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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 2008/09. 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, 2009.



**Njuguna Ndung'u**

**Governor**

## **PREFACE**

In the first half of the fiscal year 2007/08, all key sectors of the economy recorded improved performance. Partly reflecting this improvement, the economy which had grown by 6.3 percent in 2006, grew by 7.1 percent in 2007. Key sectors including transport and communications, building and construction and tourism contributed to the good performance. However, in the second half of the fiscal year 2007/08, the performance of the economy declined to a growth of 0.8 percent following the post election crisis, unfavourable weather conditions, high costs of production and high international crude oil prices. This slowdown continued into the first half of fiscal year 2008/09 with GDP growth at 2.5 percent from 6.2 percent in a similar period of 2007/08. Consequently, economic growth decelerated to 1.7 percent in 2008. During the third quarter of fiscal year 2008/09, the economy turned around to a growth of 3.9 percent.

Monetary policy remained focused on maintaining price stability over the review period. Overall inflation was high in the fiscal year 2008/09 due to the supply shocks arising from the delayed effects of the post election crisis and drought which hit the economy in the second quarter of the fiscal year. While the world commodity prices significantly dropped in the first half of the fiscal year, its benefits were offset by the depreciation of the Kenya shilling exchange rate following the global financial crisis. As a result, overall inflation averaged 25.3 percent in 2008/09 compared to 18.2 percent in 2007/08. Average underlying inflation also increased to 8.5 percent from 6.0 percent over the same period. Consequently, the monetary policy objective of maintaining inflation at 5.0 percent was not realised.

The performance of the banking sector remained strong in the fiscal year. The banking sector maintained high capital adequacy ratios, adequate liquidity and low non-performing loans in relation to gross loans. Gross loans and advances increased leading to better asset quality and improved profitability.

The balance sheet of the Central Bank increased by 13 percent in the fiscal year 2008/09. The expansion reflected efforts to maintain the required statutory foreign reserves import cover and lending to commercial banks to ease liquidity tightness in the money market. The bank's profits increased by 158.2 percent, owing to foreign currency transaction gains, proceeds from the sale of Grand Regency Hotel (held by the Bank as security against receivable costs that had been fully provided for) and lower costs for monetary policy operations. Owing to the improved performance, approved dividends to Government increased by 80 percent to Ksh 7.2 billion from Ksh 4 billion paid out in the fiscal year 2007/08.

The Central Bank was actively involved in several regional integration initiatives particularly those relating to monetary integration. The Bank participated in the implementation of monetary co-operation programmes of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB).

Since the operationalization of the Micro-finance Act in May 2008 several regulations were issued for deposit-taking microfinance business. The Bank approved twenty-nine business names, issued one license to commence deposit taking business and gave a letter of intent to one applicant. Seven more applications are at different stages of consideration. The implementation of this Act is expected to lead to orderly growth and development of the micro-finance industry, which continues to meet the needs of the increasing number of un-banked and under-served segment of the Kenyan population.

Although the economy suffered major setbacks in the months following the December 2007 elections, the global recession and the drought conditions, some sectors such as tourism have started recovering. The outlook for the fiscal year 2009/10 is therefore positive, supported by growth enhancing policies being implemented by the Coalition Government. It is also expected that the transient inflationary pressures caused by effects of the post election crisis, high international prices and the drought effects will dissipate and subsequently unlock any postponed investment ventures. The Central Bank shall continue to implement monetary policy to support economic recovery while keeping watch on inflation expectations.

## UTANGULIZI

Katika kipindi cha kwanza cha mwaka wa kifedha 2007/ 08, sekta zote kuu katika uchumi ziliimarika kiutendakazi. Ili kudhihirisha kuimarika huku, uchumi ambao ulikuwa umestawi kwa asilimia sita nukta tatu (6.3%) mwaka wa 2006, uliimarika hadi kiwango cha asilimia saba nukta moja (7.1%) mwaka wa 2007. Sekta kuu zikiwemo uchukuzi na mawasiliano, nyumba na ujenzi pamoja na utalii zilichangia kuimarika huku. Hata hivyo, katika kipindi cha pili cha mwaka wa kifedha 2007/ 08, utendakazi wa kiuchumi ulishuka hadi asilimia nukta nane (0.8%) kufuatia mchafuko wa baada ya uchaguzi, hali mbaya ya anga, garama ya juu ya uzalishaji na bei ghali ya mafuta ulimwenguni. Hali hii duni iliendelea hadi katika kipindi cha kwanza cha mwaka wa kifedha wa 2008/ 09 nao ustawi wa kinyumbani ukishuka hadi asilimia mbili nukta tano (2.5%) kutoka asilimia sita nukta mbili (6.2%) katika kipindi sawia mwaka uliopita wa 2007/ 08. Kuzidi, ustawi wa kiuchumi ulishuka hadi asilimia moja nukta saba (1.7%) mwaka wa 2008. Katika robo ya tatu ya mwaka wa kifedha 2008/ 09, uchumi uliimarika kwa kiwango cha asilimia tatu nukta tisa (3.9%).

Sera ya kifedha iliendelea kulenga udhibiti wa bei katika kipindi cha uchunguzi. Kiwango jumla cha mfumuko wa bei ulikuwa juu katika mwaka wa kifedha wa 2008/ 09 kutokana na pandashuka za upatikanaji zilizosababishwa na athari za mchafuko wa baada ya uchaguzi na ukame ulioathiri uchumi katika robo ya pili ya mwaka wa kifedha. Ingawa bei za bidhaa ulimwenguni zilishuka kwa kiwango kikubwa katika kipindi cha kwanza cha mwaka huu wa kifedha, manufaa ya kushuka kule yalikwazwa na kushuka kwa thamani ya shilingi ya Kenya katika soko la ubadilishanaji kutokana na mchafuko wa kifedha ulimwenguni. Kutokana na hayo, kiwango jumla cha mfumuko wa bei ukakadiria asilimia ishirini na tano nukta tatu (25.3%) katika kipindi cha 2008/ 09 ikilinganishwa na asilimia kumi na nane nukta mbili (18.2%) katika kipindi cha 2007/ 08. Mfumuko kadiri wa bei pia ulipanda hadi asilimia nane nukta tano (8.5%) kutoka asilimia sita (6%) katika kipindi sawia kilichopita. Hivyo basi lengo, la sera ya kifedha, la kuimarisha mfumuko wa bei katika kiwango cha asilimia tano (5%) halikufanikishwa.

Utendakazi katika sekta ya ubenki ulizidi kuwa dhabiti katika mwaka wa kifedha. Sekta ya ubenki ilidumisha kuwepo kwa viwango vya juu vya migao ya rasilimali, uwezo mkuu wa kifedha na idadi ndogo ya mikopo isiyolipwa ikilinganishwa na jumla ya mikopo yote. Jumla ya mikopo na vishika mkono/ karadha iliongezeka na kuchangia kuimarika kwa ubora wa mali na kuongezeka kwa faida.

Masalio katika vitabu vya hesabu za kifedha yaliongezeka kwa kiwango cha asilimia kumi na tatu (13%) katika mwaka wa kifedha wa 2008/09. kuimarika huku kulionyesha juhudi za kudumisha kiwango kilichohitajika kisheria cha hifadhi za kigeni, bima ya uingizaji na mikopo kwa benki za kibiashara ili kulegeza uwezo wa kifedha katika soko la kifedha. Faida ya Benki iliimarika kwa asilimia mia moja, hamsini na nane nukta mbili (158.2%), kutokana na mapato ya biashara ya pesa za kigeni, mapato kutokana na kuuzwa kwa hoteli ya Grand Regency (iliyochukuliwa na Benki kama dhamana dhidi ya garama za huduma zilizotolewa kikamilifu) na garama ya chini ya shuguli za sera ya kifedha. Kufuatia kuimarika huku, idhini kwa mapato

ya faida iliongezeka kwa asilimia themanini (80%) hadi shilingi bilioni saba nukta mbili (7.2 billion) kutoka shilingi bilioni nne (4 billion) zilizolipwa katika mwaka wa kifedha uliotangulia wa 2007/ 08.

Benki Kuu ilijishugulisha katika miradi kadhaa ya ushirikiano wa kikanda hasa ile inayohusika na ushirikiano wa kifedha. Benki pia ilihusika katika utekelezaji wa miradi ya ushirikiano wa kifedha katika jamii ya Afrika Mashariki (EAC), soko la pamoja la Afrika ya Mashariki na Kusini (COMESA) na Shirikisho la Benki Kuu barani Afrika (AACB).

Tangu kutekelezwa kwa sheria ya mashirika madogo ya kifedha mnamo Mei 2008, kanuni kadhaa zimetolewa kwa mashirika madogo ya kifedha yanayopokea arabuni. Benki iliidhinisha majina ishirinio na tisa ya biashara, imetoa leseni moja ili kuidhinisha upokezi wa arabuni na kukabidhi barua moja ya kuonyesha nia kwa mtumaombi mmoja. Maombi mengine saba yako katika viwango mbalimbali vya utathmini. Kutekelezwa kwa sheria hii inanuiwa kuleta ustawi kwa mpangilio mwafaka na maendeleo katika sekta ya mashirika madogo ya kifedha, ambayo yanazidi kutoa huduma muhimu kwa idadi kubwa ya Wakenya wasio na akaunti katika benki na wapatao huduma duni.

Ingawa uchumi umeathirika pakubwa katika miezi iliyofuatia uchaguzi wa Desemba 2007, sumbivi la kiuchumi ulimwenguni na hali ya kiukame, sekta zingine kama vile sekta ya utalii zimeanza tene kuimarika. Matarajio katika mwaka wa kifedha wa 2009/ 10 ni mema, ikitegemea sera za kukoleza ustawi zikitekelezwa na serikali ya muungano. Inatarajiwa pia kuwa presha za muda za mifumuko ya bei iliyosababishwa na athari za mchafuko wa baada ya uchaguzi, bei za juu za mafuta ulimwenguni na athari za ukame zitapungua na hivyo basi kuwezesha miradi yoyote ya uwekezaji iliyohairishwa. Benki Kuu itaendelea kutekeleza sera ya kifedha ili kusaidia katika ustawi wa kiuchumi na kudhibiti matarajio ya mifumuko ya bei.

## ***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, Resource  
Planning & Strategic  
Management*



**MR. KENNEDY ABUGA**  
*Director, Governor's Office*



**MR. NICHOLAS B.T.A. KORIR**  
*Director, Estates, Supplies and  
Transport Department*



**MS. ROSE A. DETHO**  
*Director, Bank Supervision  
Department*



## **SENIOR MANAGEMENT**



**MR. GERALD A. NYOMA**

*Director, Banking &  
National Payment Systems*



**MR. JACKSON M. KITILI**

*Director, Monetary Operations  
and Debt Management*



**MR. CHARLES G. KOORI**

*Director, Research Department*



**MR. JAMES T. LOPOYETUM**

*Director, Currency Operations  
and Branch Administration*



**MR. WILLIAM NYAGAKA**

*Director, Internal Audit & Risk  
Management*

## MEMBERS OF THE MONETARY POLICY COMMITTEE



Prof. Njuguna Ndung'u  
Governor, Chairman



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



Mr. Joseph K. Kinyua  
PS, Treasury  
Treasury Representative



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



Mr. Charles Koori  
Member



Dr. Rose W. Ngugi  
Member



Prof. Terry C. I. Ryan  
Member



Mr. Wycliffe Mukulu  
Member



Mr. John Birech  
Member

## **BANK REORGANISATION**

### **Appointment of The Deputy Governor**

Dr. Hezron Nyangito was appointed Deputy Governor of the Central Bank of Kenya with effect from September 8, 2008.

### **New Appointments to Management**

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

<b>Appointed</b>	<b>Position</b>	<b>Date</b>
James Teko Lopoyetum	Director, Currency Operations and Branch Administration	18.09.2008
Charles Koori	Director, Research	22.10.2008
Peter K. Rottich	Director, Human Resources and Administration	06.05.2009

### **Retired**

Jones M. Nzomo - Director, Human Resources and Administration

### **Departmental Restructuring**

The Management restructured the Human Resources and Services Department resulting in creation of the Department of Estates, Supplies and Transport; and Human Resources and Administration Department as part of wider strategy to achieve better efficiency and effectiveness in service delivery.

### **Review of Mandatory Retirement age for Public Servants**

The Bank reviewed the mandatory retirement age for its staff from 55 years to 60 years in line with the Government's new policy which took effect from March 5, 2009.

### **Implementation of Performance Management and Appraisal System (PMAS)**

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

## **Regional Games and Inter-Branches Games**

Members of staff in the Banki Kuu Sports Club travelled to Rwanda for reciprocal regional games between National Bank of Rwanda and the Central Bank of Kenya on July 26 - 27, 2008 and inter-branches games in Mombasa from August 29-30, 2008.

## **Central Bank Family Fun Day**

Central Bank of Kenya successfully held the inaugural Central Bank of Kenya (CBK) Family Fun Day on June 13, 2009 at the Kenya School of Monetary Studies. The event was hosted by the Bank to facilitate staff interaction with their families and colleagues.

## **Bank Policy on Training**

The Board approved and circulated the official training policy on Human Resources Development and it became effective from February 19, 2009. The training policy aims to guide and inform human resources development and the allocation of the training budgetary resources towards a holistic human resource development. The gist of training policy is a well tailored choice of courses/programmes and attachments and the cascading of the ideas and experiences attained to build new competencies and develop innovative approaches in handling the threats to the achievements of the Bank's core mandate. The policy articulates goals and objectives of training and outlines the Bank's human resource development strategies.

## **Kenya Public Service Celebrations Week**

The Bank participated in the inaugural Public Service Week celebrations held between August 20-22, 2008 at the KICC COMESA grounds. The event was held in all districts in the country and involved ministries, government departments and state corporations. Activities 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 to understand better how the Bank serves them.

## **Donations for Nakumatt/Molo Fire Victims Fund**

The Board of Directors, members of staff and the CBK Charity Fund Management Committee donated Ksh 10,531,700.00 towards the Presidential Fund for the Nakumatt/Molo fire victims.

## **Technical Advisors**

The Central Bank of Kenya requested technical assistance from development partners to strengthen its Research, Monetary Operations and Debt Management and Currency Operations and Branches Administration Departments. The aim of the technical assistance is to improve

the Bank's macroeconomic and monetary policy management capacity as well as promoting and deepening of domestic debt markets.

The technical assistance covered matters relating to the formulation of monetary policy and macroeconomic and monetary policy management capacity.

The project implementation is through a **Joint-Contribution Agreement** signed between the European Commission (EC) and UNDP on December 31, 2008. This is in addition to the Protocol of Implementation signed between the EC, Treasury and the Central Bank. Central Bank is responsible for the delivery of programme activities to achieve identified benchmarks and capacity building requirements, as set forth in the Annual Work Plan while UNDP provides technical support for implementation and management of the activities under the Annual Work Plan.

The recruitment process for Technical Advisors (TAs) was initiated in October 2008. One Technical Advisor for Research Department was recruited in January 2009. The recruitment process has not yielded suitable candidates for the remaining two positions. In this regard, the Central Bank has approached the Sveriges Riksbank to second two experts to fill the two vacant positions of Technical Advisor, Financial Sector, Debt and Bond Markets and Technical Advisor, Currency Operations and Branch Administration.

### **Relocation of the Deposit Protection Fund Board**

The Operations and staff of the Deposit Protection Fund Board relocated to Marshalls House Building as a further step towards attaining its full autonomy from the Central Bank.

### **Monetary Policy Committee**

The Monetary Policy Committee of the Bank was allocated office space within the executive wing of the Bank building where all its members and operations are housed.

## **1. WORLD ECONOMY**

According to the International Monetary Fund's July 2009 update of the World Economic Outlook, the global economy grew by 3.1 percent in 2008 compared with 5.1 percent in 2007. Most of the slowdown was in advanced economies, particularly in the United States, which experienced housing market strains aggravated by financial stress. The financial crisis which originated in the US subprime market led to a slowdown in economic activity in advanced economies while developing and emerging markets continued to grow at modest rates. Economic performance worsened from September 2008 with the default of Lehman brothers, a large US investment bank, the rescue of American International Group (AIG) – the largest insurance company, and intervention in a number of institutions both in the US and Europe. Furthermore, as the financial sector became risk averse, the ensuing stock market reaction was a flight to safety cascaded across the global financial system depressing market prices for major assets.

Emerging and developing economies grew by 6 percent in 2008 compared with 8.3 percent in 2007. The slowdown in economic activity in China and India, the leading countries in this region reflected weaker exports and investment respectively. Investment and consumption in China was robust, while export growth and private consumption in India continued to be strong. In Sub-Saharan Africa real GDP growth moderated to 5.2 percent in 2008 from 6.2 percent in 2007 in the face of the financial turmoil and high energy and food prices. Economic performance in oil exporting countries benefited from a big improvement in the terms of trade. The impact of high oil prices on oil importing countries was also partly offset by high export prices on commodities such as coffee, cocoa and cotton.

Trends in key economic indicators capture succinctly the adverse impact of the global financial crisis in Kenya. The Kenya shilling depreciated against the major international currencies. Against the US dollar the Kenya Shilling depreciated by 13.3 percent from Ksh 67.8 in August 2008 to Ksh 78.0 percent by December 2008. Gross official foreign exchange reserves, held by the Central Bank, declined by 16.5 percent from US\$3.4 million in June 2008 ( equivalent to 4.5 months



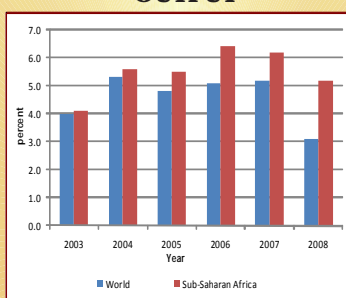
of imports cover) to US\$2.9million (equivalent to 3.4 months of imports cover) in December 2008. Exports declined by 9.3 percent from US\$ 1312 million in the July-September 2008 Quarter to US\$ 1189 million in the October-December 2008 Quarter. The various export activities and their contribution to the absolute decline of exports included coffee (4 percent), tea (22 percent), manufactured goods (41 percent), raw materials (13 percent) and other exports (35 percent). Tourism earnings, which were adversely impacted by the post election crisis in January 2008, declined by 9.9 percent to US\$ 190 million in the October-December 2008 Quarter from US\$ 211 million in the July September 2008 Quarter. Remittances from migrant workers to their countries of origin declined by 11.2 percent from US\$ 646.1 million in the year to June 2008 to US\$ 573.4 million in the year to June 2009. The Nairobi Stock Exchange (NSE) indicators of performance declined. In particular the NSE 20 Share Index declined by 32.1 percent between July and December 2008, while market capitalisation fell by 30.1 percent over the same period. Partly reflecting the adverse effects of the global financial crisis and the impact of the post election crisis, economic performance decelerated from a real GDP growth of 7.1 percent in 2007 to 1.7 percent growth in 2008.

## Capital Flows

### Net Capital Flows to Developing Countries

Capital flows to developing countries were adversely affected by the global financial crisis, which was triggered by the sub-prime mortgage crisis in the United States. Net private capital flows to developing countries declined from US\$ 1,158 billion in 2007 to US\$ 707 billion in 2008, a reversal to the upward trend recorded since 2002 (Table 1.1). The decrease was mainly

**CHART 1A: WORLD ECONOMIC OUTPUT**



Source: IMF World Economic Outlook

**TABLE 1.1: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES 2002-2008 (US \$ BILLION)**

	2002	2003	2004	2005	2006	2007	2008*
Net private and official flows	162.4	258.6	370.7	498.7	668.3	1157.7	727.3
of which:							
Net private flows	156.8	269.1	396.5	569.7	739.2	1157.5	706.9
Net equity flows	161.5	181.0	254.7	347.2	462.7	658.6	599.0
FDI flows	152.5	155.5	216.0	279.1	358.4	520.0	583.0
Portfolio flows	9.0	25.5	38.7	68.1	104.3	138.6	15.7
Net debt flows	-4.7	88.1	141.8	222.5	276.5	498.9	107.9
medium & long-term							
debt flows	0.7	26.6	73.3	135.9	166.4	296.4	124.2
Short-term debt flows	-5.4	61.5	68.5	86.6	110.1	202.5	-16.3
Net official flows	5.6	-10.5	-25.8	-71.0	-70.9	0.2	20.4

\* Estimate

Source: Global Development Finance (2009)



reflected in debt and portfolio flows. The fall in net debt flows followed decreased short-term debt flows, cross-border lending by commercial banks, and reduced bond financing. All developing regions with the exception of the Middle East and North America experienced reduced capital flows.

### Net Foreign Direct Investment (FDI) Flows to Developing Countries

Net Foreign Direct Investment (FDI) flows to developing countries rose from US\$ 520 billion in 2007 to US\$ 583 billion in 2008, and accounted for 40 percent of global FDI flows (Table 1.2). The FDI flows reflect economic reforms and opening up of more sectors for foreign investors as in the case of India.

