371,582**	**311,717**
LIABILITIES			
Currency in circulation	21	125,024	108,042
Deposits	22	143,228	125,637
International Monetary Fund	11	63,276	37,448
Other liabilities	23	7,134	1,488
Dividends payable	24	2,641	-
Provisions	25	113	97
TOTAL LIABILITIES		**341,416**	**272,712**
EQUITY AND RESERVES			
Share capital	26	5,000	5,000
General reserve fund	27	23,166	26,805
Proposed dividend	28	2,000	7,200
TOTAL EQUITY AND RESERVES		**30,166**	**39,005**
TOTAL LIABILITIES AND EQUITY		**371,582**	**311,717**

The financial statements were approved by the Board of Directors for issue on 20 September 2010 and signed on its behalf by:



Governor

Director

The notes set out on pages 82 to 128 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30 2010

	Share capital KShs million	General reserve fund KShs million	Proposed Dividend KShs million	Total KShs million
At 1 July 2008				
Opening balance as previously stated	1,500	12,754	4,000	18,254
Prior year adjustment*	-	1,522	-	1,522
Restated opening balance	**1,500**	**14,276**	**4,000**	**19,776**
Comprehensive income for the year				
Profit for the year	-	23,229	-	23,229
Total comprehensive income for the year	**-**	**23,229**	**-**	**23,229**
Transactions with owners directly recorded in equity				
Additional capital paid during the year	3,500	(3,500)	-	-
2008 dividends paid	-	-	(4,000)	(4,000)
Proposed dividend	-	(7,200)	7,200	-
Total contributions by and distribution to the owners	**3,500**	**(10,700)**	**3,200**	**(4,000)**
As at 30 June 2009	**5,000**	**26,805**	**7,200**	**39,005**
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 year	**-**	**(1,639)**	**-**	**(1,639)**
Transactions with owners directly recorded in equity				
2009 dividends paid	-	-	(4559)	(4559)
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**

The notes set out on pages 82 to 128 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30 2010

	Note	2010 KShs'million	2009 KShs'million
Operating activities			
Net cash (absorbed)/generated by operating activities	29(a)	**35,756**	**14,161**
Investing activities			
Receipts of government loan		227	1,110
Purchase of property and equipment		(650)	(697)
Purchase of intangible assets		(379)	(388)
Proceeds from disposal of property and equipment		-	10
Proceeds from International Monetary Fund - SDR accounts		(25,358)	(708)
Net cash used in investing activities		**(26,160)**	**(673)**
Financing activities			
Dividends paid		(4,559)	(4,000)
Currency in circulation		16,982	8,292
Net cash from financing activities		**12,423**	**4,292**
Net increase in cash and cash equivalents		22,019	17,780
Cash and cash equivalents at start of year		256,542	225,300
Exchange rate effects		(1,247)	13,462
Cash and cash equivalents at end of year	29(b)	**277,314**	**256,542**

The notes set out on pages 82 to 128 form an integral part of these financial statements

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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.

(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*.

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

(vi) New standards adopted during the year

On 1 January 2009, the Bank retrospectively adopted IAS 1; *Presentation of Financial Statements (revised in 2007)*. As a result in the financial statements, certain disclosures and note terminologies have changed. In addition changes in owners' equity are presented in the statement of changes in equity while all non owner changes in equity are presented in other comprehensive income.

(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. 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 2010

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. 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.

(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 2010

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 Bank provides free medical treatment to staff, spouse and up to a maximum of four children below the age of 23 years. The related expenses are recognised once incurred.

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

(f) Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated 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.

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 accumulated 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 2010

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 Controller and Auditor-General.

The Bank also operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The Bank determines the terms and conditions for granting of the above loans with reference to the prevailing market interest rates and may determine different rates for different classes of transactions and maturities.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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 2010

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 2010

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 2010

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 netted off against the liability for 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 4.5% 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.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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 Board of directors in the year 2007 passed a policy on dividends payments to the Government of Kenya stating all dividends should be net of unrealised revaluations gains and after taking into the 10% retained earnings as required by the Central Bank of Kenya Act Cap 491.

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 2010

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 2010, and have not been applied in preparing these financial statements as follows:

- Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items* clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments which become mandatory for the Bank's 2011 financial statements, with retrospective application required, is not expected to have a significant impact on the financial statements.

- IAS 24 *Related Party Disclosures* amends the definition of a related party and modifies certain related party disclosure requirements for government related entities. The amendment to IAS 24 will become mandatory for the Bank's 2011 financial statements and are expected to have an impact on the presentation of related party information in the Bank's financial statements.

- IFRS 9 *Financial Instruments*, published on 12 November 2009 as part of phase 1 of the IASB's comprehensive project to replace IAS 39, deals with classification and measurement of financial assets. The requirements of this standard represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets; amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value.

  The standard eliminates the existing IAS 39 categories of *held-to-maturity, available-for-sale* and *loans and receivables*. For an investment in an equity instrument which is not held for trading, the standard permits an irrevocable election, on initial recognition, on an individual share-by-share basis, to present all fair value changes from the investment in other comprehensive income. No amount recognised in other comprehensive income would ever be reclassified to the statement of comprehensive income at a later date. However, dividends on such investments are recognised in the statement of comprehensive income, rather than other comprehensive income unless they clearly represent a partial recovery of the cost of the investment.

  Investments in equity instruments in respect of which an entity does not elect to present fair value changes in other comprehensive income would be measured at fair value with changes in fair value recognised in the statement of comprehensive income.

  The standard requires that derivatives embedded in contracts with a host that is a financial asset within the scope of the standard are not separated; instead the hybrid financial instrument is assessed in its entirety as to whether it should be measured at amortised cost or fair value.

  The standard is effective for annual periods beginning on or after 1 January 2013. Management is in the process of assessing the impact of the revised standard to the Bank.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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 2010

		2010 KShs million	2009 KShs million
4	**INTEREST INCOME**		
	Cash and cash equivalents (Note 4a)	57	21
	Held to maturity investments (Note 4b)	1,015	6,889
	Loans and advances (Note 4c)	1,726	1,821
	Held for trading investments (Note 4d)	291	121
		3,089	**8,852**
(a)	**Interest income from cash and cash equivalents**		
	Interest on Sterling Pound deposits	-	3
	Interest on US Dollar deposits	-	5
	Interest on Euro deposits	-	9
	Income from IMF	57	4
		57	21
(b)	**Interest income from held to maturity investments**		
	Interest on Sterling Pound term deposits	372	3,436
	Interest on US Dollar term deposits	328	2,060
	Interest on Euro term deposits	315	1,393
		1,015	**6,889**

The weighted average interest rates for term deposits were:

	2010	2009
US Dollar	0.36%	1.72%
UK Sterling Pounds	0.48%	2.48%
Euro	0.54%	2.58%

		2010 KShs million	2009 KShs million
(c)	**Interest income from loans and advances**		
	Interest on loan due from Government	993	1,025
	Interest on Government overdraft	314	466
	Interest on staff loans	80	75
	Interest on reverse REPOs	245	70
	Interest on local commercial banks overnight loans	11	45
	Interest on foreign commercial banks overnight loans	3	26
	Other interest income	80	114
		1,726	**1,821**
(d)	Interest income from held for trading investments		
	Interest income – World Bank RAMP	**291**	**121**

During the year, the Bank 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 (2009- US $ 400 million) for the Programme.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

4 INTEREST INCOME (Continued)

	2010 KShs million	2009 KShs million
(e) Additional disclosure on income by source		
Foreign investments earnings	1,366	7,058
Local investments earnings	1,643	1,719
Other interest earnings	80	75
	3,089	**8,852**

5 INTEREST EXPENSE

	2010	2009
Interest on monetary policy issues/ REPOs	2	334
Interest paid to IMF	89	98
	91	**432**

6 FEE AND COMMISSION INCOME

	2010	2009
Commission on sale of Government securities	3,000	3,000
Poverty Reduction and Growth Facility (PRGF) (IMF-GoK) Commission	5	5
	3,005	**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. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.

7 FOREIGN EXCHANGE (LOSS) /GAIN

	2010	2009
Foreign exchange dealing profit (Note 7a)	786	1,470
Foreign Bonds Pending Receivables	13	-
Foreign exchange translation (loss)/gain (Note 7b)	(2,046)	11,992
	(1,247)	**13,462**

(a) Foreign exchange dealing profit

	2010	2009
Gains on sale of foreign exchange to Government	784	1,227
Foreign exchange dealing profit on commercial banks	2	243
	786	**1,470**

(b) Foreign exchange translation loss

	2010	2009
Revaluation (loss)/gain on current accounts	(378)	(1,242)
Revaluation loss on foreign deposits	(3,545)	15,546
Revaluation loss on IMF accounts	(363)	(2,318)
Revaluation of RAMP securities	2,240	-
Others	-	6
	(2,046)	**11,992**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