**TABLE 1.2: NET FDI INFLOWS TO DEVELOPING COUNTRIES  
2002/08 (US\$ Billion)**

	2002	2003	2004	2005	2006	2007	2008*
East Asia & Pacific	59.4	56.8	70.3	104.4	105.2	175.3	185.1
Europe & Central Asia	18.5	30.5	55.5	62.8	114.9	154.4	170.8
Latin America & the Caribbean	53.0	42.3	64.6	70.8	71.6	107.5	124.8
Middle East & North Africa	4.7	7.6	6.9	14.1	25.0	24.2	22.5
South Asia	6.7	5.4	7.8	10.3	23.2	29.9	47.5
<b>Sub-Saharan Africa</b>	<b>10.2</b>	<b>12.9</b>	<b>9.9</b>	<b>16.8</b>	<b>18.5</b>	<b>28.6</b>	<b>32.4</b>
<b>Kenya</b>	<b>0.02</b>	<b>0.08</b>	<b>0.04</b>	<b>0.01</b>	<b>0.03</b>	<b>0.69</b>	<b>0.05</b>
<b>Total</b>	<b>152.5</b>	<b>155.5</b>	<b>216.0</b>	<b>279.1</b>	<b>358.4</b>	<b>520.0</b>	<b>583.0</b>

\* Estimate

Source: Global Development Finance (2009)

### Net Portfolio Flows to Developing Countries

Net portfolio flows (mainly equity) to developing countries decreased from US\$ 139 billion in 2007 to US\$ 16 billion in 2008 (Table 1.3). This was a reversal from the upward trend recorded since 2002 following the international financial turmoil. The reversal reflected diversification away from the developing countries by international investors fuelled by increased uncertainty about what was perceived to be safer securities. Developing regions which experienced the largest decline in

**TABLE 1.3: NET PORTFOLIO FLOWS TO DEVELOPING COUNTRIES 2002/08(US & BILLION)**

	2002	2003	2004	2005	2006	2007	2008*
East Asia & Pacific	3.8	12.5	19.3	25.7	56.2	35.2	7.4
Europe & Central Asia	3.5	0.7	3.6	8.0	10.5	26.4	-8.4
Latin America & the Caribbean	1.4	3.3	-0.6	12.2	11.2	29.6	-6.5
Middle East & North Africa	-0.5	0.2	0.7	2.4	1.0	-2.1	2.0
South Asia	1.0	8.0	9.0	12.4	10.4	36.1	18.0
<b>Sub-Saharan Africa</b>	<b>-0.4</b>	<b>0.7</b>	<b>6.7</b>	<b>7.4</b>	<b>15.0</b>	<b>13.5</b>	<b>3.2</b>
<b>Kenya</b>	<b>-0.005</b>	<b>-0.038</b>	<b>-0.066</b>	<b>-0.030</b>	<b>-0.021</b>	<b>-0.025</b>	<b>-0.026</b>
<b>Total net Flows</b>	<b>9.0</b>	<b>25.5</b>	<b>38.7</b>	<b>68.1</b>	<b>104.3</b>	<b>138.6</b>	<b>16.0</b>

\* Estimate

Sources: Global Development Finance (2008) & Economic Survey 2009

portfolio flows were in Latin America and the Caribbean, in Europe and Central Asia, and in the East Asia and Pacific. Net portfolio flows to Sub-Saharan Africa also decreased from US\$ 14 billion in 2007 to US\$ 3 billion in 2008.

### Remittances to Developing Countries

Remittances from migrant workers to their countries of origin increased from US\$ 281 billion (2.1 percent of GDP) to US\$ 305 billion (1.9 percent of GDP) (Table 1.4). However, this represented a slower growth of 9 percent compared with an average of 20 percent between 2003 and 2007. The reduced remittances was more pronounced in developing countries in Europe and Central Asia unlike the South Asia which is relatively less dependent on remittances from the United States, the center of the global financial crisis. South Asia indeed receives more remittances from the Gulf Cooperation Council which benefited from the surge in oil prices in the first half of 2008 (Global Development Finance 2009). Remittances to Sub-Saharan Africa also increased marginally from US\$ 19 billion in 2007 to US\$ 20 billion in 2008.

**TABLE 1.4: REMITTANCE FLOWS TO DEVELOPING COUNTRIES  
2002/08 (US\$ BILLION)**

	2002	2003	2004	2005	2006	2007	2008*
East Asia & Pacific	29.5	35.4	39.2	46.7	53.0	65.3	69.6
Europe & Central Asia	13.7	15.5	22.2	31.2	38.3	50.4	53.1
Latin America & the Caribbean	27.9	36.6	43.3	50.1	59.2	63.1	63.3
Middle East & North Africa	15.2	20.4	23.0	24.3	25.7	31.3	33.7
South Asia	24.1	30.4	28.7	33.1	39.6	52.1	66.0
<b>Sub-Saharan Africa</b>	<b>5.0</b>	<b>6.0</b>	<b>8.0</b>	<b>9.4</b>	<b>12.9</b>	<b>18.6</b>	<b>19.8</b>
<b>Kenya</b>			<b>0.34</b>	<b>0.38</b>	<b>0.41</b>	<b>0.57</b>	<b>0.61</b>
<b>Total</b>	<b>115.5</b>	<b>144.3</b>	<b>164.4</b>	<b>194.8</b>	<b>228.7</b>	<b>280.8</b>	<b>305.4</b>
<b>as % of GDP</b>	<b>1.9</b>	<b>2.1</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.1</b>	<b>1.9</b>

\* Estimate

Source: Global Development Finance (2009) & Economic Survey 2009

### Economic Outlook for 2009 and 2010

Financial stress has manifested itself on global economic activity through a number of channels. Loss in consumer and business confidence particularly in the US has adversely impacted purchases of consumer durables and investment goods. Countries in Western Europe and advanced Asia have been affected by a slowdown in trade while developing countries in Europe and the Commonwealth of Independent States (CIS) have been affected due to their dependence on external financing and manufacturing exports. Countries in Africa, Latin

America and the Middle East face weak export demand coupled with low commodity prices. Accordingly, global growth is projected to decline by 1.3 percent in 2009.

Nevertheless, global output is expected to grow by 1.9 percent in 2010, an increase of 0.5 percent from earlier projections. Developments so far indicate a slowdown in the rate of deterioration in the housing and labor markets in the US. In Japan, output is stabilizing following improved consumer confidence and aggressive fiscal policies. Growth in emerging Asia has been revised upwards to 7 percent in 2010 reflecting developments in India and China which have had successful macroeconomic stimulus and a faster than expected recovery in capital flows. Output projections for Latin America and CIS which have been revised upwards by 1.1 percent and 0.8 percent to 1.6 percent and 1.2 percent respectively reflect rising commodity prices. Economic growth forecast for emerging Sub-Saharan Africa of 3.9 percent is however broadly unchanged as the region has been negatively affected by the decline in global trade.

## **DOMESTIC ECONOMY - OVERVIEW**

Economic growth in the country slumped to 1.7 percent in 2008, from 7.1 percent in the year 2007. The subdued growth reflected adverse after-effects of the post election crisis and high international crude oil prices which eventually stifled the transport sector and increased the cost of fuel and energy resources utilized in several other sectors. Similarly, the global financial crisis that emerged in the last quarter of 2008 further decreased production levels and export demand. In addition, production in the agricultural sector fell due to inadequate rainfall in most parts of the country.

Performance of the agricultural sector alone in 2008 declined to -5.4 percent. Insufficient rainfall, high costs of fertilizer and other farm inputs and disruptions due to the post election crisis in the first quarter of 2008 were the main causes of poor output in 2008 in addition to the subsequent drought effects that weakened the recovery process.

Manufacturing sector grew by 3.8 percent in 2008, despite challenges posed by high cost of raw materials, depreciation of the shilling and after-effects of the post election crisis.

Building and construction sector grew by 8.3 percent in 2008 compared with 6.9 percent in 2007. This was supported by increased investment in housing and infrastructure. As a result, cement consumption increased by 16.2 percent, from 2,357,070 metric tonnes in 2007/2008 to 2,738,732 metric tonnes in 2008/2009.

Transport and communication sector was severely affected by post election violence in early 2008 and thereafter by high domestic fuel prices attributed to soaring international crude oil prices. These contributed to growth in the sector decelerating from 15.1 percent in 2007 to 3.1 percent in 2008.

In 2008, tourism sector declined by 35.9 percent from 16.3 percent growth in 2007 following insecurity in the first quarter of 2008, and subsequent travel bans which drastically reduced the number of international arrivals by 30.4 percent from 1,048,732 visitors in 2007 to 729,490 visitors in 2008.

Recovery was expected in the fourth quarter of 2008 but the global financial crisis set in dealing another major blow to the industry.

Broad money and reserve money growth decelerated below target levels in fiscal year 2008/09, reflecting the slowdown in economic performance, increase in lending rates, and risk aversion by commercial banks desirous to tame any likely increase in non-performing loans from the perceived poor performing sectors.

Domestic credit grew by 21 percent in the fiscal year 2008/09 compared to 16.9 percent in fiscal year 2007/08. Credit to Government and private sector grew by 30.3 and 20.7 percent respectively in 2008/9 compared to 15.1 and 29.6 percent in fiscal year 2007/08. The slowdown in private sector credit in 2008/09 is largely attributed to increased perceived risk by the lenders to households following the global economic crisis. Private sector credit expanded to trade (31.0 percent) business services (14.5 percent) manufacturing (14.0 percent) and real estate (14.0 percent). Loans to private household declined by 19.7 percent while that to finance and insurance sector shrunk by 25.3 percent.

The balance of payments deteriorated from overall surplus of US \$ 683 million during fiscal year 2007/08 to a deficit of US \$ 422 million during fiscal year 2008/09. The deterioration was in tandem with developments in the global economy, in particular effects of the global financial crisis and economic crisis, and domestic factors including the post election disturbances. Exports of goods expanded by 0.5 percent while imports grew by 8 percent in the year. This widened the current account deficit from US\$ 1,073 million in June 2008 to a deficit of US\$ 2,671 million in June 2009. The widening of the current account deficit was due increased imports of machinery and equipment, increased oil and chemical imports and a decline in the service account surplus.

Government budgetary operations fell within targets in both revenues and expenditure. The below target revenue performance was attributed to lower than envisaged expansion of economic activity. The deficit at 4.6 percent of GDP was within the target of 5.8 percent of GDP for the fiscal year 2008/09. The deficit was financed largely from domestic sources.

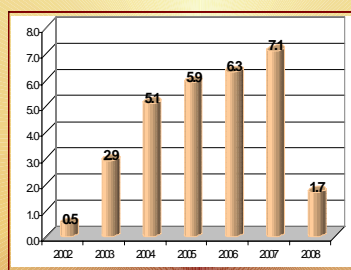
Twelve month overall inflation declined from 23.9 percent in June 2008 to 17.8 percent in June 2009. The improvement reflect the recovery from the post election crisis, decline in oil prices and increased supply of seasonal food items. But the drought effect on food supply coupled with computation problems of inflation had a major effect on the reported inflation numbers.

Outlook for the domestic economy is stable but contingent on a number of factors. The economy is projected to grow by 3.1 percent in the fiscal year 2009/10. The 2009/10 budget has supportive fiscal measures to the growth target. However, economic growth in 2009/10 will significantly depend on the performance of the agricultural sector which has been buffeted by drought in the first half of the year. The consequences of drought are being permeated to other sectors through power and water rationing. The other factor is the duration and severity of the global economic recession. With the revision of the basket of consumer goods used to calculate inflation and use of new methodology, the CPI levels will reduce. This will help anchor inflation expectation at lower levels.



## 2. REAL SECTOR

**CHART 2A: REAL GDP GROWTH RATES, 2002 - 2008 (%)**



Sources: Economic Survey & Central Bank of

Economic growth slowed down to 1.7 percent in 2008 from 7.1 percent in 2007, due to a number of factors including the post election violence in the first quarter of 2008. High global commodity prices, including oil and the global financial crisis, which set in during the fourth quarter of 2008, depressed tourism and export demand further. Rainfall was inadequate and drought set in the October - December quarter of 2008. The sectors which contributed most to the economic downturn were agriculture and tourism because of disruption of farming activities and insecurity which kept off would be visitors from coming to the country. Transport was adversely affected.

**TABLE 2.1: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES**

MAIN SECTORS	Share in 2008 Real GDP (%)	Kshs Million					
		2003	2004	2005	2006	2007	2008
Agriculture, Forestry & Fishing	22.75	280,854	285,764	305,500	319,069	325,742	309,522
Mining	0.48	5,213	5,195	5,334	5,554	6,272	6,472
Manufacturing	9.98	105,822	110,544	115,698	122,953	130,892	135,802
Electricity and water supply	2.32	27,074	27,877	27,862	27,475	29,987	31,555
Wholesale and retail trade, repairs	10.19	92,604	100,486	106,091	118,357	131,989	138,677
Hotels & Restaurants	0.98	9,899	13,741	15,572	17,894	20,814	13,298
Construction	3.20	31,530	32,932	35,401	37,649	40,229	43,572
Transport, Storage & Communications	11.89	104,915	112,260	122,316	136,306	156,849	161,721
Financial intermediation	3.81	42,064	42,657	45,030	47,170	50,319	51,868
Real estate, renting and business services	5.40	61,864	63,740	65,882	68,446	70,860	73,461
Public administration and defense	3.31	46,991	47,062	46,460	45,722	44,788	45,074
Education	5.90	71,045	72,435	72,963	73,152	75,855	80,277
Health and social work	2.21	25,431	26,408	27,249	28,146	29,053	30,106
Other community, social and personal services	3.74	42,917	44,514	45,829	47,815	49,422	50,919
Private households with employed persons	0.31	3,855	3,932	4,011	4,091	4,173	4,256
Less : Financial services indirectly measured	(0.83)	(10,315)	(10,800)	(11,261)	(11,835)	(12,157)	(11,250)
<b>Total GDP at basic 2001 prices</b>	<b>85.65</b>	<b>941,763</b>	<b>978,747</b>	<b>1,029,937</b>	<b>1,087,964</b>	<b>1,155,087</b>	<b>1,165,330</b>
Taxes less subsidies on products	14.35	113,895	130,795	145,143	161,367	182,952	195,294
<b>Real GDP at 2001 market prices</b>	<b>100.00</b>	<b>1,055,658</b>	<b>1,109,542</b>	<b>1,175,080</b>	<b>1,249,331</b>	<b>1,338,039</b>	<b>1,360,624</b>
GDP at Mkt Prices		1,055,658	1,109,542	1,175,080	1,249,331	1,338,039	1,360,624
Overall GDP Deflator		107	115	120	130	136	154
	Share in Real GDP in 2008 (%)	Growth Rates in percent					
		2003	2004	2005	2006	2007	2008
Agriculture, Forestry & Fishing	22.75	0.7	1.7	6.9	4.4	2.1	-5.0
Mining & Quarrying	0.48	3.5	-0.3	2.7	4.1	12.9	3.2
Manufacturing	9.98	6.0	4.5	4.7	6.3	6.5	3.8
Electricity and water supply	2.32	14.0	3.0	-0.1	-1.4	9.1	5.2
Wholesale and retail trade, repairs	10.19	1.5	8.5	5.6	11.6	11.5	5.1
Hotels & Restaurants	0.98	-20.3	38.8	13.3	14.9	16.3	-36.1
Building & Construction	3.20	1.0	4.4	7.5	6.4	6.9	8.3
Transport & Communications	11.89	3.5	7.0	9.0	11.4	15.1	3.1
Financial intermediation	3.81	1.5	1.4	5.6	4.8	6.7	3.1
Real estate, renting and business services	5.40	2.3	3.0	3.4	3.9	3.5	3.7
Public administration and defense	3.31	0.6	0.2	-1.3	-1.6	-2.0	0.6
Education	5.90	9.7	2.0	0.7	0.3	3.7	5.8
Health and social work	2.21	2.8	3.8	3.2	3.3	3.2	3.6
Other community, social and personal services	3.74	-0.0	3.7	3.0	4.3	3.4	3.0
Private households with employed persons	0.31	2.0	2.0	2.0	2.0	2.0	2.0
Less : Financial services indirectly measured	(0.83)	-3.3	4.7	4.3	5.1	2.7	-7.5
<b>Total GDP at basic 2001 prices</b>	<b>85.65</b>	<b>2.6</b>	<b>3.9</b>	<b>5.2</b>	<b>5.6</b>	<b>6.2</b>	<b>0.9</b>
Taxes less subsidies on products	14.35	1.3	14.8	11.0	11.2	13.4	6.7
<b>Real GDP at 2001 market prices</b>	<b>100.00</b>	<b>2.5</b>	<b>5.1</b>	<b>5.9</b>	<b>6.3</b>	<b>7.1</b>	<b>1.7</b>

Sources: Economic Survey 2009



## AGRICULTURE

The agricultural sector performed poorly in fiscal year 2008/09 due to adverse weather and the post election crisis contracting by 5.4 percent, compared with a positive growth of 2.1 percent in 2007. Prices of fertilizers and other farm inputs also increased, further aggravating the situation in the sector.

The amount of processed tea declined by 0.1 percent in fiscal year 2008/09, compared with 11.9 percent fall in fiscal year 2007/08, as a result of both the shortage of labour in 2008 due to the post election violence and the drought experienced in the first half of 2009 (Table 2.2).

**TABLE 2.2: OUTPUT GROWTH IN KEY CROPS**

PRODUCT	Jun 2004/05	Jun 2005/06	Jun 2006/07	Jun 2007/08	Jun 2008/09
<b>Tea</b>					
Output (MT)	321,440	295,791	375,226	328,216	327,713
Output Growth %	0.19%	-8.07%	25.24%	-11.89%	-0.15%
<b>Horticulture</b>					
Output (MT)	160,729	162,099	167,959	206,485	184,239
Output Growth %	18.24%	3.98%	8.00%	19.77%	-10.77%
<b>Coffee</b>					
Output (MT)	51,136	47,995	50,899	39,842	53,701
Output Growth %	-9.77%	-7.14%	12.58%	-30.82%	34.78%
<b>Sugarcane</b>					
Output (MT)	4,751,432	4,953,329	4,953,167	5,228,645	5,357,764
Output Growth %	3.73%	8.52%	0.88%	2.83%	2.47%

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

Compared to the previous year fiscal year 2007/08, coffee output recovered to grow by 34.8 percent from 39,842 metric tonnes to 53,701 metric tonnes.

Horticultural exports reduced in fiscal year 2008/09 by 10.8 percent. The post election crisis hindered cultivation while the global financial crisis in the fourth quarter of 2008 reduced demand for horticultural exports thus decreasing export volumes and values.

In the sugar sector, cane deliveries increased by 2.5 percent from 5,228,645 metric tones in fiscal year 2007/08 to 5,357,764 metric tonnes in fiscal year 2008/09.

## MANUFACTURING

Manufacturing sector output grew by 3.8 percent in 2008 compared with 6.5 percent in 2007. The industry faced high costs of production and reduced demand for its products as a result of post election violence in the first quarter and global financial crisis in the last quarter of 2008. However, manufacturing of beverages, clothing, wood and non metallic products thrived. In addition, there were uncertainties in the supply of imported inputs due to pirate activities in the region.

Growth in fiscal year 2008/09 was mainly driven by, among other products, cement and beer, which grew by 29.3 percent and 16.2 percent, respectively. Cement output grew to 3,405,146 metric tonnes in fiscal year 2008/09 from 2,633,494 metric tonnes in fiscal year 2007/08, while beer production increased to 442.9 million litres from 381.2 million litres in fiscal year 2007/08. Similarly, sugar and soda ash production rose marginally by 1.1 percent and 1.2 percent, respectively. Milk and cigarette production fell by 2.4 percent and 0.5 percent, respectively, to stand at 387.6 million litres and 15 million milles in fiscal year 2008/2009 (Table 2.3).

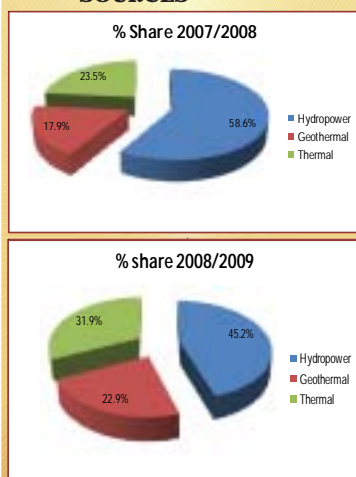
**TABLE 2.3: PRODUCTION OF SELECTED MANUFACTURED GOODS**

PRODUCT	Jun 2004/05	Jun 2005/06	Jun 2006/07	Jun 2007/08	Jun 2008/09
<b>Processed Sugar</b>					
Output (MT)	507,306	504,589	474,944	530,129.00	536,135.33
Output Growth %	-3.35%	2.92%	-5.14%	10.79%	1.13%
<b>Cement Production *</b>					
Output (MT)	1,975,464	2,104,918	2,370,982.00	2,633,494.00	3,405,146.00
Output Growth %	22.86%	2.64%	14.50%	10.28%	29.30%
<b>Soda Ash</b>					
Output (MT)	357,521	364,760	385,756	439,958	445,220
Output Growth %	1.30%	1.58%	4.89%	16.00%	1.20%
<b>Milk *</b>					
Output ('000 litres)	284,144	351,609	402,009	397,209	387,554
Output Growth %	17.19%	17.71%	14.18%	-1.23%	-2.43%
<b>Beer</b>					
Output ('000 litres)	257,124	278,905	328,345	381,164	442,877
Output Growth %	19.13%	8.01%	20.70%	15.99%	16.19%
<b>Cigarettes</b>					
Output (Number of sticks)	10,052,423	12,048,634	13,280,558	15,075,078	14,995,064
Output Growth %	21.28%	20.57%	9.35%	12.26%	-0.53%

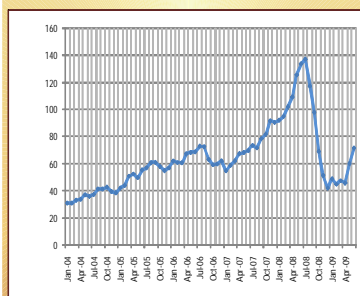
**Sources: Kenya National Bureau of Statistics, Sugar Board, Dairy Board, Kenya Revenue Authority and Magadi Soda**

## ENERGY SECTOR DEVELOPMENTS

Insufficient rainfall in the past one year to June 2009 caused electricity generation to fall by 7.8 percent from 6,066.6 million

**CHART 2B: PERCENTAGE SHARE OF ELECTRICITY SOURCES**

Source: Kenya Power & Lighting Co.

**CHART 2C: SAUDI ARABIAN CRUDE OIL**

Source: Ministry of Energy

kilowatt hours in June 2008 to 5,594.4 million kilowatt hours. Hydropower generation, which comprises 46.5 percent of total generated electricity, was most affected by the drought, decreasing by 18.3 percent from 3,488.1 million kilowatt hours in June 2008 to 2,849.10 million kilowatt hours in June 2009. Consumption of electricity increased, marginally (Table 2.4, Chart 2B and Chart 2C).

**TABLE 2.4: PERFORMANCE OF ENERGY SUB-SECTORS**

	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009
Electricity Supply (Generation)					
Output (KWH Millions)	5,246.20	5,654.00	6,097.20	6,066.60	5,594.40
Growth %	7.9%	7.8%	7.9%	-0.5%	-7.8%
Of which:					
Hydro-power Generation (KWH Millions)	2,867.80	3,025.30	3,300.10	3,488.10	2,849.10
Growth (%)	-12.0%	5.5%	9.1%	5.7%	-18.3%
Geo-Thermal Generation (KWH Millions)	1,034.30	1,003.40	1,014.90	1,020.50	1,179.00
Growth (%)	31.3%	-3.0%	1.1%	0.6%	15.5%
Thermal (KWH Millions)	1,344.00	1,625.30	1,782.90	1,558.00	1,653.70
Growth (%)	64.5%	20.9%	9.7%	-12.6%	6.1%
Consumption of electricity (KWH Millions)	4,351.40	4,605.70	4,965.70	5,242.90	5,281.40
Growth %	7.0%	5.8%	7.8%	5.6%	0.7%
Consumption of Fuels (Metric Tonnes)	2,549	2,742	3,002	2,939	2,041
Growth %	13.2%	7.6%	9.5%	-2.1%	-30.6%

Sources: Kenya National Bureau of Statistics

## BUILDING AND CONSTRUCTION

In 2008, the building and construction industry grew by 6.9 percent, and reflected growth in public works and road construction. Cement consumption increased by 16.2 percent to reach 2,738,732 metric tonnes in fiscal year 2008/09.