7 FOREIGN EXCHANGE (LOSS) /GAIN (Continued)

Exchange rates	2010 KShs million	2009 KShs million
US Dollar	81.80	77.05
GBP	123.01	128.83
Euro	99.88	108.90

Foreign currency investment mix	2010	2009
US Dollar	40%+ /-5%	42%
GBP Sterling Pound	30%+/-5%	35%
Euro	20%+/-5%	23%
	100%	100%

8 OTHER OPERATING INCOME

	2010 KShs million	2009 KShs million
Recovery on impaired loan (Note 8a)	-	3,141
Actuarial gain on retirement benefit obligations	468	1,370
Miscellaneous income	36	90
Licence fees from Commercial Banks and bureaus	159	-
Rent received	3	16
KSMS other operating income-hospitality services and tuition fee	318	222
Proceeds from disposal of property and equipment	-	10
	984	4,849

(a) Recovery on impaired loan

	US$ Million	KShs Million
10% on sale of Grand Regency Hotel	4.5	277
90% on sale of Grand Regency Hotel	40.5	2,671
Receipt from the Receiver Manager	-	297
Retirement benefits for employees of the Hotel	-	(104)
	45	3,141

The recovery on impaired loan in 2009 relates to write back of provisions for Exchange Bank Limited loan. In 1992, during a period of severe shortage of foreign currency in Kenya, Exchange Bank sold foreign currency amounting to US$ 210 million to the Bank. Exchange Bank was credited with KShs 13.5 billion being the Kenya shilling equivalent but did not deliver the foreign currency in the Bank's overseas correspondent accounts as required to. The amount of KShs 13.5 billion owing from Exchange Bank was eventually off set by repayments and against deposits held at the Bank and the outstanding balance of about KShs 4.5 billion was secured by way of a legal charge on L.R. No. 209/9514 (belonging to Uhuru Highway Development Limited and trading as Grand Regency Hotel) valued at KShs 2.5 billion. The Hotel was sold in 2008 for US $ 45 million (KShs 3.1 billion) leaving an irrecoverable balance of KShs 1.5 billion that was already fully provided for and with the sale of the hotel, extinguished from the books of the Bank.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

9 OPERATING EXPENSES

	2010 KShs million	2009 KShs million
Staff costs (Note 9(a))	3,736	3,260
Currency expenses (Note 9(b))	1,491	1,260
Property maintenance expenses (Note 9(c))	566	660
Depreciation on property and equipment (Note 17)	544	231
Amortisation on intangible assets (Note 19)	19	28
Other expenses (Note 9(d))	1,011	1,057
Auditors' remuneration	5	4
Banking expenses	4	4
Operating lease rentals (Note 18)	3	3
	7,379	**6,507**

(a) Staff costs

	2010 KShs million	2009 KShs million
Personnel emoluments	3,357	2,925
Medical benefit	143	135
Staff training and development costs	218	188
Directors' expenses	18	12
	3,736	**3,260**

(b) Currency expenses

	2010 KShs million	2009 KShs million
Notes production	1,047	1,108
Coins production	429	140
Notes issue	8	7
Coin Issue	5	5
Agency Centres	2	-
	1,491	**1,260**

(c) Property maintenance expenses

	2010 KShs million	2009 KShs million
Upkeep of property	197	234
Security of premises	204	193
Property renovation	56	121
Electricity	57	71
Others	52	41
	566	**660**

(d) Other expenses

	2010 KShs million	2009 KShs million
Transport and travelling	136	125
Office expenses	108	126
Postal service expense	99	88
Legal and professional fees	100	105
Other administrative expenses	568	613
	1,011	**1,057**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2010 KShs million	2009 KShs million
Cash and cash equivalents (Note 10(a))	15,651	8,975
Held for trading investments (Note 10(b))	33,515	15,449
Held to maturity investments (Note 10(c))	235,459	222,276
Gold holdings	57	34
	284,682	**246,734**

(a) Cash and cash equivalents

Special project accounts	7,051	4,695
Current account	4,350	2,598
Domestic forex currency cheque clearing	4,244	1,676
Forex travellers cheques	6	6
	15,651	**8,975**

(b) Held for trading

US Dollar deposits	16	925
Fixed income securities	33,346	14,469
Accrued interest	153	55
	33,515	**15,449**

(c) Held to maturity investments

Term deposits (Note 10 (c)(i))	235,264	221,824
Accrued interest on term deposits	195	452
	235,459	**222,276**

(i) Term deposits

Dollar deposits	75,773	90,534
Sterling Pound deposits	94,070	80,649
Euro deposits	65,421	50,641
	235,264	**221,824**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

11. INTERNATIONAL MONETARY FUND

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

	2010		2009	
	SDR Million	KShs Million	SDR' Million	KShs Million
Assets				
IMF balances (SDR asset account)	218	26,272	8	914
Liabilities				
International Monetary Fund Account No. 1	20	2,430	20	3,128
International Monetary Fund Account No. 2	-	4	-	3
International Monetary Fund – PRGF Account	279	33,734	281	33,599
IMF-SDR Allocation account	218	26,867	-	-
International Monetary Fund loans to Government of Kenya	2	241	6	718
	519	63,276	307	37,448
Security at 30 June	238	28,079	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.

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) is accounted for in the books of the Government of Kenya.

12 ITEMS IN THE COURSE OF COLLECTION

	2010 KShs million	2009 KShs million
Items in the course of collection	**316**	**1,430**

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

13 ADVANCES TO BANKS

	2010 Kshs Million	2009 Kshs million
REPO Treasury Bills	-	9,552
REPO Treasury Bonds	-	5,437
Treasury Bonds Discounted	17	10
Treasury Bills Discounted	13	9
Accrued interest	1	3
	31	**15,011**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

13 ADVANCES TO BANKS (Continued)

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

	2010 KShs million	2009 KShs million
Irrecoverable amount from banks under liquidation	3,767	3,767
Government overdraft account (see below and Note 30)	17,649	5,124
Loan from IMF to the Government of Kenya (Note 30)	241	718
Advances to employees		
Salary advance	186	178
Car loans	419	379
Housing scheme	1,916	1,746
Development loan	280	189
	24,458	12,101
Provision for loan impairment (banks & staff)	(3,784)	(3,784)
Net advances as at 30 June	**20,674**	**8,317**

Movement in the loan impairment allowance is as follows:

	2010	2009
At start of the year	(3,784)	(8,352)
Additional impairment allowance made during the year	(1)	(63)
Irrecoverable amount on sale of the Hotel	-	1,490
Recoveries on sale of the Hotel in the year (Note 8a)	-	3,141
Other recoveries	1	-
At end of the year	**(3,784)**	**(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 based on the Government financial statements for 2007/2008, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 16,882,643,732 based on the Government financial statements for 2006/2007.

15. OTHER ASSETS

	2010 KShs million	2009 KShs million
Prepayments and sundry debtors	678	972
Deferred currency expenses	1,570	1,580
Advances	214	318
	2,462	**2,870**

The policy of the Bank is to recognise currency notes expenses upon issuing out of currency notes for circulation.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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.

	2010 KShs million	**2009 KShs million**
Present value of funded obligations	11,550	9,582
Fair value of plan assets	(14,868)	(11,678)
Present value of net asset	(3,318)	(2,096)
Unrecognised actuarial gain	1,424	671
Balance at 30 June	**(1,894)**	**(1,425)**

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

Current service costs	507	453
Interest costs	844	921
Expected return on plan assets	(1,087)	(1,085)
Net gains recognised in the year	-	(67)
Adjustment for previous year values	(399)	(135)
Past service cost	-	(1,138)
Total expenses included in operating expenses	(135)	(1,051)

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

Net liability at start of period	(1,425)	(55)
Net expense recognised in the profit or loss	(135)	(1,051)
Employer contributions	(334)	(319)
Net liability at end of period	(1,894)	(1,425)
Actual return on plan assets	**2,852**	**(380)**

The principal actuarial assumptions at the reporting date were:

	2009	2008
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 2010

16 RETIREMENT BENEFIT ASSET (Continued)

Historical information	2010 KShs million	2009 KShs million	2008 KShs million	2007 KShs million	2006 KShs million
Fair value of plan assets	14,868	11,678	12,136	10,774	9,260
Present value of funded obligations	(11,550)	(9,582)	(10,496)	(9,416)	(8,126)
Retirement benefit obligations	**3,318**	**2,096**	**1,640**	**1,358**	**1,134**