## TRANSPORT AND COMMUNICATION

### Transport

In the first half of fiscal year 2008/09, transport sector activity was lightly subdued by high crude oil prices and setting in of the global financial crisis which, to some extent, depressed export and tourism demand and ultimately demand for transport services. Kenya pipeline throughput increased by 4.8 percent from 3,373,855 metric tonnes to 4,058,727 metric tonnes, while cargo throughput in the port of Mombasa increased by 7.6 percent from 16,290,399 metric tonnes to 17,534,495 metric tonnes.

### Telecommunications

In the telecommunications sector, excise duty on airtime services increased by 3.6 percent from Ksh 6,397 million in fiscal year

2007/08 to Ksh 6,630 million in fiscal year 2008/09.

**TABLE 2.5: PERFORMANCE OF TRANSPORT AND COMMUNICATION SUB-SECTORS**

Activity	Jun 2004/05	Jun 2005/06	Jun 2006/07	Jun 2007/08	Jun 2008/09
<b>Cargo by KPA</b>					
Output (MT)	13,284,921	13,524,051	15,198,435	16,290,399	17,534,495
Output Growth %	6.23%	1.28%	12.38%	7.18%	7.64%
<b>Throughput by Kenya Pipeline</b>					
Output ('000 litres Equivalent)	3,459,298	3,627,232	3,963,076	3,873,855	4,058,727
Output Growth %	11.83%	4.90%	9.26%	2.51%	4.77%
<b>Excise duty on Airtime</b>					
Output (Ksh Million)	2,982	3,963	5,360	6,397	6,630
Growth %	32.74%	35.41%	35.28%	16.49%	3.64%

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

## TOURISM

Two adverse developments worked against the tourism sector in 2008. The political crisis in the first quarter of 2008 kept off tourists for the remainder of the year, while the global financial crisis decreased demand for tourism. In the first half of 2009, however, tourism improved. Looking at major tourist divisions, Nairobi and conference tourism seems to have recovered fully. But Mombasa and the lodges are still lagging behind in recovery. Consequently, tourism arrivals increased by 1.6 percent to 863,753 in fiscal year 2008/09 compared to 850,456 visitors in fiscal year 2007/08 (Table 2.6).

**CHART 2D: TOURIST ARRIVALS**



Source: Kenya Tourist Board

**TABLE 2.6: TOURIST ARRIVALS BY POINT OF ENTRY**

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

FY - Fiscal year

Source: Kenya Tourist Board

## USE OF AVAILABLE RESOURCES

Total resources available to the economy measured in gross national disposable income amounted to 106.9 percent of GDP in 2008, down from 107.3 percent in 2007. Total consumption comprised 92.1 percent of total resources in 2008, falling from 94.3 percent in 2007. Investment remained at 19.0 percent as a

total of share range while savings increased to 14.8 percent from 13.1 percent in 2007.

**TABLE 2.7: USE OF RESOURCES (KSH MILLION)**

	2003	2004	2005	2006	2007	2008
Gross national disposable income	1,192,664	1,345,167	1,503,398	1,747,297	1,959,407	2,244,329
Net current transfers	67,609	80,856	95,868	129,916	143,152	147,656
Gross national income	1,125,055	1,264,311	1,407,530	1,617,381	1,816,255	2,096,673
Net factor income payments (Y(f))	-6,728	-10,017	-8,194	5,053	9,706	3,127
Gross domestic product (at market prices)	1,131,783	1,274,328	1,415,724	1,622,434	1,825,961	2,099,800
Total Consumption (C)	1,078,028	1,190,029	1,313,504	1,505,806	1,720,926	1,933,330
Government consumption - C(g)	205,207	227,596	246,056	283,236	337,560	360,569
Private consumption - C(p)	872,821	962,433	1,067,448	1,222,570	1,383,366	1,572,761
Gross domestic investment (I)	186,542	217,742	239,446	291,209	348,008	402,232
Gross fixed capital formation	179,254	207,196	264,728	309,592	354,248	408,327
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	437,376	484,642	551,264
Imports of goods and nfs (M)	-339,301	-435,844	-523,970	-613,764	-691,220	-876,550
Discrepancy	-63,604	-33,342	-8,464	1,807	-36,395	89,524
GDP deflator (2001=100)	107.21	114.85	120.48	129.86	136.47	154.33
Real GDP	1,055,658	1,109,541	1,175,081	1,249,331	1,338,039	1,360,626
Real GDP growth (annual in %)	2.90%	5.10%	5.90%	6.30%	7.10%	1.70%
Gross National savings	114,636	155,138	189,894	241,491	238,481	310,999
Gross Domestic Savings	47,027	74,282	94,026	111,575	95,329	163,343
Total National Balance(S-I)	-71,906	-62,604	-49,552	-49,718	-109,527	-91,233
CAB (X-M+Y(f)+TR(f))	-8,302	-29,262	-41,088	-51,525	-73,132	-180,757
Discrepancy	-63,604	-33,342	-8,464	1,807	-36,395	89,524
CAB + DISCREPANCY	-71,906	-62,604	-49,552	-49,718	-109,527	-91,233
Kenya - National Accounts						
In shares of GDP						
Gross national disposable income	105.38%	105.56%	106.19%	107.70%	107.31%	106.88%
Net current transfers (TR(f))	5.97%	6.34%	6.77%	8.01%	7.84%	7.03%
Gross national income	99.41%	99.21%	99.42%	99.69%	99.47%	99.85%
Net factor income payments (Y(f))	-0.59%	-0.79%	-0.58%	-0.31%	-0.53%	-0.15%
Gross domestic product (GDP)						
Gross Domestic Product (expend)						
Total Consumption ©	95.25%	93.38%	92.78%	92.81%	94.25%	92.07%
Government consumption - C(g)	18.13%	17.86%	17.38%	17.46%	18.49%	17.17%
Private consumption - C(p)	77.12%	75.52%	75.40%	75.35%	75.76%	74.90%
Gross domestic investment (I)	16.48%	17.09%	16.91%	17.95%	19.06%	19.16%
Gross fixed capital formation	15.84%	16.26%	18.70%	19.08%	19.40%	19.45%
Increase/Decrease in stocks	0.64%	0.83%	-1.79%	-1.13%	-0.34%	-0.29%
Exports of goods and services (X)	23.87%	26.35%	27.92%	26.96%	26.54%	26.25%
Imports of Goods and services (M)	-29.98%	-34.20%	-37.01%	-37.83%	-37.86%	-41.74%
Gross National savings	10.13%	12.17%	13.41%	14.88%	13.06%	14.81%
Gross Domestic Savings	4.16%	5.83%	6.64%	6.88%	5.22%	7.78%
Total National Balance(S-I)	-6.4%	-4.9%	-3.5%	-3.1%	-6.0%	-4.3%
Trade Balance (TB=X-M)	-6.1%	-7.9%	-9.1%	-10.9%	-11.3%	-15.5%
CAB (X-M+Y(f)+TR(f))	-0.7%	-2.3%	-2.9%	-3.2%	-4.0%	-8.6%
CAB + DISCREPANCY	-6.4%	-6.9%	-6.9%	-6.9%	-6.9%	93.1%

Source: Economic Survey, 2009

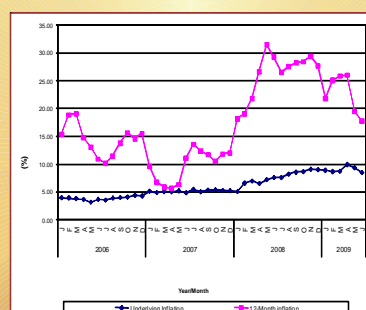


## MONETARY POLICY MANAGEMENT

### 4. INFLATION

The 12-month overall inflation declined from 29.3 percent in June 2008 to 17.8 percent in June 2009. The decline was largely attributed to the fading effects of the post election crisis and falling prices of seasonal food items and petroleum products. Average annual inflation, however, increased from 18.5 percent in the year to June 2008 to 25.0 percent in the year to June 2009, reflecting effects of high international crude oil prices in the second half of 2008, drought experienced in the first quarter of 2009, and an upward bias resulting from the methodology used in compiling the CPI. The Carli (arithmetic mean) method currently in use has an upward bias that has been established across aggregate of the CPI basket goods but is in the process of being rectified.

**CHART 8A: 12-MONTH INFLATION (%)**



Source: Kenya National Bureau of Statistics

The 12-month underlying inflation increased from 7.6 percent in June 2008 to 8.5 percent in June 2009. Within this period, underlying inflation peaked at 9.9 percent in April 2009, a sign that inflationary pressures might have arisen from the supply side shocks that included depreciation of the Kenyan shilling and supply constraints of food.

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

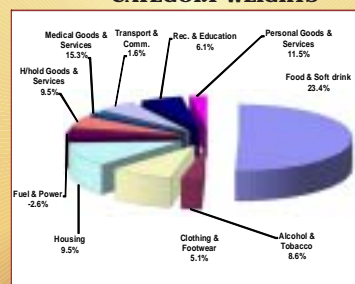
	2008							2009					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Overall	29.26	26.51	27.58	28.24	28.43	29.37	27.72	21.87	25.09	25.86	26.07	19.52	17.76
Underlying	7.60	7.61	8.23	8.59	8.67	9.10	9.04	8.89	8.67	8.75	9.95	9.37	8.51

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 weights in the basket are presented in Chart 8B.

**CHART 8B: GOODS AND SERVICES CATEGORY WEIGHTS**



Source: Kenya National Bureau of Statistics

In June 2009, food and non alcoholic drinks consumer prices recorded the highest 12-month inflation of 23.4 percent compared to the other categories. This, however, was a sharp decline from 40.1 percent in June 2008 for the same category. In the fuel and power category, inflation decreased from 20.1 percent to -2.6 percent owing to falling international crude oil prices which led to a fall in domestic prices of petroleum products. Consequently, inflation for transport and telecommunication fell by 19.4 percent from 21.0 percent in June 2008 to only 1.6 percent in June 2009. Similarly, the

alcohol and tobacco, recreation and education and clothing and footwear categories all experienced a declining 12-month inflation in the margins of 5.6 percent, 0.8 percent and 0.2 percent, respectively. The 12-month inflation for medical goods and services, personal goods and services, housing and household goods and services increased from 10.3 percent, 6.8 percent, 6.6 percent and 8.6 percent, respectively, in June 2008 to 15.3 percent, 11.5 percent, 9.5 percent and 9.5 percent, respectively, in June 2009.

### **Inflation Outlook**

As in the past, fluctuations in international crude oil prices will affect the stability of domestic prices. Similarly, the ongoing power rationing and water shortage is likely to lead to higher cost of production and ultimately, increased prices of goods and services (inflation). The change over in the methodology of compiling the CPI (from the arithmetic to the geometric aggregation) and the revision of the CPI basket to reflect more recent consumption patterns and the wider coverage of the sample across towns and provinces will not only lower the inflation rate but also generate a series more representative of the general price level in the country. In addition, the food supply problems occasioned by drought will continue driving food inflation for some time to come until food supply returns to normality.



## 5. MONEY AND CREDIT DEVELOPMENTS

### Monetary Policy for Fiscal Year 2008/09

Monetary policy for the fiscal year 2008/09 was directed towards achieving and maintaining underlying inflation at 5 percent. Accordingly, the Central Bank 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 17.1 percent and 10.7 percent, respectively, in the year to June 2009. However, the target growth for reserve money was scaled down to 16.2 percent following the reduction of the cash reserve ratio (CRR) from 6 percent to 5 percent effective December 4, 2008 (Table 5.1). The lowering of the CRR was to enhance commercial banks capacity to lend to the private sector. The Central Bank also reduced the Central Bank Rate (CBR) by 50 basis points to 8.50 percent to encourage banks to lower lending rates. In April 2009 the Central Bank eased liquidity conditions by lowering the CBR by a further 50 basis points to 8 percent. The direction of the CBR was to guide money market participants on the direction of short-term interest rates. To implement monetary policy the Bank relied on open market operations (OMOs) using repurchase order agreement securities (REPOs).

**TABLE 5.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2007/08 MONETARY PROGRAMME**

	Jun'08	Sep'08	Dec'08	Mar'09	Jun'09
Reserve money (Ksh million)	149.2	152.3	170.7	164.2	165.3
NFA of CBK (Ksh million)	216.1	211.6	229.6	247.1	265.6
Memo:					
Annual change in reserve money	18.0	16.0	9.7	9.1	10.7
Annual change in extended broad money (M3)	17.5	17.3	17.0	16.0	17.1
Real GDP growth					5.8
Overall inflation					7.5

Source: Central Bank of Kenya

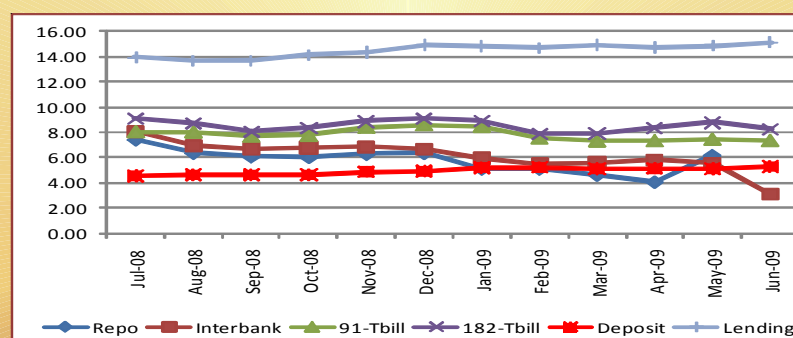
### Monetary Policy Implementation

The Central Bank implemented monetary policy in an economy buffeted by domestic and external shocks. In the first two months of 2008 the country was engulfed in post election disturbances that affected production and distribution channels and contributed to the slowdown of the economic activity in 2008. The lagged effect of the post election violence on

production prevailed through out the financial year. This was further compounded by the inadequate long rains in 2008 while the short rains failed in most parts of the country. In addition to domestic factors, external shocks exacerbated the negative pressure on economic performance. The shocks included high commodity prices, the global financial crisis and the subsequent global economic slowdown.

These factors resulted in lower than projected demand for and supply of bank credit and slower growth in bank deposits. Consequently, monetary aggregates expanded less rapidly than envisaged at the beginning of the financial year. Efforts by the Central Bank to increase 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 days and 182 days treasury bill rates) positively reflected the monetary policy conditions and trended downwards during the financial year. However, commercial bank lending rates increased from 14.1 percent in June 2008 to 15.1 percent in June 2009 (Chart 5A), mainly due to perceived risks in the economy. The increase was attributed to higher risk perception by commercial banks.

**CHART 5A: INTEREST RATES JULY 2007- JUNE 2009 IN PERCENT**

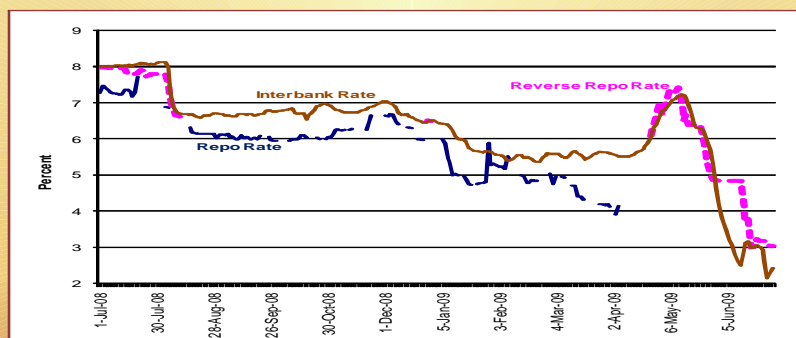


Source: Central Bank of Kenya

The Government offloaded part of its shareholding in a leading telecommunication company, the Safaricom. The sale of the Safaricom shares attracted large foreign exchange inflows from March 2008 through May 2008. The foreign exchange inflow supported about 11.2 percent appreciation of the Kenya Shilling relative to the US Dollar. In the domestic banking sector, credit increased as bank customers acquired loans to purchase the Safaricom shares. The liquidity build up before allotment of the shares was, however, largely locked up in the leading

transactions bank which led to skewed liquidity distribution in the interbank market. To ease the resultant liquidity shortfall Central Bank undertook repo sales to mop up the excess liquidity in the lead bank and reverse repo purchases to provide liquidity to banks that were short of liquidity (Chart 5B).

**CHART 5B: REPO AND INTERBANK RATES JUL 2008 TO JUN 2009**



Source: Central Bank of Kenya

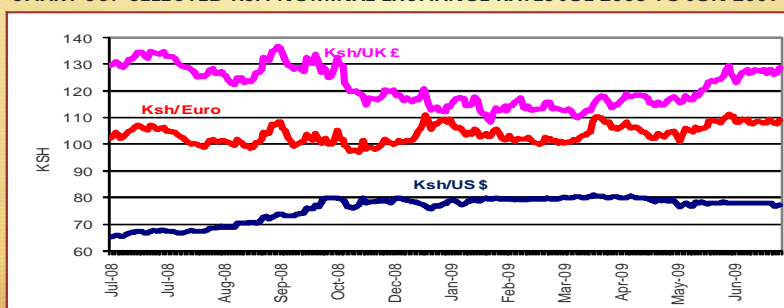
The global financial crisis peaked in September 2008 and Kenya was not insulated from the secondary effects. The Shilling depreciated by 13.7 percent in September and October 2008 from Ksh 68.83 to the US Dollar on 1<sup>st</sup> September 2008 to 79.65 on October 31, 2008 (Chart 5C), as investors in the stock market diversified to safer assets. The depreciation was compounded by offloading of Safaricom shares held by international investors keen to make profits on their investments.

Bank lending was affected by the tightness in the international credit markets where banks were not lending to each other and the local interbank rates trended upwards in October and November 2008. The Central Bank reacted promptly by lowering the Central Bank Rate (CBR), the rate at which Central Bank lends to commercial banks overnight by 50 basis points to 8.5 percent and reduced the cash ratio requirement from 6 percent to 5 percent in December 2008. The Monetary Policy Committee (MPC) maintained the policy stance in February 2009 but reviewed the CBR downward by 50 basis points to 8 percent in April 2009. These measures were intended to lower the cost of credit and affect the short-term rates whose effects would be transferred to lending rates and promote lending to the private sector. The Central Bank adjusted the reserve money programme in December 2008 to reflect the lower CRR requirement but maintained the broad money target unchanged to underscore the need for banks to expand credit to the private sector. While credit to the private sector did not increase as envisaged, lending to Government increased. In particular,

Government issued an infrastructure bond for Ksh 18.5 billion in February 2009. The bond was oversubscribed and its proceeds were ring fenced to finance specific infrastructure projects including roads, geothermal power generation and irrigation.

The Central Bank commenced liquidity supply to the interbank market through reverse repos again in April 2009. This followed market liquidity tightness that resulted from low government expenditure following delayed decisions on the Supplementary Budget Estimates by Parliament. The injections eased the tightness as evidenced in the decline in the interbank rate (Chart 5C).

CHART 5C: SELECTED KSH NOMINAL EXCHANGE RATES JUL 2008 TO JUN 2009



Source: Central Bank of Kenya

## Money Supply

Money supply, M3, declined from 18.7 percent in the year to June 2008 to 13.0 percent in the twelve months to June 2009 as shown in Table 5.2. M3 growth was below the target of 17.1 percent in June 2009. The slowdown in M3 growth was a reflection of the slow down in economic growth in 2008.

TABLE 5.2: PERFORMANCE OF MONETARY AGGREGATES  
JUNE 2007 - JUNE 2008 (Percent )

	RM		M3	
	Act.	Targ.	Act.	Targ.
<b>2008</b>				
Jun	18.2	18.0	18.7	17.5
Jul	18.1	16.0	19.2	17.3
Aug	13.2	16.0	17.0	17.3
Sep	14.5	16.0	17.2	17.3
Oct	16.8	9.7	19.4	17.0
Nov	14.3	9.7	19.4	17.0
Dec	4.2	9.7	15.9	17.0
<b>2009</b>				
Jan	-1.8	9.1	11.8	16.0
Feb	1.2	9.1	11.1	16.0
Mar	1.6	9.1	11.7	16.0
Apr	4.0	10.7	7.5	17.1
May	8.8	10.7	10.6	17.1
Jun	4.6	10.7	13.0	17.1

Source: Central Bank of Kenya

The slower M3 growth followed the decline of the banking systems' net foreign assets (NFA) which partly offset the growth in net domestic assets (NDA). NFA declined by 4.5 percent compared with growth of 30.8 percent a year earlier. The decline in NFA, which was in Central Bank holdings, reflected exchange loss on revaluation and official debt service. Growth in NDA of the banking system rose to 22.3 percent compared with 13.1 percent a year ago, reflecting credit expansion to the private sector and Government in the year to June 2009.

**TABLE 5.3: MONEY SUPPLY AND ITS SOURCES (KSH BN)**

		Jun 2007 Act	Jun 2008 Act	Jun 2009 Act	Annual % Change	
					2007/08	2008/09
<b>1.0 Liabilities</b>						
<b>Money Supply</b>						
Money supply, M2	1/	605.5	716.0	812.1	18.2	13.4
Money supply, M3	2/	708.4	840.7	950.2	18.7	13.0
Overall Liquidity, L	3/	884.4	1028.6	1166.9	16.3	13.5
<b>2.0 Assets (2.1+2.2)</b>	<b>4/</b>					
<b>2.1 Net foreign assets</b>	<b>5 /</b>	222.7	291.3	278.2	30.8	-4.5
Central Bank		163.7	202.6	208.8	23.8	3.1
Banking Institutions		59.1	88.7	69.4	50.2	-21.8
<b>2.2 Net domestic assets (2.21+2.22)</b>		485.6	549.4	672.1	13.1	22.3
<b>2.21 Domestic Credit (2.210+2.211)</b>		600.3	701.8	854.0	16.9	21.7
2.210 Government (net)		157.2	133.4	173.9	-15.1	30.3
2.211 Private sector and other public sector		443.2	568.3	680.2	28.2	19.7
<b>2.22 Other assets net</b>		-114.7	-152.4	-181.9	32.8	19.4
Memorandum Item:						
<b>Reserve Money</b>	<b>6/</b>	129.4	152.9	159.9	18.2	4.6

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)

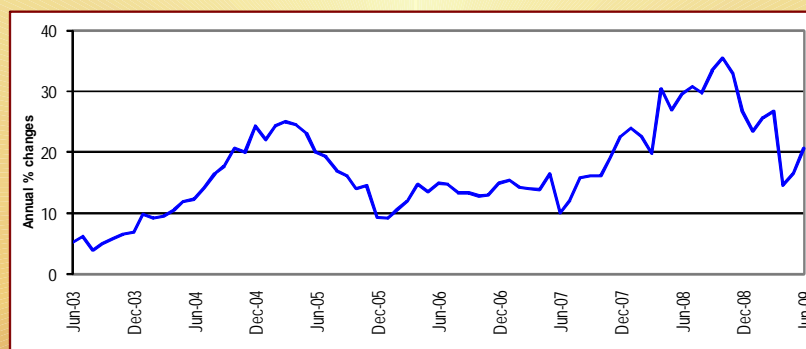
5/ Reserve money comprises currency in circulation & commercial banks balances held with the Central Bank.