17 PROPERTY AND EQUIPMENT

30 June 2010 Cost	**Land and buildings KShs million**	**Motor vehicles KShs million**	**Furniture and Equipment KShs million**	**Total KShs million**
At start of year	988	196	3,813	4,997
Reclassification to intangible asset (Note 19)	-	-	(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**
30 June 2009				
Cost				
At start of year	987	215	3,130	4,332
Additions	1	13	683	697
Disposals	-	(32)	-	(32)
At end of the year	988	196	3,813	4,997
Depreciation				
At start of the year	945	169	2,651	3,765
Charge for the year	9	39	183	231
Eliminated on disposal	-	(32)	-	(32)
At end of the year	954	176	2,834	3,964
Net book value at 30 June 2009	**34**	**20**	**979**	**1,033**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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:

	2010 KShs million	2009 KShs million
Cost		
At 30 June	300	300
Amortisation		
At 1 July	25	22
Amortisation for the year	3	3
At end of the year	28	25
Net carrying value at end of the year	**272**	**275**

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	2010 Total KShs million	2009 Total KShs million
Cost				
At 1 July	217	351	568	180
Reclassification from property and equipment(Note 17)	-	115	115	-
At 1 July 2009 restated	217	466	683	180
Additions	3	376	379	388
At end of the year	220	842	1,062	568
Amortisation				
At 1 July	190	-	190	162
Amortisation for the year	19	-	19	28
At end of the year	209	-	209	190
Net carrying value at end of the year	**11**	**842**	**853**	**378**

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

CENTRAL BANK OF KENYA
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20 DUE FROM GOVERNMENT OF KENYA

	2010 KShs million	2009 KShs million
At start of the year	33,329	34,439
Accrued interest receivable	328	-
Receipts during the year	(555)	(1,110)
At end of the year	**33,102**	**33,329**

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

	2010 KShs million	2009 KShs million
Kenya notes	120,574	104,002
Kenya coins	4,444	4,034
Commemorative coins	6	6
	125,024	**108,042**
Balance at the beginning of the year	108,042	99,750
Deposits by banks	(271,430)	(283,489)
Withdrawals by banks	288,412	291,781
Balance at the end of the year	**125,024**	**108,042**

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 netted off against the liability for 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 2010

22 DEPOSITS

	2010 KShs million	2009 KShs million
Local commercial banks (Note 22 a)	85,236	51,901
Local banks forex settlement accounts (Note 22 b)	3,669	1,297
External banks forex settlement accounts	94	89
Other public entities and project accounts	10,672	8,181
Government of Kenya(Note 22 c)	43,557	64,169
	143,228	**125,637**

(a) Local commercial banks

Clearing accounts	34,681	7,974
Cash reserve ratio	50,555	43,927
	85,236	**51,901**

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. Prior to that, the ratio was 6% and it is currently at 4.5%. 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. Currently there are 43 licensed commercial banks and 2 mortgage finance companies.

(b) Local banks forex settlement accounts

	2010 KShs million	2009 KShs million
Euro	441	228
Dollar	2,900	952
Sterling Pound	328	117
	3,669	**1,297**

(c) Government of Kenya

Paymaster General	22,504	23,785
Treasury Funding Account	17,151	15,747
The Exchequer Account	1,601	18,417
Others	2,301	6,220
	43,557	**64,169**

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
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23 OTHER LIABILITIES

	2010 KShs million	2009 KShs million
Impersonal accounts	4,707	325
Sundry creditors	733	663
Bonds Pending payables	1,026	-
Refundable deposits	668	421
Development deposits	-	79
	7,134	1,488

24 DIVIDENDS PAYABLE

Dividends payable	2,641	-

The movement in dividends payable is as follows:

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

25 PROVISIONS

Leave accrual	60	66
Gratuity to staff members	53	31
	113	97

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.

28 DIVIDENDS

The directors have recommended payment of a dividend of KShs 2.0 billion for the year ended 30 June 2010 (2009: KShs 7.2 billion).

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

29(a) NOTES TO THE CASH FLOW STATEMENT

Cash flows from operating activities	**2010 KShs million**	**2009 KShs million**
Net (loss)/profit for the year	(1,639)	23,229
Adjustments for:		
Depreciation of property and equipment	545	231
Amortization of prepaid operating leases	3	3
Amortization of intangible assets	19	28
Revaluation of currency production costs	-	1,522
Exchange rate loss/(profit) effects	1,247	(13,462)
Gain on disposal of property and equipment	-	(10)
Surplus in defined benefit scheme	(469)	(1,370)
Operating profit before working capital changes	**(294)**	**10,171**
Net increase in loans and advances	(12,357)	(4,857)
Decrease in amounts repayable under repurchase agreements	-	(1,807)
Increase in balance with International Monetary Fund	25,828	17,751
Increase in project accounts	-	(244)
(Increase)/decrease in accrued interest on balances due from banking institutions	(2,196)	1,767
Decrease in items in the course of collection	1,114	1,455
Increase/(decrease) in deposits	17,591	(5,504)
Decrease/(increase) in other assets	408	(1,626)
Increase/(decrease) in other liabilities	5,662	(2,945)
Net cash generated by operations	**35,756**	**14,161**

(b) Cash and cash equivalents

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

	2010 KShs million	**2009 KShs million**
Term deposits	235,264	221,824
Current accounts	4,350	2,598
Domestic forex cheques clearing	4,244	1,676
Travellers Cheques	6	6
Gold holdings	57	34
	243,921	226,138
Advances to Banks	31	15,010
Investments with RAMP	33,362	15,394
	277,314	**256,542**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2010

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 2010 amounted to KShs 2,801 million (2009: KShs 2,492 million). The advances are at preferential rates of interest determined by the Bank.

		2010 KShs million	2009 KShs million
(ii)	**Loans to executive directors**		
	At start of the year	9	1
	Loans advanced during the year	-	10
	Loan repayments	(3)	(2)
	At end of the year	**6**	**9**
(iii)	**Loans to key management personnel**		
	At start of the year	39	18
	Loans advanced during the year	57	41
	Loan repayments	(34)	(20)
	At end of the year	**62**	**39**
(iv)	**Directors' emoluments:**		
	Fees to non executive directors	15	25
	Other remuneration to executive directors	50	50
		65	**75**
(v)	**Remuneration to senior management**	**182**	**148**
(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;
- 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 2010 (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:

Due from Government of Kenya (Note 20)	33,102	33,329
Overdraft account (Note 14)	17,649	5,124
Loan from IMF to the Government of Kenya (Note 11)	241	718
Government of Kenya deposits (Note 22)	43,557	64,169

(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 26 million (2009: KShs 13million).

(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 and Risk Management Department.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (continued)

31 RISK MANAGEMENT (Continued)

(a) Structure and Reporting (continued)

(ii) Internal Audit and Risk Management Department (IARM)

The Internal Audit arm of IARM 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 Audit Committee. Action plans that are taken to reduce the risks to acceptable levels are monitored.

(b) 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.

31 RISK MANAGEMENT (Continued)

(c) 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 2010 (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):

	2010 KShs million	2009 KShs million
Individually impaired:		
Staff loans	49	30
Banks in liquidation	3,766	3,767
	3,815	3,797
Allowance for impairment	(3,784)	(3,784)
	31	**13**
Loans past due but not impaired:		
Past due upto 30 days	33,102	33,329
Past due 31 – 60 days	-	-
Past due 61 – 90 days	-	-
Past due 91 – 150 days	-	-
	33,102	**33,329**
Loans neither past due nor impaired:		
Staff loans and advances	2,752	2,463
IMF on let to the Goverment	241	717
Goverment Overdraft	17,649	5,124
	20,642	**8,304**

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:

	2010 KShs Millions	2009 KShs Millions
Assets		
Republic of Kenya	63,408	65,736
United Kingdom	189,088	194,138
Rest of Europe	2,310	31,341
United states of America	116,243	20,481
Rest of the World	533	21
	371,582	**311,717**
Liabilities		
Republic of Kenya	**371,582**	**311,717**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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 2010		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
Assets						
Balances due from banking institutions and gold holdings	0.36-0.54%	277,283	348	-	7,051	284,682
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	-	-	-	-	2,462	2,462
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**	**13,872**	**371,582**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk - continued

As at 30 June 2010		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	-	-	-	-	125,024	125,024
Deposits	-	-	-	-	143,228	143,228
International Monetary Fund	-	-	-	-	63,276	63,276
Other liabilities	-	-	-	-	7,134	7,134
Provisions	-	-	-	-	113	113
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	30,166	30,166
Total liabilities and equity		**-**	**-**	**-**	**371,582**	**371,582**
Interest sensitivity gap 2010		**278,271**	**1,699**	**77,740**	**-357,710**	**-**