**Source: Central Bank of Kenya**

## Domestic Credit

The banking system credit to the domestic economy grew by 21.7 percent in the year to June 2009 compared with 16.9 percent a year earlier. Credit to Government increased by 30.3 percent in the year to June 2009 compared with 15.1 percent net repayment in June 2008. Following the slowdown in economic growth in 2008, credit growth to the private and other public sector, declined to 19.7 percent from 28.2 percent in June 2008 as shown in Chart 5D.



**CHART 5D: ANNUAL PERCENTAGE CHANGES IN PRIVATE**

Source: Central Bank of Kenya

Private sector credit grew by 20.7 percent in the year to June 2009. Most of the private sector credit expansion was to the trade sector (31.0 percent), business services (14.5 percent), real estate (14.0 percent) and manufacturing (14.0 percent) as shown in Table 5.4. These sectors accounted for 59.5 percent of the credit extended during the year.

**TABLE 5.4: CREDIT TO PRIVATE AND OTHER PUBLIC SECTORS (KSH BN)**

	2008 Jun		2009 Jun		Annual Change	
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)
1. Credit to other public sector	10.1	1.8	6.3	0.9	-3.7	-37.2
Local government	-2.6	-0.5	-4.2	-0.6	-1.6	61.2
Parastatals	12.7	2.2	10.5	1.5	-2.1	-16.9
2. Credit to private sector	558.3	98.2	673.8	99.1	115.6	20.7
Agriculture	27.1	4.8	31.3	4.6	4.1	15.2
Manufacturing	70.1	12.3	86.3	12.7	16.2	23.2
Trade	63.8	11.2	99.6	14.6	35.8	56.1
Building and construction	35.2	6.2	40.0	5.9	4.8	13.5
Transport & communications	44.3	7.8	54.6	8.0	10.3	23.2
Finance & insurance	26.6	4.7	19.9	2.9	-6.7	-25.3
Real estate	26.9	4.7	43.3	6.4	16.4	60.9
Mining and quarrying	5.3	0.9	21.3	3.1	16.0	299.7
Private households	104.9	18.5	84.3	12.4	-20.7	-19.7
Consumer durables	27.0	4.7	42.8	6.3	15.8	58.7
Business services	61.3	10.8	78.1	11.5	16.8	27.4
Other activities	65.6	11.6	72.4	10.6	6.8	10.3
3. TOTAL (1+2) *	568.3	100.0	680.2	100.0	111.8	19.7

\*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, increased by 4.6 percent in the twelve months to June 2009 compared with 18.2 percent expansion in a similar period in 2008 and the 10.7 percent target. As shown in Table 5.5, the expansion in reserve money reflected lower growth in both commercial banks reserves and cash outside banks. Commercial bank reserves grew by 4.7 percent in the year to June 2009, while cash outside banks expanded by 4.5 percent.

The sources of reserve money in the twelve months to June 2009 were growth of net foreign assets (NFA) and net domestic assets of the Central Bank. NFA increased by 3.1 percent in the year to June 2009 from 23.8 percent the previous year. Net domestic assets (NDA) of the Central Bank rose by 1.6 percent during the year to June 2009 reflecting drawdown of Government deposits and expansion in commercial banks' net liability to Central Bank following the Bank's injection of liquidity to the interbank market through reverse repo.

**TABLE 5.5: RESERVE MONEY AND ITS SOURCES (KSH BN)**

	2007 June	2008 June	2009 June	Change (%)	
				2007/08	2008/09
1. Net Foreign Assets	163.7	202.6	208.8	23.8	3.1
2. Net Domestic Assets	-34.3	-49.6	-48.8	-44.8	1.6
2.1 Government Borrowing (net)	-3.5	-27.7	-23.5	-696.3	14.9
2.2 Advances & Discounts	-15.7	4.5	15.0	128.9	230.8
2.3 Other Domestic Assets (net)	-17.5	-28.9	-42.8	65.8	-47.9
3. Reserve Money	129.4	152.9	159.9	18.2	4.6
3.1 Currency outside banks	78.1	83.6	87.3	7.0	4.5
3.2 Bank reserves	51.2	69.3	72.6	35.3	4.7

Source: Central Bank of Kenya

## Outlook

Over the next twelve months to June 2010, the Bank will target 14.5 percent expansion in money supply, M3, and 10.9 percent growth in reserve money as shown in Table 5.6. The liquidity supply will boost economic recovery from 1.7 percent growth in 2008 to 3.0 percent in 2009. 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 5.6: MONETARY PROGRAMME FOR 2009/10**

Monetary Programme for 2009/10		
	Jun-09	Jun-10
	Est	Proj.
Ksh Billion		
Reserve Money	160.2	181.4
Net Foreign assets	208.3	229.5
Money Supply (M3)	966.5	1,106.6
Net Foreign assets	277.3	316.2
Annual Growth Rates		
Money Supply (M3)	15.0	14.5
Reserve Money	7.0	10.9
Real GDP	3.0	3.1
GDP deflator	12.2	10.1

Source: Central Bank of Kenya



## 6. INTEREST RATES

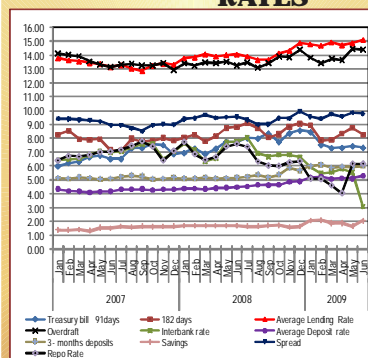
### Central Bank Rate (CBR)

The central bank rate (CBR) was revised downwards from 9 percent in July 2008 to 8.0 percent in June 2009. The Monetary Policy Committee lowered the central bank rate to signal to the market easing of monetary conditions the Bank was pursuing.

### Short Term Rates

The short term rates trended downwards in the fiscal year following the reduction of the Central Bank rate. The 91-day Treasury bill rate declined from 8.0 percent in July 2008 to 7.3 percent in June 2009. The 182-day Treasury bill rate declined from 9.1 percent in July 2008 to 8.3 percent in June 2009. The interbank rate followed a similar trend, falling from 8.1 percent in July 2008 to 3.1 percent in June 2009. The decline in the interbank rate was a reflection of liquidity availability in the economy and thus lowered cost of credit.

**CHART 9A: INTEREST RATES**



Source: Central Bank of Kenya

### Lending Rates

Average lending rates increased in the fiscal year 2008/09 from 13.9 percent in July 2008 to 15.1 percent in June 2009. The rise in the overall lending rate reflected the increase in lending rates for the 1-5 years loans category in both the business and personal loans. This was mainly attributed to the perceived increased riskiness of borrowers given the slowdown in economic activities. The over 5 years and overdraft interest rates did not change on average in the fiscal year.

**TABLE 9.1: INTEREST RATES (%)**

	2008						2009					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91-day	8.031	8.017	8.36	7.75	8.39	8.59	8.46	7.55	7.31	7.33	7.45	7.33
Treasury bill 182-day	9.09	8.75	8.08	8.32	8.86	9.08	8.93	7.89	7.91	8.34	8.77	8.28
Average Lending Rate	13.91	13.66	13.66	14.12	14.32	14.87	14.78	14.67	14.92	14.71	14.85	15.09
Overdraft	13.49	13.11	13.43	13.91	13.85	14.40	13.84	13.46	13.78	13.66	14.46	14.41
Interbank rate	8.07	6.92	6.70	6.81	6.83	6.66	5.95	5.49	5.57	5.81	5.55	3.08
Average Deposit rate	4.54	4.65	4.62	4.65	4.86	4.89	5.19	5.23	5.09	5.12	5.10	5.28
3 - months deposits	5.25	5.39	5.19	5.39	5.89	5.68	6.00	6.11	5.89	5.96	5.95	6.02
Savings	1.67	1.68	1.73	1.74	1.61	1.65	2.10	2.13	1.90	1.91	1.67	2.08
Spread	9.37	9.01	9.04	9.47	9.46	9.98	9.59	9.44	9.78	9.59	9.87	9.80

Source: Central Bank of Kenya

## Deposit Rates

Average deposit rates increased by 80 basis points from 4.5 percent in July 2008 to 5.3 percent in June 2009. The increase in the deposit rates emanated from increases in the rates for 0-3 month's deposits and over 3 months deposits categories. The rise in deposit rate in this category is attributed to the increased need for the banks to attract and retain deposits for longer periods, and perceived competition following the lowering of Treasury bills threshold from Ksh 1 million to Ksh 100,000 in order to attract small investors into the Government securities segment. The deposit rate on demand deposits declined from 1.3 percent in July 2008 to 1.1 percent in June 2009. The savings deposits on the other hand increased from 1.7 percent in July 2008 to 2.1 percent in June 2009.

The increase in the overall lending interest rate in June 2009 was much higher than the increase in overall deposit rate. Consequently, the interest rate spread rose from 9.4 percent in July 2008 to 9.8 in June 2009. Chart 9A and Table 9.1 percent the movement in interest rates during the period.

## Interest Rates Outlook

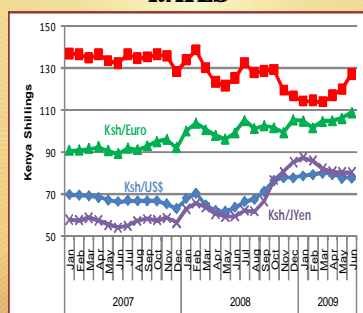
Interest rates are expected to remain stable, consistent with expected stability in most of the macroeconomic fundamentals. They are expected to remain stable in the medium terms as they tend towards the CBR that has been declining. The Bank would support interest rates stability by continued implementation of prudent monetary policy. But, in order to stimulate savings and investments, deposit rates must increase and lending rates must decline in line with return on investments as well as encourage production in future. Lower interest rates spread will signal increasing efficiency in the financial market.

## 7. EXCHANGE RATES

### The Kenya Shilling Exchange Rates

The Kenya shilling depreciated against major world currencies in the fiscal year 2008/09 (Table 11.1 and Chart 11A). The shilling depreciated against the US dollar by 22.1 percent between June 2008 and June 2009 to exchange at an average of Ksh 77.9 per US dollar in June 2009 compared with Ksh 63.8 per US dollar in June 2008. The depreciation of the shilling against the US dollar, which mainly occurred during the first half of the fiscal year 2008/09, initially triggered sale of shares allocated to foreign investors after the shares commenced trading at the Nairobi Stock Exchange. The foreign investors were mostly speculating and this led to huge outflows of foreign exchange. The depreciation of the local unit was further amplified by the international financial crisis. 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. However, during the second half of the fiscal year, the shilling fluctuated within a narrow range of Ksh 77.9 to Ksh 80.30 per dollar.

**CHART 11A: KENYA SHILLING EXCHANGE RATES**



Source: Central Bank of Kenya

The shilling also depreciated against the Sterling Pound, the Euro and the Japanese Yen to exchange, on average, at Ksh 127.2 per Sterling Pound, Ksh 109.0 per Euro and Ksh 80.6 per 100 Japanese Yen in June 2009, respectively, compared with Ksh 125.3 per Sterling Pound, Ksh 99.2 per Euro and Ksh 59.6 per 100 Japanese Yen in June 2008.

Against African currencies, the Kenya shilling gained against the Uganda shilling by 9.3 percent in the fiscal year 2008/09 to exchange at Ush 27.5 per Kenya shilling in June 2009. The Kenya shilling, however, depreciated against the South African Rand and the Tanzania shilling by 20.1 percent and 9.5 percent to exchange at Ksh 9.6 per Rand and Tsh 16.9 per Kenya shilling in June 2009 compared with Ksh 8.0 per Rand and Tsh 18.6 per Kenya shilling in June 2008.

**TABLE 11.1: KENYA SHILLING EXCHANGE RATES**

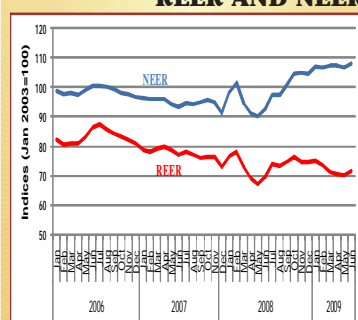
	2006			2007			2008			2009		% Change Jun-08 to Jun-09
	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	
Kshs/US\$	72.2	73.4	69.6	69.9	66.6	63.3	68.1	63.8	78.0	78.9	77.9	22.1 <sup>b</sup>
Kshs/Stg. £	127.5	135.4	136.8	136.9	132.3	128.5	134.0	125.3	116.5	114.3	127.2	1.6 <sup>b</sup>
Kshs/Euro	87.5	93.0	92.0	90.9	89.3	92.2	100.2	99.2	105.0	105.0	109.0	9.9 <sup>b</sup>
Kshs/Yen	62.6	64.0	59.5	58.1	54.3	56.5	63.2	59.6	85.4	87.4	80.6	35.2 <sup>b</sup>
Kshs/Rand	11.8	10.5	9.9	9.7	9.3	9.3	9.8	8.0	7.8	8.0	9.6	20.1 <sup>b</sup>
Ushs/Kshs*	25.2	25.3	26.1	26.0	25.0	27.1	25.2	25.1	25.1	25.1	27.5	9.3 <sup>a</sup>
Tshs/Kshs*	16.3	17.1	18.6	18.6	19.0	18.4	17.1	18.6	16.6	17.0	16.9	-9.5 <sup>b</sup>

\*Currency per Kenya shilling

<sup>a</sup>--appreciation<sup>b</sup>--depreciation**Source: Central Bank of Kenya**

## International Trade Competitiveness

The performance of the Kenya shilling against bilateral currencies was reflected in the basket of currencies of Kenya's major trading partners. The trade-weighted nominal effective exchange rate (NEER) index depreciated by 16.6 percent between June 2008 and June 2009 as shown in Chart 11B. The real effective exchange rate index (REER), which is a measure of external competitiveness, depreciated by a small margin of 2.6 percent reflecting higher inflation in Kenya relative to the inflation in trading partner countries.

**CHART 11B: 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**

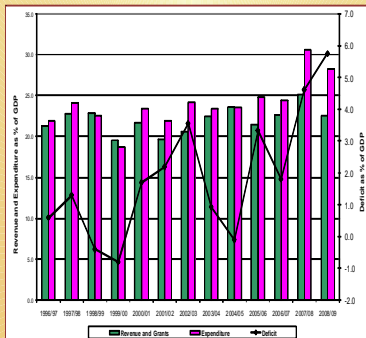
## Outlook for the Kenya Shilling

The Kenya shilling is expected to remain stable as effects of the international financial crisis bottom up. However, demand for foreign currency is likely to be strong in the next fiscal year consistent with expectations of higher imports of capital goods and food in line with the economic recovery program and the prevailing drought conditions. The continued pursuit of prudent monetary policy by the Central Bank is expected to reign in domestic inflation thus contributing positively to the country's external competitiveness.

# FISCAL POLICY MANAGEMENT

## 8. GOVERNMENT BUDGETARY OPERATIONS

**CHART 3A: GOVERNMENT BUDGET PERFORMANCE**



Sources: Central Bank of Kenya and Treasury

Government budgetary operations in the fiscal year 2008/09 resulted in a budget deficit of Ksh 110.6 billion or 4.6 percent of GDP on commitment basis compared with Ksh 77.2 billion (4.5 percent of GDP) in a similar period in the fiscal year 2007/08. In addition, Government receipts fell below the target for the period, following a decline of non-tax revenue and Appropriation-in-Aid (A-in-A). However, as shown in Table 3.1 and Chart 3A, the deficit was well within the revised budget target of Ksh 137.7 billion or 5.8 percent of GDP for the fiscal year.

**TABLE 3.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS**

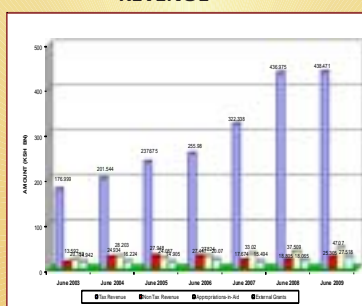
	FY 2006/2007	FY 2007/2008	FY 2008/2009		
	Actual	Actual	Prov	Target	Over(+) /below (-) target
<b>1. REVENUE</b>	<b>388.5</b>	<b>457.7</b>	<b>511.4</b>	<b>538.4</b>	<b>-27.0</b>
Revenue	373.0	432.2	493.3	510.8	-17.6
Tax Revenue	322.3	381.1	437.0	438.5	-1.5
Non Tax Revenue	17.7	15.4	18.8	25.3	-6.5
Appropriations-in-Aid	33.0	35.7	37.5	47.1	-9.6
External Grants	15.5	25.4	18.1	27.5	-9.5
<b>2. EXPENSES</b>	<b>419.6</b>	<b>534.8</b>	<b>621.9</b>	<b>676.0</b>	<b>-54.1</b>
Recurrent Expenditure	339.2	403.4	462.2	470.6	-8.3
Development Expenditure	80.4	131.5	159.7	205.4	-45.8
<b>3. DEFICIT ON A COMMITMENT BASIS (1-2)</b>	<b>-31.0</b>	<b>-77.2</b>	<b>-110.6</b>	<b>-137.7</b>	<b>-27.1</b>
Deficit on a commitment basis as a % of GDP	-1.8	-4.5	-4.6	-5.8	
<b>4. ADJUSTMENT TO CASH BASIS</b>	<b>-5.6</b>	<b>9.3</b>	<b>17.2</b>	<b>-0.4</b>	<b>17.6</b>
<b>5. DEFICIT ON A CASH BASIS</b>	<b>-36.6</b>	<b>-67.9</b>	<b>-93.4</b>	<b>-138.1</b>	<b>-44.7</b>
Deficit on a cash basis as a % of GDP	-2.1	-4.0	-4.6	-5.8	
<b>6. DISCREPANCY: Expenditure (+) / Revenue (-)</b>	<b>0.0</b>	<b>-7.9</b>	<b>-3.6</b>	<b>0.0</b>	<b>3.6</b>
<b>7. FINANCING</b>	<b>36.6</b>	<b>59.9</b>	<b>83.5</b>	<b>138.1</b>	<b>-54.6</b>
Domestic (Net)	34.7	-13.9	50.9	75.9	-25.0
External (Net)	-2.0	6.3	11.6	41.1	-29.6
Capital Receipts (privatisation)	4.0	67.5	0.0	0.0	0.0
Others	0.0	0.0	21.1	21.1	0.0

Sources: Treasury and Central Bank of Kenya

### Government Revenue

Government revenue (including grants) amounted to Ksh 511.4 billion in the fiscal year 2008/09 compared with Ksh 457.7 billion in a similar period in the fiscal year 2007/08 (Chart 3B). However, as a percentage of GDP, the revenue and grants declined from 22.5 percent to 21.4 percent during the period. Even though the revenue performance improved in the fiscal year 2008/09, it was still below the target set for the fiscal year. The shortfall was mainly attributed to decline of the corporate taxes and VAT attributed to slower-than-envisaged expansion in economic activities.

**CHART 3B: COMPOSITION OF REVENUE**



Sources: Central Bank of Kenya and Treasury

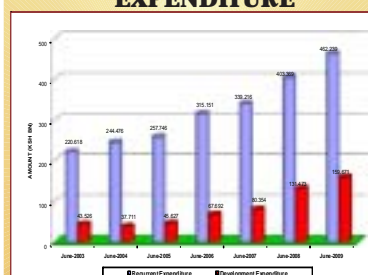


Cumulative tax revenue collection in the year to June 2009 was Ksh 437.0 billion, or 14.7 percent above Ksh 381.1 billion collected in a similar period of fiscal year 2007/08. The tax revenue was, however, below the target by Ksh 1.5 billion for the period. Similarly, Appropriation-in-Aid (A-I-A) increased by Ksh 1.8 billion while non-tax revenue went up by Ksh 3.4 billion. External grants, however, declined by Ksh 7.4 billion.

Following these developments, the percentage of tax revenue in total revenue increased from 83.3 percent in the fiscal year 2007/08 to 85.5 percent in a similar period in 2008/09. Similarly, the percentage of non-tax revenue rose from 3.4 percent to 3.7 percent during the same period. The proportion of A-I-A, however, decreased from 7.8 percent to 7.3 percent while the percentage of external grants in total revenue decreased from 5.6 percent to 3.5 percent during the same period.

### Expenditure and Net Lending

**CHART 3C: GOVERNMENT EXPENDITURE**



Sources: Central Bank of Kenya and Treasury

As shown in Chart 3C, Government expenditure and net lending increased by 16.3 percent, from Ksh 534.8 billion in the fiscal year 2007/08 to Ksh 621.9 billion in the fiscal year 2008/09. This rise was due to increases of 14.6 percent and 21.4 percent in recurrent and development expenditures, respectively.

The recurrent expenditure increased by Ksh 58.9 billion, from Ksh 403.4 billion in the fiscal year 2007/08 to Ksh 462.2 billion in the fiscal year 2008/09. This was attributed to increases of Ksh 10.4 billion in wages and salaries, interest payments of Ksh 4.1 billion and Ksh 44.4 billion in other expenses. Recurrent expenditure were Ksh 8.3 billion below target.

Development expenditure increased from Ksh 131.5 billion to Ksh 159.7 billion in the period reflecting increased expenditure on infrastructure development. The development expenditure were Ksh 45.8 billion or 34.8 percent below target. The lower than target performance was attributed to slower implementation rates especially with respect to the externally financed projects. However, the percentage of development expenditure in total expenditure increased from 24.6 percent in the fiscal year 2007/08 to 25.7 percent in a similar period in the fiscal year in 2008/09, while recurrent expenditure declined from 75.4 percent to 74.3 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.

### Financing

The budgetary operations of the central Government during the period under review resulted in a financing requirement of Ksh 89.8 billion compared with Ksh 90.7 billion in the fiscal year 2007/08 (Table 3.2). The financing requirement comprised Ksh 83.5 billion to finance the budget deficit and Ksh 6.3 billion to overdraft owed to the Central Bank (the overdraft is by law limited to 5% of audited tax revenues and must be repaid by the end of the financial year). The financing was sourced through net domestic borrowing of Ksh 72.4 billion from commercial banks and non-bank sources, foreign borrowing of Ksh 11.6 billion, draw down of Government deposits at the Central bank of Kenya by Ksh 3.3 billion and net refinancing costs of Telkom totalling Ksh 2.5 billion.

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

I. FINANCING REQUIREMENTS	2004/05	2005/06	2006/07	2007/08	2008/09
1. Budget deficit	-	36.5	37.0	58.0	83.5
2. External debt reduction	0.6	-	1.7	-	-
3. Domestic debt reduction	19.6	5.6	5.6	6.2	6.3
3.1 Central Bank (incl. items in transit)	4.3	5.6	5.6	-	6.3
3.2 Commercial banks (net of deposits)	15.3	-	-	6.2	-
3.3 Non-bank sources	-	-	-	-	-
4. Increase in GoK deposits at CBK	6.1	15.4	-	26.4	-
<b>TOTAL</b>	<b>26.4</b>	<b>57.5</b>	<b>44.3</b>	<b>90.7</b>	<b>89.8</b>
II. FINANCING SOURCES	2004/05	2005/06	2006/07	2007/08	2008/09
1. Budget surplus	7.3	-	-	-	-
2. External debt increase	-	1.3	-	4.4	11.6
3. Increase in domestic debt	19.1	49.3	22.2	18.8	72.4
3.1 Central Bank	-	-	-	9.3	-
3.2 Commercial banks	-	27.1	7.3	-	43.6
3.3 Non-bank sources	19.1	22.1	14.9	9.5	28.8
4. Reduction in GoK deposits at CBK	-	-	18.1	-	3.3
5. Refinancing costs	-	7.0	4.0	67.5	2.5
<b>TOTAL</b>	<b>26.4</b>	<b>57.5</b>	<b>44.3</b>	<b>90.7</b>	<b>89.8</b>

Source: Treasury and Central Bank of Kenya

### Outlook for the Fiscal Year 2009/10

In the budget estimates for the fiscal year 2009/10, Government revenue excluding external grants is estimated at Ksh 569.6 billion (22.4 percent of GDP). External grants are estimated at Ksh 35.3 billion (1.4 percent of GDP) during the fiscal year. Similarly, Government expenditure is estimated at Ksh 772.4 billion or 30.3 percent of GDP which will comprise Ksh 509.1 billion (19.9 percent of GDP) in recurrent expenditure and Ksh

261.3 billion (10.3 percent of GDP) in development expenditure.

The overall budget deficit including grants is therefore estimated at Ksh 168.2 billion (6.6 percent of GDP) in fiscal year 2009/10. The deficit is to be financed through net external borrowing of Ksh 50.2 billion (2.0 percent of GDP), net domestic borrowing of Ksh 109.5 billion (4.3 percent of GDP), privatization proceeds of Ksh 6.0 billion and net refinancing costs of Telkom totalling Ksh 2.5 billion.

## 9. PUBLIC DEBT

Kenya's public and publicly guaranteed debt increased by 21.0 percent in the fiscal year 2008/09 to Ksh 1,053.8 billion in June 2009 from Ksh 870.6 billion in June 2008 (Table 4.1). The increase in the overall Government debt stock comprised Ksh 87.9 billion in domestic debt and Ksh 95.3 billion in external debt. The percentage of domestic debt in total debt decreased from 49.5 percent to 49.2 percent during the period while the proportion of external debt increased from 50.3 percent to 50.8 percent.

**TABLE 4.1: PUBLIC DEBT (KSH BN)**

	June 2006		June 2007		June 2008*		June 2009**	
	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%
<b>DOMESTIC DEBT</b>								
<b>Securitized debt</b>	<b>349.7</b>	<b>97.7</b>	<b>402.9</b>	<b>99.6</b>	<b>427.2</b>	<b>99.2</b>	<b>511.6</b>	<b>98.7</b>
Treasury Bills	130.3	36.4	130.0	32.1	111.3	25.8	116.8	22.5
Of which Repo Treasury bills	35.5	9.9	35.5	8.8	34.4	8.0	33.3	6.4
Treasury Bonds	218.4	61.0	272.2	67.3	315.2	73.2	360.7	69.6
Government Stocks	1.1	0.3	0.8	0.2	0.8	0.2	0.8	0.1
<b>Non Securitized debt</b>	<b>8.1</b>	<b>2.3</b>	<b>1.8</b>	<b>0.4</b>	<b>3.4</b>	<b>0.8</b>	<b>6.9</b>	<b>1.3</b>
Overdraft/Advances	8.1	2.3	1.1	0.3	0.4	0.1	5.1	1.0
others	0.0	0.0	0.7	0.2	3.0	0.7	1.8	0.3
<b>TOTAL DOMESTIC DEBT</b>	<b>357.8</b>	<b>100.0</b>	<b>404.7</b>	<b>100.0</b>	<b>430.6</b>	<b>100.0</b>	<b>518.5</b>	<b>100.0</b>
(as a % of GDP)	23.2		23.6		21.2		21.7	
(as a % of Total Debt)	45.3		50.5		50.1		49.2	
<b>EXTERNAL DEBT**</b>								
Bilateral	154.9	35.9	137.9	34.8	153.2	34.8	185.4	34.6
Multilateral	255.5	59.3	240.3	60.6	268.2	61.0	326.9	61.1
Comm. Banks	1.3	0.3	0.3	0.1	0.0	0.0	0.0	0.0
Export Credit	19.5	4.5	18.0	4.5	18.5	4.2	23.1	4.3
<b>TOTAL EXTERNAL DEBT</b>	<b>431.2</b>	<b>100.0</b>	<b>396.6</b>	<b>100.0</b>	<b>440.0</b>	<b>100.0</b>	<b>535.3</b>	<b>100.0</b>
(as a % of GDP)	27.9		23.1		21.6		22.4	
(as a % of Total Debt)	54.7		49.5		50.5		50.8	
<b>TOTAL PUBLIC DEBT</b>	<b>789.1</b>		<b>801.3</b>		<b>870.6</b>		<b>1053.8</b>	
(as a % of GDP)	51.1		46.7		42.8		44.0	

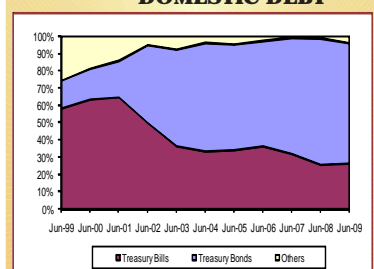
Sources: Central Bank of Kenya and Treasury

As a percentage of GDP, overall public debt stock increased from 42.8 percent to 44.0 percent during the period following a slower growth in GDP (Table 4.1). In particular, the proportion of external debt in GDP rose from 21.6 percent to 22.4 percent while domestic debt increased from 21.1 percent of GDP to 21.7 percent. Since June 2003, the overall debt-to-GDP ratio has been on a downward trend which is indicative of a sustainable debt stock in the medium term.

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

## Public Domestic Debt

**CHART 4A: COMPOSITION OF GOVERNMENT DOMESTIC DEBT**



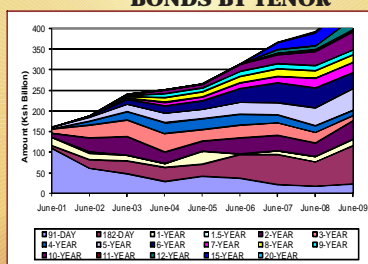
Sources: Central Bank of Kenya and Treasury

Public domestic debt increased by 20.4 percent in the fiscal year 2008/09 from Ksh 430.6 billion in June 2008 to Ksh 518.5 billion in June 2009. This reflects increases of Ksh 39.9 billion in Treasury bills (excluding Repos), Ksh 45.6 billion in Treasury bonds and Ksh 3.5 billion in other domestic debt. Government overdraft at Central Bank, which is the main component of other domestic debt, increased to Ksh 5.1 billion, and was within the legal limit of Ksh 16.9 billion. As shown in Chart 4A, 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.

Outstanding Treasury bonds increased from Ksh 315.2 billion in June 2008 to Ksh 360.7 billion in June 2009. 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 finance for infrastructural 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 the period to maturity) increased from 3 years and 8 months in June 2008 to 3 years and 9 months in June 2009. These development is consistent with the government debt management strategy of restructuring domestic debt to longer dated instruments in order to minimise the risks associated with short term domestic borrowing. The infrastructure bond issued in February 2009 was oversubscribed by Ksh 8.0 billion, indicating a potentially big demand for such bonds by investors and the vibrancy in the bond market.

As shown in Chart 4B, the Government made significant progress in issuing long-term instruments during the fiscal year 2008/09. The 5-year Treasury bond, however, accounted for the largest proportion of outstanding Government securities during the period, though remaining at 11.1 percent in June 2009 as at June 2008. The percentage of Treasury bonds with maturities of between 10-years and 20-years increased from 20.7 percent to 27.0 percent during the period following successful issuance of longer dated Treasury bonds.

**CHART 4B: 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 4.2 and 4.3. Treasury bills holdings by commercial banks increased from 23.7 percent in June 2008 to 54.2 percent in June 2009. Commercial bank holdings of Treasury bonds decreased marginally from 49.5 percent to 48.8 percent during the period. The success in the bond market in re-opening bond issues to add to their liquidity and support for bond trading was a resounding success in the year.

**TABLE 4.2: OUTSTANDING STOCK OF TREASURY BILLS BY HOLDER (KSH BN)**

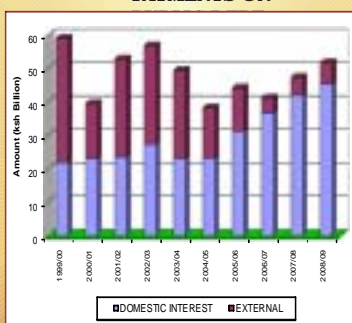
Holders	Jun-06		Jun-07		Jun-08		Jun-09	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	83.3	63.9	80.8	62.2	69.4	62.4	108.0	78.3
Central Bank*	35.7	27.4	35.6	27.4	43.0	38.6	33.3	24.2
Comm. Banks	47.0	36.1	45.1	34.7	26.4	23.7	74.6	54.2
NBFIs	0.5	0.4	0.2	0.2	0.0	0.0	0.0	0.0
Insurance Companies	11.0	8.5	13.5	10.4	17.0	15.3	17.0	12.4
Parastatals	11.2	8.6	9.0	6.9	7.2	6.4	2.3	1.7
of which NSSF	0.6	0.5	0.2	0.1	0.1	0.0	0.0	0.0
Building Societies	0.5	0.4	0.6	0.5	1.1	0.9	0.0	0.0
Others	24.2	18.6	26.0	20.0	16.7	15.0	10.5	7.6
<b>Total</b>	<b>130.3</b>	<b>100.0</b>	<b>130.0</b>	<b>100.0</b>	<b>111.3</b>	<b>100.0</b>	<b>137.8</b>	<b>100.0</b>

Source: Central Bank of Kenya

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

Holders	Jun-06		Jun-07		Jun-08		Jun-09	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	101.0	46.3	141.5	52.0	156.8	49.8	176.8	49.0
Central Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Comm. Banks	100.1	45.9	140.7	51.7	156.1	49.5	176.0	48.8
NBFIs	0.9	0.4	0.9	0.3	0.7	0.2	0.8	0.2
Insurance Companies	26.4	12.1	27.5	10.1	31.9	10.1	38.3	10.6
Parastatals	23.2	10.6	27.3	10.0	29.5	9.4	31.4	8.7
of which NSSF	4.9	2.2	6.8	2.5	11.3	3.6	15.8	4.4
Building Societies	1.8	0.8	1.3	0.5	0.9	0.3	0.5	0.1
Others	65.9	30.2	74.6	27.4	96.0	30.5	113.8	31.5
<b>Total</b>	<b>218.4</b>	<b>100.0</b>	<b>272.2</b>	<b>100.0</b>	<b>315.2</b>	<b>100.0</b>	<b>360.7</b>	<b>100.0</b>

Source: Central Bank of Kenya

**CHART 4C: INTEREST PAYMENTS ON**

Sources: Central Bank of Kenya and

## Domestic Debt Service

As shown in Chart 4C, cumulative Government expenditure on interest and other charges on domestic debt increased from Ksh 42.2 billion in the fiscal year 2007/08 to Ksh 45.5 billion in the fiscal year 2008/09. However, domestic interest in ordinary Government revenue decreased from 10.6 percent to 10.1 percent during the period following a higher rate of growth in revenue. This is an indication that despite the rise in the stock of domestic debt, the capacity of the Government to service the debt has also increased. Furthermore, domestic interest payments on new domestic borrowing decreased from Ksh 10.1



billion in the fiscal year 2007/08 to Ksh 7.9 billion in the fiscal year 2008/09 due to lower interest rates.

### Public and Publicly Guaranteed External Debt

Kenya's external debt increased by 21.7 percent, from Ksh 440.0 billion (US\$ 6.8 billion) in June 2008 to Ksh 535.3 billion (US\$ 6.9 billion) in June 2009 following the weakening of the Kenya shilling against the Euro, the dollar and the sterling Pound (Table 4.4). The increase in external debt comprised external loans disbursement of Ksh 24.3 billion and revaluation loss of Ksh 70.1 billion which more than offset repayment of Ksh 15.7 billion.

**TABLE 4.4: DISTRIBUTION OF EXTERNAL PUBLIC DEBT**

	Jun-06	%	Jun-07	%	Jun-08	%	Jun-09	%
Bilateral	154.9	35.9	137.9	34.8	153.2	34.8	185.4	34.6
Multilateral	255.5	59.3	240.3	60.6	268.2	61.0	326.9	61.1
Commercial loans	1.3	0.3	0.3	0.1	0.0	0.0	0.0	0.0
Export Credit	19.5	4.5	18.0	4.5	18.5	4.2	23.1	4.3
Total	431.2	100.0	396.6	100.0	440.0	100.0	535.3	100.0

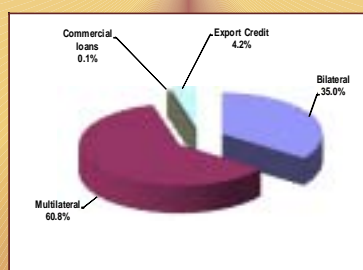
Sources: Central Bank of Kenya and Treasury

The percentage of external debt owed to multilateral corporations (including loans from the IMF) increased from 61.0 percent in June 2008 to 61.1 percent in June 2009, while that owed bilateral creditors decreased from 34.8 percent to 34.6 percent. (Table 4.4, and Charts 4D and 4E). However, the percentage of external debt contracted through export credits remained unchanged at 4.3 percent.

**CHART 4D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2009**



**CHART 4E: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2008**



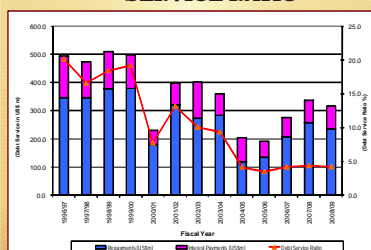
Sources: Central Bank of Kenya and Treasury

The percentage of external debt held in US dollars, sterling Pound, and the Euro decreased from 30.1 percent, 5.9 percent and 34.1 percent in June 2008 to 27.2 percent, 5.7 percent and 31.4 percent in June 2009, respectively. However the external debt proportion held in other currencies including SDRs increased from 4.7 percent to 10.6 percent during the period. The external debt proportion held in Japanese Yen remained unchanged at 25.1 percent.

### External Debt Service

External debt service increased from Ksh 22.9 billion or 5.8 percent of ordinary revenue to Ksh 23.9 billion or 5.2 percent of ordinary revenue following the weakening of the shilling against the major currencies. The external debt service in the



**CHART4F: EXTERNAL DEBT  
SERVICE AND DEBT  
SERVICE RATIO**

Sources: Central Bank of Kenya and

period comprised Ksh 17.6 billion in principal repayments and Ksh 6.3 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 4.2 percent in the fiscal year 2008/09. As shown in Chart 4F, 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.

### Prospects for Fiscal Year 2008/09

The budget estimates for fiscal year 2009/10 has Government domestic borrowing projected at Ksh 109.5 billion (4.3 percent of GDP), while external borrowing is estimated at Ksh 50.2 billion (2.0 percent of GDP). However, as indicated in the Government Budget Strategy Paper for fiscal years 2009/10 to 2011/12, gross domestic debt-to-GDP ratio is projected to increase from 22.7 percent in June 2009 to 24.2 percent in June 2010 as GDP is expected to grow at a slower rate compared with domestic debt. Consequently, external debt-to-GDP ratio is expected to increase from 22.0 percent to 23.9 percent during the period, which will however be lower than the 24.1 percent in June 2009.

## 10. BALANCE OF PAYMENTS

### Overview

Kenya's balance of payments was influenced by developments in the global economy in 2008. Exports of horticulture and raw materials were lower due to slow growth in Kenya's trading partner countries. The situation was compounded by the increase in the value of imports resulting in the widening of the current account deficit by US\$ 1,598 million. On the other hand the capital and financial account improved by US\$ 493 million. The overall balance of payments position thus declined from a surplus of US\$ 683 million during the fiscal year 2007/08 to a deficit of US\$ 422 million during the fiscal year 2008/09 (Table 10.1).

**TABLE 10.1: BALANCE OF PAYMENTS (US \$ M)**

ITEM	Year to June 2009*					Year to Jun 2009*	Absolute Change
	Year to Jun 2008*	Q1 Jul-Sep	Q2 Oct-Dec	Q3 Jan-Mar	Q4 Apr-Jun		
<b>1. OVERALL BALANCE</b>	683	-292	-273	-160	302	-422	-1,105
<b>2. CURRENT ACCOUNT</b>	-1,073	-937	-628	-508	-599	-2,671	-1,598
<b>2.1 Goods</b>	-5,428	-1,958	-1,665	-1,264	-1,365	-6,252	-824
Exports (fob)	4,648	1,312	1,189	1,099	1,024	4,623	-25
Coffee	169	35	30	47	68	179	10
Tea	755	256	229	210	182	877	122
Horticulture	739	159	170	177	162	668	-71
Oil products	145	20	28	19	19	87	-58
Manufactured Goods	571	188	137	131	114	570	-1
Raw Materials	320	73	57	62	55	247	-72
Re-exports	213	85	85	65	47	281	68
Other	1,736	496	453	388	376	1,713	-23
Imports (cif)	10,076	3,269	2,854	2,363	2,388	10,875	799
Oil	2,448	1,081	540	400	536	2,556	108
Chemicals	1,318	384	339	353	308	1,384	66
Manufactured Goods	1,505	409	445	301	323	1,477	-28
Machinery & Transport Equipment	2,762	862	825	801	663	3,151	389
Other	2,043	534	706	509	560	2,309	265
<b>2.2 Services</b>	4,355	1,021	1,038	757	766	3,581	-774
Non-factor services (net)	2,015	568	591	397	377	1,934	-81
of which tourism	786	211	190	146	117	664	-123
Income (net)	-69	-21	-19	-15	-17	-73	-4
of which official interest	-141	-21	-27	-23	-26	-97	44
Current Transfers	2,409	475	466	374	405	1,720	-689
Private (net)	2,102	480	470	374	405	1,730	-372
Public (net)	307	-5	-5	0	0	-10	-317
<b>3. CAPITAL &amp; FINANCIAL ACCOUNT</b>	1,756	645	355	347	901	2,249	493
<b>3.1 Capital Transfers (net)</b>	337	47	37	101	62	247	-90
<b>3.2 Financial Account</b>	1,419	598	318	247	839	2,002	583
Official, medium & long-term	96	-18	45	15	78	119	23
Inflows	348	52	103	74	132	361	12
Outflows	-252	-71	-58	-59	-54	-242	11
Private, medium & long-term (net)	14	629	-47	-145	21	459	445
Commercial Banks (net)	-493	636	-35	-136	7	472	965
Other private medium & long-term (net)	507	-6	-12	-9	13	-14	-520
Short-term (net) incl. errors & omissions	1,309	-13	319	377	741	1,424	115
memo:							
<b>Gross Reserves</b>	5,786	1,548	5,012	4,320	4,822	4,822	-965
Official	3,445	1,119	3,151	2,714	3,219	3,219	-226
imports cover**	4	3	3	3	3	3	0
imports cover***	5	0	4	3	4	4	-1
Commercial Banks	2,341	429	1,861	1,606	1,602	1,602	-739

\* 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

Kenya's trade deficit widened from US\$ 5,428 million during the fiscal year 2007/08 to US\$ 6,252 million in fiscal year 2008/09. This was the result of an increase of 7.9 percent in the value of imports against a decline of only 0.5 percent in merchandise exports.

### Imports

The value of Kenya's merchandise imports rose to US\$ 10,875 million during the fiscal year 2008/09 from US\$ 10,076 million in the fiscal year 2007/08. The most notable increase was the machinery and transport equipment category which rose by 14.1 percent. Expenditures on this import category included power generating machinery, electrical machinery, telecommunication and sound recording equipment, and office equipment.

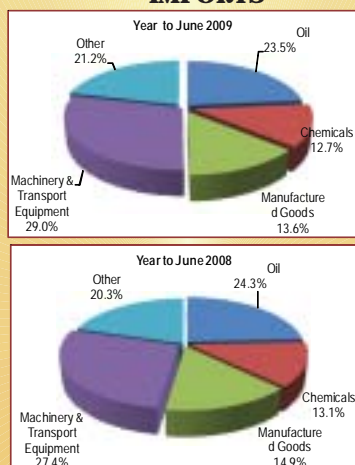
Oil imports, mainly jet fuel and motor spirits (premium), increased, by 4.4 percent from US\$ 2,448 million to US\$ 2556 million during the period under review reflecting increased import volumes (Chart 10A).

Other miscellaneous imports rose by 13.5 percent mainly on account of increased imports of maize by US\$ 331 million to US\$ 344 million in the fiscal year 2008/09, owing to food shortages during the year.