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk - continued		3 months or less	Between 3-12 months	Over 1 year	Non- interest bearing	Total
As at 30 June 2009	**Interest rate**	**KShs million**	**KShs million**	**KShs million**	**KShs million**	**KShs million**
Assets						
Balances due from banking institutions and gold holdings	1.72-2.58%	242,039	-	-	4,695	246,734
International Monetary Fund (SDR Account)	0-0.5%	914	-	-	-	914
Items in the course of collection	-	-	-	-	1,430	1,430
Advances to Banks	-	15,011	-	-	-	15,011
Loans and advances	3%	74	934	7,309	-	8,317
Other assets	-	-	-	-	2,870	2,870
Property, plant and equipment	-	-	-	-	1,034	1,034
Prepaid leasehold land	-	-	-	-	275	275
Intangible assets	-	-	-	-	378	378
Retirement benefit asset	-	-	-	-	1,425	1,425
Due from Government of Kenya	3%	-	1,110	32,219	-	33,329
Total assets		**258,038**	**2,044**	**39,528**	**12,107**	**311,717**
Liabilities and equity	-					
Currency in circulation	-	-	-	-	108,042	108,042
Deposits	-	-	-	-	125,637	125,637
International Monetary Fund	-	-	-	-	37,448	37,448
Other liabilities	-	-	-	-	1,488	1,488
Provisions	-	-	-	-	97	97
Equity and reserves	-	-	-	-	39,005	39,005
Total liabilities and equity		-	-	-	311,717	311,717
Interest sensitivity gap 2009		**258,038**	**2,044**	**39,528**	**-299,610**	**-**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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. The Board is yet to establish limits on exposure gaps; these limits will be utilised to ensure risk positions are effectively managed. The limits will provide possible alternative assumptions to be applied as well as professional judgement to an analysis of the data available to support each assumption.

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(b). 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:

	2010 KShs million	**2009 KShs million**
Effect on profit before tax of a +13% change in interest rates	101	440
Effect on profit before tax of a -13% change in interest rates	(101)	(440)

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: 30 - 40%
GDP: 45 - 55%
EUR: 10 - 20%
CHF: 0 - 5%

The net foreign currency position of the Bank as of 30 June 2010 and 2009 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 2010 (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							
Balances due to IMF	-	-	-	63,276	-	-	63,276
Commissions for EEC Development Fund	-	-	-	-	-	-	-
Local Banks forex settlements	2,900	441	328	-	-	-	3,669
Local bank guarantees	488	-	-	-	-	-	488
Forex bureaux deposits	180	-	-	-	-	-	180
Total liabilities	3,568	441	328	63,276	-	-	67,613
Net statement of financial position at June							
2010	**133,844**	**75,838**	**70,060**	**-37,004**	**57**	**542**	**243,337**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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 2009 are summarised below (all expressed in KShs million):

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	112,263	82,955	51,425	-	-	57	246,700
Special Drawing Rights	-	-	-	914	-	-	914
Gold holdings	-	-	-	-	34	-	34
Total assets	112,263	82,955	51,425	914	34	57	247,648
Liabilities							
Balances due to IMF	-	-	-	37,448	-	-	37,448
Commissions for EEC Development Fund	-	-	79	-	-	-	79
Local Banks forex settlements	952	118	229	-	-	-	1,299
Local bank guarantees	272	-	-	-	-	-	272
Forex bureaux deposits	148	-	-	-	-	-	148
Total liabilities	1,372	118	308	37,448	-	-	39,246
Net statement of financial position 2009	**110,891**	**82,837**	**51,117**	**-36,534**	**34**	**57**	**208,402**

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.

	2010	2009
	KShs million	**KShs million**
Effect on profit before tax of a +7% change in exchange rates	21,766	16,093
Effect on profit before tax of a -7% change in exchange rates	-21,766	-16,093

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk

Liquidity risk is defined as having difficulty in finding 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.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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.

LIABILITIES	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	-	-	-	-	125,024	125,024
Deposits	92,673	-	50,555	-	-	143,228
International Monetary Fund	-	-	241	1,535	61,500	63,276
Other liabilities	-	-	7,134	-	-	7,134
Provisions		-	113			113
Dividends payable	-	-	2,641	-	-	2,641
TOTAL LIABILITIES	92,673	-	60,684	1,535	186,524	341,416
Liquidity gap 2010	**-92,673**	**-**	**-60,684**	**-1,535**	**-186,524**	**-341,416**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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 2009 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	-	-	-	-	108,042	108,042
Deposits	81,710	-	43,927	-	-	125,637
International Monetary Fund	-	-	413	1,535	35,500	37,448
Other liabilities	-	-	1,488	-	-	1,488
Provisions	-	-	97	-	-	97
TOTAL LIABILITIES	81,710	-	45,925	1,535	143,542	272,712
Liquidity gap 2009	**-81,710**	**-**	**-45,925**	**-1,535**	**-143,542**	**-272,712**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (continued)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(ii) 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 2010 (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 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
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	-	-	-	-	2,462	2,462	2,462
Due from Government of Kenya	-	-	33,102	-	-	33,102	33,102
Total assets	**33,515**	**235,459**	**96,103**	**-**	**2,462**	**367,539**	**367,539**
Liabilities							
Currency in circulation	-	-	-	-	125,024	125,024	125,024
Deposits	-	-	-	-	143,228	143,228	143,228
International Monetary Fund	-	-	-	-	63,276	63,276	63,276
Other liabilities and provisions	-	-	-	-	9,888	9,888	9,888
Total liabilities	**-**	**-**	**-**	**-**	**341,416**	**341,416**	**341,416**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (continued)