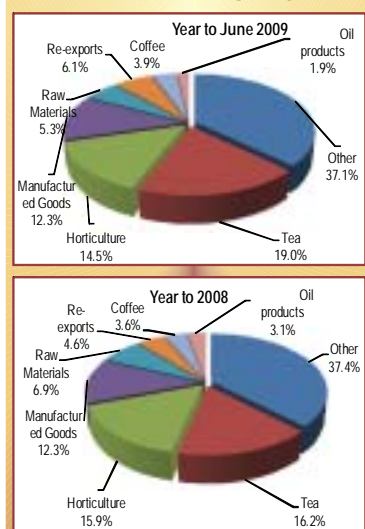
### Exports

The value of merchandise exports declined by about 0.5 percent from US\$ 4,648 million in the fiscal year 2007/08 to US\$ 4,623 million during the fiscal year 2008/09. Performance was mixed across exports categories. The value of tea exports rose during the review period reflecting a 16.8 percent increase in export prices from an average of US\$ 2,100 per tonne to an average of US\$ 2,452 per tonne, as well as a marginal increase in volumes from 357,646 tonnes to 360,081 tonnes. Coffee exports earnings also improved on account of both export price and volume increases. Unit export price of coffee rose by 2.8 percent from an average of US\$ 3,190 per tonne to an average of US\$

**CHART 10A: COMPOSITION OF KENYA'S IMPORTS**



Sources: Central Bank of Kenya

**CHART 10B: COMPOSITION OF KENYA'S EXPORTS**

Sources: Central Bank of Kenya

3,278 per tonne, while the volume went up by about 1.0 percent from 53,791 tonnes to 54,858 tonnes. The value of re-exports, particularly lubricating oil and greases, fertilizers and road vehicles increased during the period under review. On the other hand, earnings from horticultural exports declined due to weaker global demand. Export of raw materials and oil products also declined by 23 percent and 40 percent, respectively to US\$ 247 million and US\$ 87 million. This is attributed to reduction in real output in Kenya's trading countries. The exported value of manufactured goods exports remained unchanged at US\$ 570 million.

### Services, Income and Current Transfer Account

The services, income and current transfer account of the balance of payments recorded a surplus of US\$ 3,581 million in the fiscal year 2008/09 which is 21.6 percent lower than US\$ 4,355 million in fiscal year 2007/08.

Net receipts from non-factor services declined from US\$ 2,015 million to US\$ 1,934 million in the fiscal year 2008/09. This mainly reflected a slowdown in inflows related to foreign travel which declined from US\$ 786 million in the fiscal year 2007/08 to US\$ 664 million in fiscal year 2008/09. This was the result of post election crisis in early 2008 and the global economic downturn thereafter. Similarly, net payments to residents for transportation services offered to non residents declined. Net receipts on the current transfer account declined from US\$ 2,409 million to US\$ 1,720 million in fiscal year 2008/2009 largely due to reduction in transfers to non-governmental organizations and remittances.

The income account balance worsened to a net outflow of US\$ 73 million in fiscal year 2008/09 compared with a US\$ 69 million net outflow in fiscal year 2007/08, reflecting a decline in both interest earnings on official foreign exchange reserves and private sector income as international interest rates trended downwards. The decline in foreign interest income offset lower dividend payments by the private sector to non residents, and reduced interest payments by the Government on its outstanding foreign debt.

### **Capital and Financial Flows**

The capital and financial account improved by 28.1 percent from US\$ 1,756 million in the fiscal year 2007/08 to US\$ 2,249 million in the fiscal year 2008/09 reflecting increased financial inflows.

Contributing most to financial inflows were the “private medium and long-term” and “official medium and long term” categories which improved from US\$ 14 million and US\$ 96 million to US\$ 449 million and US\$ 119 million, respectively. The improvement in medium and long term financial flows reflects US\$ 472 million drawdown by the commercial banking sector of its deposits abroad (compared with a US\$ 493 build up of foreign deposits by commercial banks in the fiscal year 2007/08). Official medium and long-term financial flows improved on account of increased foreign loans to the Government which amounted to US\$ 361 million in fiscal year 2008/09, compared with US\$ 348 million in fiscal year 2007/08, and a decline in repayment on official foreign loans from US\$ 252 million to US\$ 242 million during the review period. The balance on the capital account decreased from US\$ 337 million to US\$ 247 million reflecting lower project grants to Government.

Other private medium and long-term financial flows, however, deteriorated to a net outflow of US\$ 14 million in the fiscal year 2008/2009 compared with a net inflow of US\$ 507 million a year earlier. Net short term financial inflows, including errors and omissions in recorded transactions, increased to US\$ 1,424 million in the fiscal year 2008/09 compared with US\$ 1309 million in fiscal year 2007/08 or by 8.8 percent.

### **Direction of Trade**

As shown in Table 10.2, the main destination countries for Kenya’s merchandise exports in the fiscal year 2008/2009 were Uganda (13.8 percent), United Kingdom (11.4 percent), Tanzania (9.3 percent), the Netherlands (7.9 percent), United States of America (6.3 percent), Pakistan (4.6 percent), Egypt (4.3 percent), Sudan (3.9 percent), Somalia (3.5 percent), and the Democratic Republic of Congo (3.4 percent). Overall, African countries absorbed 50.7 percent of Kenya’s merchandise exports.



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

Destination Country	Fiscal Years			Proportion (%)		
	2006/07	2007/08	2008/09	2006/07	2007/08	2008/09
Uganda	435	571	637	11.2	12.3	13.8
Tanzania	291	367	431	7.5	7.9	9.3
Egypt	151	157	199	3.9	3.4	4.3
Sudan	166	200	179	4.3	4.3	3.9
Somalia	115	179	163	3.0	3.8	3.5
DRC	116	130	158	3.0	2.8	3.4
Rwanda	73	100	140	1.9	2.2	3.0
Others	359	394	437	9.2	8.5	9.5
<b>Total Africa</b>	<b>1,705</b>	<b>2,098</b>	<b>2,344</b>	<b>44.0</b>	<b>45.1</b>	<b>50.7</b>
United Kingdom	396	520	528	10.2	11.2	11.4
Netherlands	299	372	367	7.7	8.0	7.9
USA	294	283	292	7.6	6.1	6.3
Pakistan	223	169	212	5.8	3.6	4.6
United Arab Emirates	85	151	102	2.2	3.2	2.2
Germany	69	94	96	1.8	2.0	2.1
India	65	97	88	1.7	2.1	1.9
Afghanistan	33	53	74	0.9	1.1	1.6
France	50	70	70	1.3	1.5	1.5
Others	658	742	450	17.0	16.0	9.7
<b>Total Exports</b>	<b>3,877</b>	<b>4,648</b>	<b>4,623</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Central Bank of Kenya

On the other hand, Kenya sourced imports from the United Arab Emirates (11.0 percent), India (10.9 percent), China (8.6 percent), South Africa (7.5 percent), Japan (5.6 percent), United States of America (4.5 percent), United Kingdom (3.9 percent), Germany (3.8 percent), Singapore (3.8 percent) and Saudi Arabia (3.4 percent) (Table 10.3).

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

Source Country	Fiscal Years			Fiscal Years		
	2006/07	2007/08	2008/09	2006/07	2007/08	2008/09
South Africa	454	597	815	5.5	5.9	7.5
Egypt	148	144	134	1.8	1.4	1.2
Others	365	426	348	4.4	4.2	3.2
<b>Total Africa</b>	<b>967</b>	<b>1,166</b>	<b>1,296</b>	<b>11.8</b>	<b>11.6</b>	<b>11.9</b>
India	703	1,069	1,186	8.6	10.6	10.9
United Arab Emirates	1,194	1,600	1,201	14.5	15.9	11.0
China	540	817	940	6.6	8.1	8.6
Japan	503	653	614	6.1	6.5	5.6
USA	643	393	494	7.8	3.9	4.5
United Kingdom	432	409	421	5.3	4.1	3.9
Singapore	249	194	417	3.0	1.9	3.8
Germany	304	351	354	3.7	3.5	3.3
Saudi Arabia	316	289	375	3.8	2.9	3.4
Indonesia	227	335	278	2.8	3.3	2.6
Netherlands	138	162	230	1.7	1.6	2.1
France	185	246	232	2.3	2.4	2.1
Bahrain	140	101	209	1.7	1.0	1.9
Italy	185	188	184	2.3	1.9	1.7
Others	1,479	2,101	2,444	18.0	20.8	22.5
<b>Total Imports</b>	<b>8,205</b>	<b>10,076</b>	<b>10,875</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Central Bank of Kenya

### Kenya's Trade Structure

The proportion of Kenya's total trade with Asia rose to 47.2 percent in 2008 compared with 43.2 percent in 2007. The proportion of trade with European countries and America however declined to 23.8 percent and 5.9 percent in 2008 compared with 25.1 percent and 8.6 percent in 2007, respectively (Table 10.4). Increased trade with Asian countries reflect trade with China, Japan, and India (Economic Survey 2009). Much of the trade between Kenya and European countries was with the Western Europe, the share of which, however, declined. Trade with African countries remained unchanged at 22.3 percent with the trade concentrated in the EAC and COMESA regions.



**TABLE 10.4: KENYA'S TRADE STRUCTURE**

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

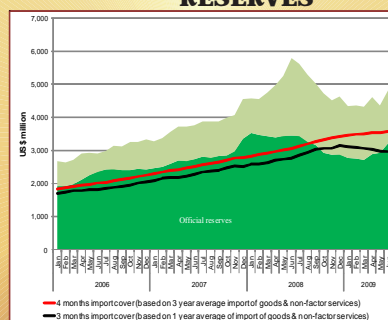
\*Provisional

**Source: Economic Survey, 2008**

## Foreign Exchange Reserves

Gross foreign assets of the banking system declined from US\$ 5,786 million at the end of June 2008 to US\$ 4,822 million at end of June 2009 (Chart 10C). This reflected the decline in both official and commercial banks' holdings of foreign exchange reserves.

Official foreign exchange reserves held by the Central Bank decreased from US\$ 3,445 million (4.5 months of import cover)<sup>1</sup> at the end of June 2008 to US\$ 3,219 million (3.6 months of import cover) at the end of June 2009. The decline in the level of reserves largely reflect exchange rate revaluation losses and draw down due to global financial crisis. The revaluation losses are as a result of the fact that a significant portion of the foreign exchange reserves are held as deposits in the Euro and the Sterling Pound. Both currencies depreciated against the Dollar. Gross official foreign exchange reserves increased from April 2009 boosted by IMF balance of payments support through the exogenous shock facility (ESF) and domestic interbank purchases by the Central Bank.

**CHART 10C: FOREIGN EXCHANGE RESERVES****Source: Central Bank of Kenya**

Foreign exchange assets of commercial banks also declined by 31.6 percent from US\$ 2,341 million at the end of June 2008 to US\$ 1,602 million at end of June 2009. Most of the commercial bank foreign exchange assets were held as balances with banks abroad in the amount of US\$ 1,240 million. Other foreign assets of commercial banks included shares and securities, foreign loans and other accounts receivable. Besides these holdings, foreign currency deposits held locally by residents also declined to stand at US\$ 1,912 million at the end of June 2009 compared with US\$ 1,924 million at the end of June 2008.

<sup>1</sup> Based on 36 months average of imports of goods and non-factor services

## **FINANCIAL SECTOR DEVELOPMENTS**

### **11. BANKING SECTOR DEVELOPMENTS**

#### **Overview**

As at the end of June 30, 2009, the Kenyan Banking sector maintained high capital adequacy ratios, adequate liquidity and low non-performing loans in relation to gross loans. The total shareholders' funds, deposits and assets expanded by 25.4 percent, 9.5 percent and 15.0 percent respectively. Liquidity was considered strong, with the ratio of liquid assets to total deposit liabilities at 40.9 percent, well above the statutory minimum requirement of 20 percent. The overall performance of the banking sector was rated strong by June 2009.

#### **Structure of the Banking Sector**

As at June 30, 2009 the Kenyan banking sector comprised of 43 commercial banks, 2 mortgage finance companies and 123 foreign exchange bureaus. The sector witnessed an increase in the branch network from 772 branches in June 2008 to 930 in June 2009 representing a growth of 20.5 percent. One deposit taking microfinance institution, namely Faulu Kenya was issued with a license to allow it to take deposits from the public during the period under review. Further, the Bank approved 29 business names for applicants seeking to operate as deposit taking microfinance institutions which is the first stage in the licensing process.

#### **Structure of the Balance Sheet**

Total assets of the banking sector rose by 15.0 percent from Ksh. 1,099.1 billion in June 2008 to Ksh 1,263.5 billion as at June 2009. The major components of the assets were net advances, Government securities and placements, accounting for 53 percent, 20 percent and 10 percent respectively. Deposits expanded by 9.5 percent from Ksh 871.2 billion to Ksh 953.7 billion in June 2009. The growth in deposits, retained profits and capital injections supported the growth in the asset base.

**TABLE 6.1: BALANCE SHEET (KSH MILLION)**

	Jun-09	Jun-08	Percent Change
Cash	24,848	19,318	28.6
Balances at CBK	55,064	56,490	-2.5
Placements	122,392	164,326	-25.5
Govt. securities	257,923	195,209	32.1
Other Investments	20,500	8,649	137.0
Loans & Advances	668,580	555,062	20.5
Foreign Assets	4,629	7,115	-34.9
Other assets	109,528	92,921	17.9
<b>Total Assets</b>	<b>1,263,464</b>	<b>1,099,090</b>	<b>15.0</b>
Deposits	953,745	871,200	9.5
Foreign Liabilities	23,088	13,453	71.6
Other liabilities	109,593	73,234	49.6
Capital & Reserves	177,038	141,203	25.4
<b>Total Liabilities and Shareholders' Funds</b>	<b>1,263,464</b>	<b>1,099,090</b>	<b>15.00</b>

Source: CBK Returns

### Non-Performing Loans

Non-performing loans (NPLs) increased by 14.0 percent from Ksh 56.3 billion in June 2008 to Ksh 64.2 billion as at the end of June 2009. The increase was attributed to the post election crisis as well as loans turning delinquent in the normal course of business. However, the ratio of gross non-performing loans to gross loans improved from 9.4 percent in June 2008 to 9.0 percent in June 2009 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 9.5 percent from Ksh 871.2 billion as at end of June 2008 to Ksh 953.7 billion as at end of June 2009. The growth in deposits was partly supported by aggressive marketing campaigns adopted by financial institutions, rapid branch network expansion and inflows from exports.

### Capital and Reserves

Capital and reserves of the banking sector increased by 25.4 percent from Ksh 141.2 billion in June 2008 to Ksh 177.0 billion in June 2009. Total banking sector capital which comprises core and supplementary capital, expanded by 26.9 percent from Ksh 129.2 billion in June 2008 to Ksh. 163.9 billion in June 2009. Total capital to risk weighted assets ratio improved from 18.1 percent in June 2008 to 19.8 percent in June 2009. Similarly, core capital grew by 24.5 percent from Ksh 117.1 billion in June

2008 to Ksh 145.8 billion in June 2009. The growth was attributed to fresh capital injection and retention of profits.

### Profitability

Despite tight economic conditions, the banking sector pre-tax profits increased by 2.9 percent from Ksh 23.9 billion in June 2008 to Ksh 24.6 billion in June 2009. Total income rose by 15.5 percent from Ksh 70.8 billion in June 2008 to Ksh 81.8 billion in June 2009. Interest on advances at Ksh. 44.0 billion constituted 54 percent of total income while staff costs made up 33 percent of total expenses. Return on assets fell from 3.5 percent in June 2008 to 3.0 percent in June 2009 occasioned by an increase in assets that were lower than the growth in profits.

**TABLE 6.2: BANKING INDUSTRY PROFITS (KSH BILLION)**

Item	Jun-09	Jun-08	Percent Change
Total income	81.8	70.8	15.5
Expenses before provisions	54.0	44.7	20.8
Profit before provisions	27.8	26.2	6.1
Provision for bad debts	3.2	2.2	45.5
<b>Profit before tax</b>	<b>24.6</b>	<b>23.9</b>	<b>2.9</b>

Source: CBK Returns

### Outlook for the Banking Sector

The dynamism in the banking sector is expected to continue as banks seek new opportunities in the face of an anticipated subdued risk appetite. The reduction in the risk appetite will be a result of the uncertainty surrounding the global financial crisis. Though the sector emerged unscathed from the first round effects, there are concerns that the “second” and “third” round effects of the crisis could impact the real sector. This may then in turn affect the quality of the loan portfolio held by banks.

Banks are, however, expected to continue to explore new opportunities locally and regionally to maintain the growth momentum. Efforts to increase capital are therefore expected as banks consolidate their market niches and explore new opportunities particularly within the East African Community.

## **12. MICRO FINANCE SECTOR DEVELOPMENTS**

The microfinance industry in Kenya comprises various types of institutions registered and regulated and/or supervised under different legislations, including commercial banks; development finance institutions such as the Agricultural Finance Corporation (AFC) and the Kenya Post Office Savings Bank (KPOSB); deposit-taking microfinance institutions and several non deposit-taking microfinance institutions. The non-deposit taking institutions are different institutional forms such as companies, trusts and NGOs; saving and credit co-operatives societies (SACCOs); accumulating and rotating savings and credit associations (ASCAs and ROSCAs) and money lenders, among others. As at June 2009, it was estimated that commercial banks, microfinance institutions, SACCOs and KPOSB had over ten million accounts.

There are four commercial banks undertaking microfinance business, namely: Equity Bank, Family Bank, K-REP Bank and Co-operative Bank. However, the number of commercial banks down streaming their business to include microfinance business, particularly to low-income households and small and micro enterprises, is growing rapidly. Indeed, the size of the microfinance business in the banking industry has increased significantly over the years.

In addition to commercial banks, the Kenya Post Office Savings Bank (KPOSB) offers financial services and products, especially savings mobilization and money transfer services to a significant portion of the Kenyan populace and is rapidly expanding its presence. KPOSB is a state-owned corporation established under the KPOSB Act and operates under that Act and the State Corporations Act. KPOSB has about 1.2 million active deposit accounts/clients with total deposits of approximately Ksh 10.1 billion. It operates a nationwide network comprising 87 branches.

The exact number of microfinance business practitioners operating country wide is largely unknown. However, the Association of Microfinance Institutions (AMFI), as at 31 December 2008, had 45 registered members. The 36 AMFI members are retail microfinance institutions with approximately

1.6 million active deposit accounts/clients. The value of total deposits held by AMFI members, excluding commercial banks, stood at Ksh 15.8 billion in 2008 with active loan clients numbering 1.3 million. Total loans disbursed during 2008 stood at Ksh 47.5 billion. These 36 AMFI members operated a total of 825 branch offices in 2008.

The number of registered societies as at December 31, 2008 was approximately 5,350. The SACCOs serve an estimated 6.19 million members with outstanding loan portfolio and shares and deposit base amounting to about Ksh 105 billion and Ksh 177 billion, respectively.

### **Microfinance Legislation**

The Microfinance Act, which came into effect from May 2, 2008 sets out the legal, regulatory and supervisory framework for the microfinance industry. So far, several regulations have been issued under the Act for deposit-taking microfinance business. However, the regulations that govern the conduct of the non-deposit taking microfinance business are yet to be put in place. The Ministry of Finance is working on the modalities of licensing, regulating and supervising the non-deposit taking microfinance business.

Since the Microfinance Act became effective on May 2, 2008 the Central Bank of Kenya has approved twenty-nine business names, issued one licence in May 2009 to Faulu Kenya Deposit Taking Microfinance Limited to commence deposit taking business, and has given a letter of intent to one applicant. Seven more applications are at different stages of review.

### **Access to Financial Services and Products**

There is widespread consensus that there is constrained access to financial services and products to majority of Kenyans. According to the FinAccess Survey, 2009, 22.6 percent of the adult population had access to formal financial services through banks and KPOSB as compared with 18.9 percent in 2006. An additional 17.9 percent of adult Kenyans were served by other formal institutions, namely, microfinance institutions and sacco societies compared with 7.5 percent in 2006. On the other hand,



the proportion of adult Kenyans that depended primarily on informal financial service providers such as ASCAs and ROSCAs, shopkeepers and money lenders declined from 35.2 percent in 2006 to 26.8 percent in 2009. Further the survey results indicate that about 67.3 percent of adult Kenyan population accessed financial services and products using formal, semi-formal and informal financial service providers compared to 62 percent in 2006. The results also revealed that the proportion of adult Kenyans that are excluded from accessing financial services and products shrank from 38.4 percent in 2006 to 32.7 percent in 2009.

The Government is committed to expanding access to financial services and products to all adult Kenyans through various policy reforms as outlined in Kenya's Vision 2030. The quasi-banking financial service providers, namely microfinance institutions and SACCOs will play a pivotal role in the fulfilment of Vision 2030 aspirations and in reducing the informal financial sector role in the economy.

## 13. NATIONAL PAYMENTS SYSTEM

### NON-CASH INSTRUMENTS

#### Kenya Electronic Payment and Settlement System (KEPSS)

Kenya Electronic Payments and Settlement System (KEPSS) moved a volume of 277,445 transactions worth Ksh 15,441 billion in the year to June 30, 2009, representing a 19.3 percent increase in volume and 6.4 percent increase in value compared to the period to June 30, 2008. The average amount moved per transaction decreased from Ksh 62.30 million to Ksh 55.67 million or by 10.6 percent. The number of transactions moved per day, however increased by 18.1 percent in the year to June 30, 2009 to 1,121 transactions compared to 949 transactions in the year to June 30, 2008. This increase is attributed to growing awareness of KEPSS as a safe and efficient mode of payment for both high value and time critical payments. The proportion of Direct payments through KEPSS increased from 93.8 percent to 94.2 percent while the proportion of Clearing House Net Settlement Instructions (NSI), processed through KEPSS decreased from 6.2 percent to 5.8 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)	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

Source: Banking/National Payments Division

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

Year to June 30	Total value moved (Ksh)	Settlement proportions Direct (Ksh m)	%	Indirect (NSI (Ksh m))	%
2006	7,461,197	6,878,229	92.20	582,968	7.80
2007	7,929,003	7,234,837	91.20	694,166	8.80
2008	14,506,951	13,606,759	93.79	900,193	6.21
2009	15,441,446	14,549,876	94.23	891,570	5.77

Source: Banking/National Payments Division

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

Multiple third parties Message Type MT 102 increased by 3.0 percent from 9,132 messages in the year to June 30, 2008 to 9,410 messages in the year to June 30, 2009. Over the same period, single third party Message Type MT 103 increased by 52.5 percent from 75,674 messages to 115,443 messages. Overall, total third party messages processed through KEPSS increased by 47.2 percent from 84,806 messages to 124,853 messages in the year to June 30, 2009 (Table 12.3). The increase in these messages reflects growing awareness of KEPSS among the public.