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

30 June 2009:	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	15,449	222,276	9,009	-	-	246,734	246,734
International Monetary Fund	-	-	914	-	-	914	914
Items in the course of collection	-	-	1,430	-	-	1,430	1,430
Advances to Banks	-	-	15,011	-	-	15,011	15,011
Loans and advances	-	-	8,317	-	-	8,317	8,317
Other assets	-	-	-	2,870	-	2,870	2,870
Due from Government of Kenya	-	-	33,329	-	-	33,329	33,329
Total assets	**15,449**	**222,276**	**68,010**	**2,870**	**-**	**308,605**	**308,605**
Liabilities							
Currency in circulation	-	-	-	-	108,042	108,042	108,042
Deposits	-	-	-	-	125,637	125,637	125,637
International Monetary Fund	-	-	-	-	37,448	37,448	37,448
Other liabilities and provisions	-	-	-	-	1,585	1,585	1,585
Total liabilities	**-**	**-**	**-**	**-**	**272,712**	**272,712**	**272,712**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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 illiqu 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 2010:

30 June 2010:	**Level 1 KShs million**	**Level 2 KShs million**	**Level 3 KShs million**	**Tota KShs millioı**
Assets				
Balances due from banking institutions and Gold holdings	33,362	-	251,320	284,68:
Total assets	**33,362**	**-**	**251,320**	**284,68:**

30 June 2009:	**Level 1 KShs million**	**Level 2 KShs million**	**Level 3 KShs million**	**Tota KShs millioı**
Assets				
Balances due from banking institutions and Gold holdings	15,449	-	231,285	246,73
Total assets	**15,449**	**-**	**231,285**	**246,73**

The effective interest rates for the principal financial assets and liabilities at 30 June 2010 and 2009 were in the following ranges:

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NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (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 2010 and 2009 were in the following ranges:

	2010	2009
Assets		
Government securities	6.64%	6.64%
Deposits with overseas correspondent banks		
- current accounts	0.0%	0.0%
- term deposits (USD)	0.36%	1.72%
- term deposits (Sterling Pounds)	0.48%	2.48%
- term deposits (Euro)F	0.54%	2.58%
Loans and advances - commercial banks	6.50%	8.50%
- Government of Kenya	6.50%	8.50%
- employees	3.0%	3.0%
Due from Government of Kenya	3.0%	3.0%
Liabilities		
- deposits	0.0%	0.0%

33 CONTINGENCIES

(i) The Bank is party to various legal proceedings with potential liability of KShs 496.8 million as at 30 June 2010(2009- KShs 496.5 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.

(ii) The Bank has applied for waiver of interest and penalties amounting to KShs 22,530,780 relating to PAYE and withholding tax arising from an assessment conducted by Kenya Revenue Authority. 32.5 % waiver was approved and the Bank has lodged another appeal requesting to be awarded full waiver and now awaiting the response. The directors are of the opinion that the liability will not crystallize because of the expected success of the request for waiver.

34 COMMITMENTS

		2010 KShs million	2009 KShs million
(a)	Capital: Authorised and contracted for	-	17
(b)	Capital: Authorised and not contracted for		
	Office furniture	1	491
	Office equipment	6	1,291
	Computer equipment	3	1,136
	Computer equipment - SIMBA Software	-	677
	Computer equipment - SIMBA Hardware	164	261
	Fixtures & fittings	-	158
	Motor vehicles	4	53
	Consultancy contracts	-	358
	Plot acquisition & development	-	650
	Others	15	86
		193	**5,161**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2010 (continued)

35 OPERATING LEASE COMMITMENTS

AS LESSEE:

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

	2010 KShs million	2009 KShs million
One year	2	11
Between two and five years	10	7
Over five years	180	140
	192	**158**

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

36 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.