**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

Source: Banking/National Payments Division

### **The Automated Clearing House Operations**

Automated Clearing House (ACH) operated smoothly during the year to June 30, 2009. The ACH Kenya shilling value throughput for the period under review was Ksh 4.67 billion with a volume of 26.41 million transactions for both debit and credit instruments. This represents an increase of 8.7 percent in value moved compared to the same period last year as indicated in Table 12.4.

Cheques dominated the non-cash payment instruments accounting for 70.2 percent of total transactions through the Clearing House. In the year to June 2009, the volume of cheques settled through the Nairobi Automated Clearing House was 18.55 million cheques valued at Ksh 3.90 billion, representing a decrease of 0.7 percent from 18.67 billion cheques valued at Ksh 3.62 billion for the period to June 30, 2008.

Electronic Funds Transfer (EFT) transactions (credit) based payments increased by 13.2 percent during this period from Ksh 676 billion to Ksh 766 billion (Table 12.4)

**TABLE 12.4: CLEARING HOUSE KSH TRANSACTION TO JUNE 30, 2009**

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

Source: 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, 2009 compared to the same period last year. The US dollar, GBP, and Euro Cheques processed through the clearing house increased by 1.4 percent, 10.0 percent, and 23.4 percent from 278, 2.7, and 7.9 thousand Cheques to 282, 2.9, and 9.8 thousand Cheques, respectively. In value terms, all the three foreign currencies recorded an increase in the value moved (Table 12.5). The US dollar continued to be the preferred currency in the domestic foreign exchange market followed by the Euro and the Pound, respectively.

**TABLE 12.5: CLEARING HOUSE KSH TRANSACTIONS AS AT JUNE, 2009**

Currency	USD		GBP		EURO	
	Value (m)	Volume	Value (m)	Volume	Value (m)	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
Growth (percent)	7.32		47.88		39.63	

Source: Banking/National Payments Division

## Automated Teller Machines (ATMs) and Plastic Card Usage

The number of ATMs increased by 40.1 percent from 1,078 ATMs as at December 2007 to 1,510 ATMs as at December 2008. Growth in ATMs is partly attributed to commercial banks' expansion strategies, which has been ongoing in the last few years driven by the desire to effectively compete for customers in the banking sector and retain or enhance market share.

Amounts dispensed through ATMs for acquirers and issuers in the year to December 2008 increased by 26.9 percent and 89.3 percent from Ksh 312.9 billion to Ksh 396.9 billion and Ksh 136.4 billion to Ksh 258.3 billion, respectively. Correspondingly, withdrawals increased for acquirers and issuers by 32.9 percent and 30.0 percent from 58.6 million withdrawals to 77.9 million withdrawals and 42.1 million withdrawals to 54.7 million withdrawals, respectively. PesaPoint ATMs dispensed Ksh 18.5 billion in the year to December 2008 with 3.4 million withdrawals (Table 12.6 A).

**TABLE 12.6A: AUTOMATED TELLER MACHINE'S USAGE**

	2004	2005	2006	2007	2008
Number of ATM machines	324	555	737	1,078	1,510
Number of transactions (m)					
Acquirers	-	-	-	58.63	77.92
Issuers	-	-	-	42.08	54.70
PesaPoint	-	-	-	-	3.44
Value of Transactions (Ksh bn)					
Acquirers	-	-	-	312.87	396.93
Issuers	-	-	-	136.44	258.33
PesaPoint	-	-	-	-	18.51

Source: NPS Survey, 4th quarter 2008

The total number of cards in use rose by 25.4 percent from 2,027,689 cards in December 2007 to 2,541,827 cards in December 2008. This increase is in tandem with the growth of Automated Teller Machines (ATMS) as customers seek to embrace convenience and increased products in the use of plastic money (Table 12.6 B).

**TABLE 12.6B: NUMBER OF CARDS IN CIRCULATION**

	2004	2005	2006	2007	2008
ATM cards	332,015	426,110	829,962	943,359	900,148
Debit cards	356,989	496,647	750,085	971,449	1,528,866
Credit cards	59,164	69,478	73,238	107,106	107,653
Charge cards	3,371	3,142	3,769	5,775	5,160
Total	751,539	995,377	1,657,054	2,027,689	2,541,827

Source: NPS Survey, 4th quarter 2008

## Mobile Phone Usage for Funds Transfer

In March 2009, the second largest mobile service provider launched its mobile money transfer service, to bring to two the number of mobile money transfer service providers in Kenya's payment sector. The Bank continues to monitor the developments in this sector as it enhances the deepening of financial services in the country. 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.

The number of registered mobile phone money transfer customers increased from 3.0 million in June 30, 2008 to 7.4 million by June 30, 2009. Correspondingly, the amount of money transferred via mobile phones increased cumulatively from Ksh 61.1 billion in the year to June 30, 2008 to Ksh 318.4 billion in the year to June 30, 2009. Similarly, the number of transactions increased from 21.8 million to 125.1 million over the same period. The number of registered agents rose from 3,011 in June 2008 to 10,735 in June 30, 2009 (Table 12.7). On a monthly basis, the total value of transactions stood at Ksh 40.18 billion with 16.85 million transactions in June 2009 up from Ksh 10.92 billion with 4.20 million transactions in June 2008. Services available to customers via mobile phone money transfer services include; Bill Payments, Balance enquiry, mini statement request, full statement request, Air time top-up, and cheque book request among others.

**TABLE 12.7: MOBILE PHONE MONEY TRANSFER**

Year to	Jun 30, 2007	Jun 30, 2008	Jun 30, 2009
Total value of transactions (Ksh billion)	1.49	61.07	318.44
Number of agents	527	3,011	10,735
Total number of transactions (million)	0.48	21.77	125.12
Number of 'registered' customers/accounts (million)	0.18	3.04	7.39

Source: Service providers

## CASH

Currency in circulation increased from Ksh 99.9 billion as at the end of June 2008 to Ksh 108.3 billion as at end of June 2009, an increase of Ksh 8.4 billion or 8.4 percent as indicated in Table 12.8. In weighted terms, Bank notes accounted for 96.2 percent of currency in circulation, while the proportion of coins stood at 3.8 percent.



**TABLE 12.8: CURRENCY IN CIRCULATION (NOTES & COINS)**

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

Source: Central Bank of Kenya, Currency Division

Notes in circulation grew by 5.3 percent from 252 million pieces in the year to June 30, 2008 to 265 million pieces in the year to June 30, 2009. There was a notable increase in the usage of Ksh 1,000, Ksh 500, Ksh 200 and Ksh 50 notes which increased by 8.9 percent, 10.6 percent, 10.1 percent and 6.4 percent respectively. Coins in circulation grew by 3.2 percent in the same period from 1,714 million pieces to 1,769 million pieces, with the Ksh 40 coin, Ksh 20 coin, Ksh 10 coin, and Ksh 5 coin increasing by 16.3 percent, 13.0 percent, 7.7 percent and 5.3 percent respectively. Public preference for bank notes explains the high proportion of currency in circulation being in Bank notes (Table 12.9). Despite the increase in coins in circulation, there have been concerns that there are shortages of the same in the market. This is partly attributed to the holding of coins by the public which affects availability especially in supermarkets.

**TABLE 12.9: CURRENCY IN CIRCULATION (PIECES)**

	Bank notes				Coins		
	2007/2008	2008/2009	%age change		2007/2008	2008/2009	%age change
	Pieces (m)	Pieces (m)			Pieces (m)	Pieces (m)	
1000/=	72.26	78.69	8.9	40/=	1.65	1.92	16.30
500/=	18.86	20.86	10.6	20/=	66.35	69.84	5.26
200/=	28.84	31.74	10.1	10/=	98.50	111.34	13.03
100/=	62.40	61.80	-1.0	5/=	140.40	151.19	7.69
50/=	41.72	44.39	6.4	1/=	499.00	511.45	2.49
20/=	10.15	10.10	-0.5	/50=	248.00	258.90	4.40
10/=	12.10	12.06	-0.3	/10=	360.00	358.64	(0.38)
5/=	5.80	5.80	0.0	/05=	300.00	305.12	1.71
252.13		265.44	5.3	1713.90		1768.39	3.2

Source: Central Bank of Kenya, Currency Division

## Cash Inflows and Outflows

Deposits by banks at Central Bank of Kenya (i.e. Cash inflows) increased by 5.3 percent from Ksh 269.1 billion as at June 30, 2008 to Ksh 283.5 billion as at June 2009. Withdrawals (i.e. cash outflows) also increased by 4.6 percent from Ksh 279.1 billion to Ksh 291.8 billion in the same period. Net currency outflow in the year to June 30, 2009 therefore amounted to Ksh 8.4 billion as indicated in Table 12.10.

**TABLE 12.10: CURRENCY INFLOWS AND OUTFLOWS (KSHS M)**

Inflow by banks	2005/2006	2006/2007	2007/2008	2007/2009
Bank Notes	196,106	226,747	268,543	283,083
Coins	713	704	562	376
<b>Total</b>	<b>196,819</b>	<b>227,451</b>	<b>269,105</b>	<b>283,459</b>
Outflows by banks				
Bank Notes	204,716	239,983	278,236	291,161
Coins	923	1,077	831	657
<b>Total</b>	<b>205,638</b>	<b>241,060</b>	<b>279,066</b>	<b>291,818</b>
<b>Net Outflows</b>	<b>(8,819)</b>	<b>(13,609)</b>	<b>(9,961)</b>	<b>(8,359)</b>

Source: Central Bank of Kenya, Currency Division

### Development in Counterfeiting Practices

Counterfeit notes more than doubled, increasing by 103.4 percent from 1,128 pieces in the year to June 30, 2008 to 2,296 pieces in the year to June 30, 2009 (Table 12.11). The resultant impact in value terms was an increase of 110.8 percent in the value of counterfeit from Ksh 799,500 in the previous year to Ksh 1,685,550 in the year to June 30, 2009.

In terms of denomination, there were 1,376 pieces of Ksh 1,000 counterfeit note making up 59.9 percent, 442 pieces of Ksh 500 or 19.2 percent, 411 pieces of Ksh 200 or 17.9 percent, 60 pieces of Ksh 100 or 2.6 percent and 7 pieces of the Ksh 50 or 0.3 percent of the counterfeit notes, respectively. Detection of counterfeits follows from stepped up public awareness regarding genuine Kenya currency. The Central Bank will continue to enhance public awareness and step up penalties for counterfeits detected in currency deposits in order to promote vigilance at the commercial banks level. The Central Bank has also invested in high level currency processors for ease of detecting counterfeits.

**TABLE 12.11: COUNTERFEIT NOTES BY DENOMINATION**

	Pieces		Proportion 2008/2009
	2007/2008	2008/2009	
1000/=	653	1,376	59.93
500/=	205	442	19.25
200/=	172	411	17.90
100/=	94	60	2.61
50/=	4	7	0.30
20/=	0	0	0.00
10/=	0	0	0.00
5/=	0	0	0.00
<b>Total</b>	<b>1,128</b>	<b>2,296</b>	<b>100.00</b>
	Amounts (KSH)		Proportion 2008/2009
	2007/2008	2008/2009	
1000/=	653,000	1,376,000	81.64
500/=	102,500	221,000	13.11
200/=	34,400	82,200	4.88
100/=	9,400	6,000	0.36
50/=	200	350	0.02
20/=	0	0	0.00
10/=	0	0	0.00
5/=	0	0	0.00
<b>Total</b>	<b>799,500</b>	<b>1,685,550</b>	<b>100.00</b>

Source: Central Bank of Kenya, Currency Department

## **CURRENT AND FUTURE DEVELOPMENTS**

### **Legal Framework**

The Central Bank of Kenya continued consultation with the Ministry of Finance and the Attorney General's office on the enactment of the proposed NPS Bill 2009. Once enacted, the Bill will enhance the Bank's oversight powers for emerging non-bank based payment, clearing settlement systems. In order to provide for the proposed Cheque Truncation, the Bank made recommendations for amendment to the Bills of Exchange Act.

### **Connectivity To Kepss**

Automation of outward Government Payments is set for implementation in October 2009 through a system known by the acronym, G-Pay system and aims at improving efficiency in Government payment processing and mitigation of risks associated with cheque issuance and usage for large value transactions.

### **East African Cross Border Payment System**

Consultations among the East African 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<sup>nd</sup> quarter of 2009/2010 financial year.

### **Value Capping**

In the year to June 30, 2009, the Government, Central Bank of Kenya, and Kenya Bankers Association finalized consultations on value capping policy and agreed to stop processing high value payments using Cheques and Electronic Funds Transfers (EFTs) with effect from October 1, 2009. Henceforth, Cheques and EFTs of Kenya Shillings one (1) million and above and domestic foreign currency cheques and EFTs whose value is equal to or exceeds US Dollars 35,000, Sterling Pounds 15,000, and Euros 30,000, will be processed through the Real Time Gross Settlement System, also known as the Kenya Electronic

Payment and Settlement System (KEPSS). Cheques of Ksh 1 million may, however, be drawn but will be on cleared collection basis.

This policy change is aimed at enhancing safety and efficiency of the payment process and instruments, by reducing the systemic importance of the Automated Clearing House.

### **Cheque Truncation System**

In order to speed up collection of cheques and therefore enhance customer service, Central Bank of Kenya and Kenya Bankers Association have been working on the introduction of Cheque Truncation System in the Automated Clearing House. Truncation involves movement of cheque images from the point of presentment through the clearing cycle.

## **14. REGIONAL INTEGRATION DEVELOPMENTS**

### **INTRODUCTION**

During 2008, the Central Bank of Kenya continued with engagement in a number of regional integration initiatives and programmes, particularly those relating to monetary integration. In particular, the CBK 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 2008.

### **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. In view of the new timetable, MAC is developing a strategic framework for fast tracking the Monetary Union to 2012 and has commissioned a comprehensive study on the proposed EAC 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.

Although the regional economies were adversely affected by a host of adverse external factors, all Partner States made good progress in achieving the outlined macroeconomic convergence criteria targets in 2008. Partner States are currently going through a challenging time as a result of a number of external shocks. In particular for Kenya, the economy was adversely affected by a combination of external and internal factors in

**TABLE 13.1: MACROECONOMIC PERFORMANCE AND CONVERGENCE UNDER THE EAC CRITERIA**

Criteria	Target level and Date	2004	2005	2006	2007	2008
Budget Deficit (Excl. Grants) / GDP*	< 6% by 2010	1.01	0.41	1.48	0.78	0.68
Budget Deficit (Incl. Grants) / GDP*	<3% by 2010	0.01	0.84	1.08	0.44	0.28
Headline Inflation – Annual averages	not > 5% per year by 2010	11.60	10.30	14.50	9.80	26.20
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	3.50	4.00	2.80
GDP Growth Rate At Factor Cost constant prices***	At least 7% p.a. by 2010	5.10	5.90	6.30	7.10	1.70
Stable Real exchange rates	Achieve and maintain stable exchange rates (REER. 2000 = 100)	102.00	91.10	83.80	73.90	69.50
Current Account Deficit (Excl. Grants) / GDP	Sustainable levels by 2010	-1.40	-1.80	-2.60	-4.50	-6.70
Gross National Savings/GDP***	at least 20% by 2010	12.20	13.60	16.00	13.60	14.80

\* Actual as a percentage of GDP on commitment basis from various Quarterly Economic and Budgetary Reviews

\*\* Based on average of calendar year imports

\*\*\* Various Economic Surveys

2008. The post election violence and high oil prices early in year, the effects of the continuing global financial and economic crisis and adverse weather have all severely affected the Kenyan economy.

The region is facing wide budget deficits, high domestic debt, and high interest rate. The developments in the global economy especially the turbulence in the international financial markets and rising world oil and commodity prices pose challenges to the management of the regional economies. Kenya has met all the primary criteria in addition to satisfying a good number of secondary criteria. The performance of Kenya and other countries of EAC in respect to each convergence criteria are provided in Table 13.1

## **THE COMESA MONETARY COOPERATION PROGRAMME**

### **Background Information**

The mandate to establish a Monetary Union in COMESA is derived from Article 4 (4) of the COMESA Treaty signed at Kampala, Uganda on 5th November, 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 track 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). Following approval by the committee of Governors to establish a CMI, Kenya subsequently expressed interest in hosting the Institute. Kenya is now awaiting the outcome of an assessment done by the Experts of the Bureau of the COMESA Committee in September 2009, on its suitability of hosting the CMI. The Central Bank wishes to thank Ministries of Trade, Finance, Foreign Affairs, Attorney General's Office, and the Office of the President for the support they have shown to the Bank in regard to CMI hosting.

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

In 2008, 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) was stable at 0.7 percent of GDP in 2008 compared with 0.8 percent of GDP in 2007. The annual inflation rate rose sharply in 2008 reflecting high international fuel and food prices as well as the disruption of food supply chains following the post-election disturbances. Kenya's official external reserves at 2.8 months of import cover in 2008, was below the 4 months of import cover AMCP target following the deficit in the balance of payments and partly due to revaluation losses.

Kenya met several of the secondary criteria targets. Total domestic revenues to GDP were 21.2 percent for 2008, well within the target of COMESA. The ratio of debt relative to GDP showed a stable and declining trend, an indicator of prudent fiscal and macroeconomic management over the year. However, real interest rates in 2008 were negative mainly reflecting inflation

emanating from supply side constraints. In addition, following a year of shocks buffeting the economy, the real GDP grew by 1.7 percent in 2008 compared with 7 percent in 2007. The economy was also buffeted by high fuel and energy prices, drought and the secondary effects of the global financial crisis. The economy is now showing signs of recovery as the effects of these shocks start to peter out. In addition, the Government is implementing an economic stimulus package aimed at boosting domestic demand and cushioning vulnerable industries.

**TABLE 13.2: KENYA'S PROGRESS IN IMPLEMENTATION OF COMESA MONETARY COOPERATION PROGRAMME DURING STAGE 1 (YEAR 2005-2010)**

Primary Criteria	Target for Stage I (2005-2010)	Year				
		2004	2005	2006	2007	2008
1. Overall budget deficit/GDP ratio (excluding grants)*	< 5 percent	1.01	0.41	1.48	0.78	0.68
2. Inflation rate– average annual underlying inflation	< 5 per cent	3.50	5.40	3.90	5.20	7.60
3. Minimization of Central Bank financing of budget **	towards 0 percent	1.52	3.96	2.93	3.21	0.59
4. External reserves in months of imports of goods and non-factor services***	= or > 4 months	3.40	3.20	3.50	4.00	2.80
Secondary Criteria	Target Stage I (2005-2010)	2004	2005	2006	2007	2008
1. Real GDP growth rate****	> 7 percent	5.10	5.90	6.30	7.10	1.70
2. Domestic fiscal receipts/GDP ratio*****	= or > 20 percent	23.94	23.60	23.27	23.88	25.66
3. Current account deficit (excluding grants) as percent of GDP	Sustainable level	-1.40	-1.80	-2.60	-4.50	-6.70
4. Achievement and maintenance of domestic investment rate	at least 20 percent	17.10	16.90	18.00	19.10	19.20
5. Maintenance of real exchange rate stability - REER Index	Maintenance of REER stability - REER Index	102.00	91.10	83.80	73.90	69.50

\* 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 26<sup>th</sup> 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 not 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**

As indicated in Table 13.3, Kenya performed well in the implementation of the AMCP. It met all the primary criteria and most of the secondary criteria for stage two of the AMCP covering the period 2004 – 2008.

Kenya managed to maintain the underlying inflation within the AMCP target of less than 10 percent. This success largely reflects



**TABLE 13.3: 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
1. Overall budget deficit/GDP ratio (Excluding grants)*	< 5 percent	1.01	0.41	1.48	0.78	0.68
2. Inflation rate	< 10 per cent	11.60	10.30	14.50	9.80	26.20
3. Contain Central Bank financing of budget**	< 10 per cent	1.52	3.96	2.93	3.21	0.59
4. External reserves of equal to or more than 3 months of imports of goods and services***	= or > 3 months	3.4	3.20	3.50	4.00	2.80
Secondary Criteria	Target for Stage II (2004-2008)	2004	2005	2006	2007	2008
1. Domestic fiscal receipts/GDP ratio****	= or > 20 percent	23.94	23.60	23.27	23.88	25.66
2. Current account deficit (excluding grants) as a percent of GDP	Sustainable level	-1.40	-1.80	-2.60	-4.50	-6.70
3. Achieve and maintain domestic investment rate of 20%	= or > 20 percent	17.10	16.90	18.00	19.10	19.20
4. Maintenance of real exchange rate stability	Maintenance of REER stability – REER Index	102.00	91.10	83.80	73.90	69.50

\* 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

the sustained implementation of an appropriate monetary policy achieved by keeping money supply in line with real economic activity during the period. The annual average underlying inflation, which excludes food, energy (fuel and power) and transport and communications indices from the overall inflation, was 7.6 percent in 2008 compared with 5.2 percent in 2007.

In 2008, Central Bank of Kenya, as directed by the Law, accommodated Government within the 5 percent limit on audited revenues. This overdraft was brought to zero by June 2009, thereby remaining within the AMCP target of less than 10 percent. This good performance can be attributed to prudential macroeconomic management and strict fiscal discipline on the part of Government even in the face of numerous challenges such as post election violence, the global financial crisis and adverse weather conditions. Kenya's official external reserves at 2.8 months of import cover in 2008, was below the 3 months and below the government target of 4 months of import cover AMCP target. The drawdown was due to the secondary effects of the global financial crisis. However, the official reserves increased to the equivalent of 3.6 months imports cover by June 2009 on account of purchases from the

interbank market and foreign exchange receipt from the IMF under the Exogenous Shock Facility in May 2009.

Kenya continues to meet almost all the secondary criteria targets. Domestic fiscal receipt to GDP ratio at 21.2 percent for 2008, met the target of the AMCP. The real effective exchange rate had remained relatively stable with a tendency to appreciation. The Kenya shilling real effective exchange rate (REER) appreciated by 11.8 percent and 6 percent in 2007 and 2008, respectively. This was attributed to relatively higher inflation in Kenya compared with the average inflation in Kenya's major trading partners. On maintaining positive real interest rate levels, Kenya did not meet this criterion in 2008, largely due to high inflation emanating from real sector factors due to supply side shocks.

### **Other Regional Integration Initiatives**

The Central Bank of Kenya also continues to actively participate in the EAC Common Market Protocol negotiation. The negotiators are currently finalizing the Annexes as well as the Sections on the scope and common tariff policies in preparation for the Protocol signing planned for November 2009. The conclusion of the Protocol and establishment of the Common Market is scheduled for January 2010.

## **15. ECONOMIC OUTLOOK**

The economy is projected to grow by less than 3 percent in 2009. The slowdown reflects the lingering effects of various external and internal shocks that have hit the economy in 2008 and 2009. Overall the ongoing infrastructure projects as well as the recovery of Tourism sector are expected to spur growth. In the medium-term the economy is projected to return to the 7 percent growth trajectory (achieved in 2007) following recovery in the world economy and resolution of domestic constraints. This will work through a combination of policy support initiatives as well as fiscal stimulus to support domestic production, lowering cost of doing business and to support and protect the wage good for the poor.

## ***FINANCIAL PERFORMANCE***

### **CENTRAL BANK OF KENYA** **ANNUAL REPORT AND FINANCIAL STATEMENTS** **FOR THE YEAR ENDED 30 JUNE 2009**

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**CENTRAL BANK OF KENYA**  
**BANK INFORMATION**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**DIRECTORS**

Prof. Njuguna Ndung'u	-	Governor and Chairman
Mrs Jacinta W. Mwatela	-	Deputy Governor and Deputy Chairman-Retired on 8 September, 2008
Dr. Hezron Nyangito	-	Deputy Governor and Deputy Chairman-Appointed on 8 September, 2008
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

**SENIOR MANAGEMENT**

Prof. Njuguna Ndung'u	-	Governor
Mrs Jacinta W. Mwatela	-	Deputy Governor - Appointment revoked on 8 September, 2008
Dr. Hezron Nyangito	-	Deputy Governor - Appointed on 8 September, 2008
Mr. Kennedy K. Abuga	-	Director – Governor's Office & Board Secretary
Mr. Aggrey J.K. Bett	-	Director – Finance, Resource Planning and Strategy Management
Mr. Jones M. Nzomo	-	Director – Human Resources and Services Department - Retired on 24 February, 2009
Ms. Rose Detho	-	Director – Banking Supervision Department
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies
Mr. William Nyagaka	-	Director – Internal Audit & Risk Management
Mr. Charles Koori	-	Director- Research Department-Appointed on 22 October, 2008
Mr. Nicholas N. B. T. Korir	-	Director – Department of Estates, Supplies and Transport
Mr. James T. Lopoyetum	-	Director – Currency Operations and Branch Administration - Appointed on 18 September 2008
Mr. Gerald Nyaoma	-	Director – Banking Department
Mr. Jackson M. Kitili	-	Director – Monetary Operations & Debt Management
Mr. Peter K. Rotich	-	Director - Human Resources and Administration-Appointed on 6 May 2009

**REGISTERED OFFICE**

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

**BRANCHES**

**Mombasa**

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

**Kisumu**

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

**Eldoret**

Kiptagich House  
 Uganda Road  
 PO Box 2710  
 30100 Eldoret, Kenya

**Kenya School of Monetary Studies**

Thika Road  
 PO Box 65041  
 00200 Nairobi, Kenya

**AUDITORS**

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

**MAIN LAWYERS**

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

**CENTRAL BANK OF KENYA**  
**DIRECTORS' REPORT**  
**FOR THE YEAR ENDED 30 JUNE 2009**

The directors submit their report together with the audited financial statements for the year ended 30 June 2009, 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 profit of KShs 23,229 million against a profit of KShs 8,995 million in 2008. This substantial higher performance over the previous year is due to foreign currency translation gains that amounted to KShs 13,462 million in the year under review compared to only a gain of KShs 54 million in 2008 and proceeds from sale of Grand Regency Hotel amounting to KShs 3,141 million. The Bank held the hotel as a security against a receivable that had been fully provided for. Contributing to this performance also are expenses associated with conduct of monetary policy that were lower than the previous year's by KShs 1,306 million owing to less need for mop-ups due to tight liquidity prevailing in the economy for most part of the year under review. These positive financial performances were tempered by foreign currency earnings that were KShs 3,373 million (32%) lower than in 2008 owing to the ongoing global economic turmoil. Some operating expenses such as currency printing costs, property maintenance and others were higher than previous year's by a total of KShs 1,479 million (29%). Currency printing costs increased due to change in accounting policy on treatment of the printing costs hence the more the new notes were issued into circulation the higher the amortised cost.

**3.2 Financial Position**

The financial position of the Bank is set out in the Balance Sheet on page 79. During the year under review, the assets of the Bank increased by KShs 36,539 million (13%). The increase is mainly due to balances due from international institutions that increased by KShs 23,248 million or 10%, balances in reverse Repo Treasury Bills and Bonds (money injections into the economy) that increased by KShs 7,947 million or 113% and loans and advances (Government overdraft) which stood at KShs 5,124 million at the end of the year compared to a nil balance last year and against the statutory limit of KShs 16 billion. In an effort to maintain the required statutory import cover, the Bank built its foreign currency reserves during the year by a net of KShs 23,248 million in shilling terms through earnings from foreign currency investments, purchases of foreign currency, loan from IMF and revaluation gains. The reverse Repos were necessitated by the need for the Bank to inject liquidity into the economy by lending to commercial banks owing to tight liquidity prevailing in the money market for the better part of the financial year. These main increases were countered by minor decreases and increases in balances of other assets.

Correspondingly, liabilities and equity also increased by KShs 36,539 million (13%) mainly due to increases in currency in circulation by KShs 8,292 million or 9%, loans from IMF by KShs 17,751 million or 86% and equity by KShs 20,751 million or 114%. The increase in currency in circulation mirror demand for cash in the economy while the increase in equity is due mainly to the net profit for the year. The above increase in liabilities were mitigated by decreases of KShs 5,504 million in commercial bank and Government deposits, KShs 1,807 million in Repo transactions and KShs 2,975 million in other liabilities.

**CENTRAL BANK OF KENYA**  
**DIRECTORS' REPORT**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**4. DIVIDEND**

The Board of Directors recommend payment of KShs 7.2 billion dividend for the year ended 30 June 2009 (2008: KShs 4 billion).

**5. DIRECTORS**

The directors who served during the year and up to the date of this report are listed on page 69.

**6. AUDITORS**

The auditors, Ernst & Young, were appointed during the financial year 2006/2007 in line with the Public Procurement and Disposal Act, 2005 for a period of three years and the term expires on conclusion of the audit of the year under review.

By order of the Board



K. R. Abaga  
BOARD SECRETARY

24th September, 2009



**CENTRAL BANK OF KENYA**  
**STATEMENT OF DIRECTORS' RESPONSIBILITIES**  
**ON THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 30 JUNE 2009**

We, the directors, certify that:

1. We are responsible for the preparation of financial statements for each financial year which present a true and fair view of the state of affairs of the Bank and of its operating results for that year. We are also responsible in ensuring that the Bank keeps proper accounting records which disclose with reasonable accuracy, the financial position of the Bank.
2. We accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgement and estimates, in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act.
3. We are responsible for safeguarding the assets of the Bank.
4. We are responsible for establishing and maintaining systems of internal control designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
5. The directors are of the opinion that the financial statements for the year ended 30 June 2009 fairly present the financial position and operating results of the Bank.
6. Nothing has come to the attention of the directors to indicate that the Bank will not remain a going concern for at least twelve months from the date of this statement.

Signed on behalf of the Board of Directors by:-



**Governor**



**Director**



## **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 five Non-Executive Directors namely Messrs Joseph K. Waiguru, Nicholas A. Nesbitt, William O. Ogara, Ms Wanza Kioko 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 and Financial Management. 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.

The Committee is currently made up of the following:

- (1) The Governor who is also the Chairman-internal member
- (2) The Deputy Governor who is the Deputy Chairman-internal member
- (3) Permanent Secretary to the Treasury or his representative who shall be non-voting member
- (4) Professor T. C. Ryan-external member appointed by Minister for Finance
- (5) Dr. Rose W. Ngugi-external member appointed by Minister for Finance

**CENTRAL BANK OF KENYA****STATEMENT OF CORPORATE GOVERNANCE (continued)**

- (6) Mrs. Sheila S.M.R. M'Mbijjewe-external member appointed by Minister for Finance
- (7) Mr. Wycliffe Mukulu-external member appointed by Minister for Finance
- (8) Mr. Charles Koori- internal member appointed by Governor
- (9) Mr. John K. Birech-internal member appointed by Governor

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

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

**Directors' Emoluments and Loans**

The remuneration paid to the Directors for services rendered during the financial year 2008/2009 is disclosed in note 28 (iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for the staff loans.

**Code of Ethics**

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

**Internal Controls**

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

**Authorizations**

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

**CENTRAL BANK OF KENYA**  
**STATEMENT OF CORPORATE GOVERNANCE (continued)****Internal Audit**

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

**Transparency**

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

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

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

**Report on the Financial Statements**

We have audited the accompanying financial statements of the Central Bank of Kenya, as set out on pages 10 to 58 which comprise the balance sheet as at 30 June 2009, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

**Directors' Responsibility for the Financial Statements**

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

**Auditor's Responsibility**

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

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

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

**Opinion**

In our opinion, the accompanying financial statements give a true and fair view of the state of financial affairs of the Bank as at 30 June 2009 and of the profit and cash flows for the year then ended in accordance with the International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

**Report on other matters**

We also report to you, based on our audit, that:

- i) We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;
- ii) In our opinion, proper books of account have been kept by the Bank, so far as appears from our examination of those books; and,
- iii) The Bank's income statement and balance sheet are in agreement with the books of account.



Nairobi  
30/9/ 2009



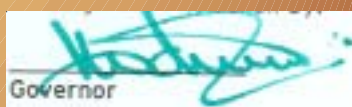
**CENTRAL BANK OF KENYA**  
**INCOME STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009**

	Note	2009 KShs million	2008 KShs million
Interest income	2	8,852	12,108
Interest expense	3	<u>(432)</u>	<u>(1,716)</u>
<b>Net interest income</b>		<b>8,420</b>	<b>10,392</b>
Fee and commission income	4	3,005	3,156
Foreign exchange gain	5	13,462	54
Other operating income	6	<u>4,849</u>	<u>421</u>
<b>Operating income</b>		<b>29,736</b>	<b>14,023</b>
Operating expenses	7	<u>(6,507)</u>	<u>(5,028)</u>
<b>Profit for the year</b>		<b><u>23,229</u></b>	<b><u>8,995</u></b>

**CENTRAL BANK OF KENYA****BALANCE SHEET****AS AT 30 JUNE 2009**

		<b>2009</b>	<b>2008</b>
<b>ASSETS</b>	<b>Note</b>	<b>KShs million</b>	<b>KShs million</b>
Balances due from banking institutions and gold holdings	8	246,734	223,486
International Monetary Fund	9	914	206
Items in the course of collection	10	1,430	2,885
Advances to Banks	11	15,011	8,542
Loans and advances	12	8,317	3,460
Other assets	13	2,870	1,241
Retirement benefit asset	14	1,425	55
Property and equipment	15	1,034	568
Prepaid operating lease rentals	16	275	278
Intangible assets	17	378	18
Due from Government of Kenya	18	<u>33,329</u>	<u>34,439</u>
<b>TOTAL ASSETS</b>		<b><u>311,717</u></b>	<b><u>275,178</u></b>
<b>LIABILITIES</b>			
Currency in circulation	19	108,042	99,750
Deposits	20	125,637	131,141
International Monetary Fund	9	37,448	19,697
Amounts repayable under repurchase agreements	21	-	1,807
Other liabilities	22	1,488	4,463
Provisions	23	<u>97</u>	<u>66</u>
<b>TOTAL LIABILITIES</b>		<b><u>272,712</u></b>	<b><u>256,924</u></b>
<b>EQUITY AND RESERVES</b>			
Share capital	24	5,000	1,500
General reserve fund	25	26,805	12,754
Proposed dividend	26	<u>7,200</u>	<u>4,000</u>
<b>TOTAL EQUITY AND RESERVES</b>		<b><u>39,005</u></b>	<b><u>18,254</u></b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b><u>311,717</u></b>	<b><u>275,178</u></b>

The financial statements were approved by the Board of Directors for issue on 24th September, 2009 and signed on its behalf by:



Governor



Director



**CENTRAL BANK OF KENYA**  
**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED JUNE 30 2009**

	Share capital KShs million	General reserve fund KShs million	Proposed dividend KShs million	Total KShs million
<b>Year ended 30 June 2008</b>				
Balance at start of the year	1,500	7,759	-	9,259
Profit for the year	-	8,995	-	8,995
Proposed dividends	-	(4,000)	4,000	-
<b>Balance at end of the year</b>	<b><u>1,500</u></b>	<b><u>12,754</u></b>	<b><u>4,000</u></b>	<b><u>18,254</u></b>
<b>Year ended 30 June 2009</b>				
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
Additional capital paid during the year	3,500	(3,500)	-	-
2008 dividends paid	-	-	(4,000)	(4,000)
Profit for the year	-	23,229	-	23,229
Proposed dividend	-	(7,200)	7,200	-
<b>Balance at end of the year</b>	<b><u>5,000</u></b>	<b><u>26,805</u></b>	<b><u>7,200</u></b>	<b><u>39,005</u></b>

\*The prior year adjustment relates to a change in policy on recognition of bank notes printing expenses as explained in Note 1a (iv).

**CENTRAL BANK OF KENYA**  
**CASH FLOW STATEMENT**  
**FOR THE YEAR ENDED JUNE 30 2009**

	Note	2009 KShs million	2008 KShs million
<b>Operating activities</b>			
Net cash (absorbed)/generated by operating activities	27 (a)	<u>14,161</u>	<u>39,160</u>
<b>Investing activities</b>			
Receipts of government loan		1,110	1,110
Purchase of property and equipment		(697)	(120)
Purchase of intangible assets		(388)	-
Proceeds from disposal of property and equipment		10	81
Proceeds on International Monetary Fund -SDR accounts		<u>(708)</u>	<u>(201)</u>
Net cash (used in)/from investing activities		<u>(673)</u>	<u>870</u>
<b>Financing activities</b>			
Dividends paid		(4,000)	-
Currency in circulation		<u>8,292</u>	<u>9,951</u>
Net cash from financing activities		<u>4,292</u>	<u>9,951</u>
Net increase in cash and cash equivalents		17,780	49,981
Cash and cash equivalents at start of year		225,300	175,265
Exchange rate effects		<u>13,462</u>	<u>54</u>
<b>Cash and cash equivalents at end of year</b>	<b>27 (b)</b>	<b><u>256,542</u></b>	<b><u>225,300</u></b>

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2009**

**1. SIGNIFICANT ACCOUNTING POLICIES**

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

**(a) Basis of preparation**

**i. 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. Changes in accounting policies**

The accounting policies adopted are consistent with those of the previous financial year except as follows:

Bank notes 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 bank note denomination. The deferred amount is recognised as prepayment and represents un-issued bank notes (currency) stock. Previously the costs were expensed upon delivery of currency stock.

**v. Standards, Amendments and Interpretations Effective in 2008**

The following amendments and interpretations to the standard are mandatory though not relevant to the Bank. The effective date of the amendments was 1 July 2008.

- Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments Disclosures - Reclassification of Financial Assets. The amendments allow entities to reclassify certain financial assets out of held-for-trading if they are no longer held for the purpose of being sold or repurchased in the near term.



**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

**v. Standards, Amendments and Interpretations Effective in 2008 (continued)**

Financial assets that would be eligible for classification as loans and receivables (i.e. those assets which, apart from not being held with the intent of sale in the near term, have fixed or determinable payments, are not quoted in an active market and contain no features which could cause the holder not to recover substantially all of its initial investment except through credit deterioration) may be transferred from 'Held-for-trading' to 'Loans and receivables', if the entity has the intention and the ability to hold them for the foreseeable future.

Financial assets that are not eligible for classification as loans and receivables may be transferred from 'Held-for-trading' to 'Available-for-sale' or to 'Held-to-maturity', only in rare circumstances. The amendment requires detailed disclosures relating to such reclassifications. The effective date of the amendment was 1 July 2008 and reclassifications before that date are not permitted.

The Bank did not make use of these amendments to reclassify any of its financial instruments between the effective date of these amendments which is 1 July 2008 and 30 June 2009.

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2008 but are not relevant to the Bank's operations:

- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions - This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed.
- IFRIC 13, Customer Loyalty Programmes – The IFRIC issued IFRIC 13 in June 2007. This interpretation requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to award credits.
- IFRIC 14, IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction - IFRIC Interpretation 14 provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 1.
- IFRIC 12, Service Concession Agreements -The IFRIC was issued in November 2006. This interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements.



**CENTRAL BANK OF KENYA**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

**vi. Standards, Amendments and Interpretations that have been issued and are not yet effective**

At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective for the Bank's operations and which the Bank has not early adopted:

- IFRS 2, Amendments to IFRS 2, Share-based Payment – Vesting Conditions and Cancellations (effective from 1 January 2009). The Standard restricts the definition of “vesting condition” to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation.
- IFRS 3 Business Combinations and IAS 27, Consolidated and Separate Financial Statements (effective 1 July 2009) - The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. IFRS 3 introduces a number of changes in the accounting for business combinations occurring after this date that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27 requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Other consequential amendments were made to IAS 7, Statement of Cash Flows, IAS 12 Income Taxes, IAS 21, The Effects of Changes in Foreign Exchange Rates, IAS 28 Investment in Associates and IAS 31, Interests in Joint Ventures. The changes by IFRS 3 and IAS 27 will affect future acquisitions or loss of control and transactions with minority interests.
- IFRS 8, Operating Segments. This standard requires disclosure of information about the Bank's operating segments and replaced the requirement to determine primary (business) and secondary (geographical) reporting segments of the Bank. IFRS replaces IAS 14, Segment Reporting (IAS 14) upon effective date.
- IAS 1, (Revised 2007) Presentation of Financial Statements. The standard replaces IAS 1, Presentation of Financial Statements (revised in 2003) as amended in 2005. The revised IAS 1 was issued in September 2007 and is effective for accounting periods beginning on or after 1 January 2009 with early application permitted. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income, which presents income and expense items recognised in profit or loss, together with all other items of recognised income and expense, either in one single statement, or in two linked statements.

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2008 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

**vi. Standards, Amendments and Interpretations that have been issued and are not yet effective (continued)**

- IAS 23, Borrowing Costs (effective from 1 January 2009)-The IASB issued an amendment to IAS 23 in April 2007. The revised IAS 23 requires capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.
- IAS 32, Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation - These amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for financial years beginning on or after 1 January 2009. The revisions provide a limited scope exception for puttable instruments to be classified as equity if they fulfil a number of specified features.
- IAS 39, Financial Instruments: Recognition and Measurement – Eligible Hedged Items - These amendments to IAS 39 were issued in August 2008 and become effective for financial years beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item.
- IFRIC 15, Agreement for the Construction of Real Estate-IFRIC 15 was issued in July 2008 and becomes effective for financial years beginning on or after 1 January 2009. The interpretation is to be applied retrospectively. It clarifies when and how revenue and related expenses from the sale of a real estate unit should be recognised if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. Furthermore, the interpretation provides guidance on how to determine whether an agreement is within the scope of IAS 11 or IAS 18.
- IFRIC 16, Hedges of a Net Investment in a Foreign Operation - IFRIC 16 was issued in July 2008 and becomes effective for financial years beginning on or after 1 October 2008. The interpretation is to be applied prospectively. IFRIC 16 provides guidance on the accounting for a hedge of a net investment. As such it provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of a net investment, where within the group the hedging instruments can be held in the hedge of a net investment and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment.
- IFRIC 17, Distribution of Non-Cash Assets to Owners-effective for periods beginning on or after 1 July 2009-This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends.
- IFRIC 18, Transfers of Assets from Customers effective for periods beginning on or after 1 July 2009-This interpretation provides guidance on how to account for items of property, plant and equipment received from customers, or cash that is received and used to acquire or construct specific assets. This interpretation only applies to such assets that are used to connect the customer to a network or to provide ongoing access to a supply of goods or services or both.

**CENTRAL BANK OF KENYA****ACCOUNTING POLICIES****FOR THE YEAR ENDED 30 JUNE 2009 (continued)****1. SIGNIFICANT ACCOUNTING POLICIES (continued)****a) Basis of preparation (continued)**

The directors anticipate that the adoption of these standards will have no material effect on the financial statements of the Bank.

**vii. Improvements to IFRS's**

In May 2008, the International Accounting Standards Board issued its first omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard.

The Bank has not yet adopted the following amendments and anticipates that these changes will have no material effect on the financial statements.

- IFRS 7, Financial Instruments: Disclosures: Removal of the reference to 'total interest income' as a component of finance costs.
- IAS 8, Accounting Policies, Change in Accounting Estimates and Errors: Clarification that only implementation guidance that is an integral part of an IFRS is mandatory when selecting accounting policies.
- IAS 10, Events after the Reporting Period: Clarification that dividends declared after the end of the reporting period are not obligations.
- IAS 16, Property, Plant and Equipment: Items of property, plant and equipment held for rental, are transferred to inventory when the rental ceases and they are held for sale.
- IAS 18, Revenue: Replacement of the term 'direct costs' with 'transaction costs' as defined in IAS 39.
- IAS 19, Employee Benefits: Revised the definition of 'past service costs', 'return on plan assets' and 'short term' and 'other long-term' employee benefits. Amendments to plans that result in a reduction in benefits related to future services are accounted for as curtailment. Deleted the reference to the recognition of contingent liabilities to ensure consistency with IAS 37.
- IAS 20, Accounting for Government Grants and Disclosures of Government Assistance.
- IAS 38, Intangible Assets: Expenditure on advertising and promotional activities is recognised as an expense when the company either has the right to access the goods or has received the service.
- IAS 39, Financial Instruments: Recognition and Measurement: Changes in circumstances relating to derivatives are not reclassifications and therefore may be either removed from, or included in, the 'fair value through profit or loss' classification after initial recognition. Removed the reference in IAS 39 to a 'segment' when determining whether an instrument qualifies as a hedge. Require the use of the revised effective interest rate when remeasuring a debt instrument on the cessation of fair value hedge accounting.

**(b) Significant accounting judgement and estimates**

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

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(b) Significant accounting judgement and estimates (continued)**

The most significant use of judgement and estimates are as follows:

**(i) Impairment losses on loans and advances**

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

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

**(ii) Pensions**

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

**(iii) Property, equipment and intangible assets**

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

**(iv) Useful life of currency**

Useful lives of the various bank notes 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.

**(c) Revenue recognition**

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

**CENTRAL BANK OF KENYA**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(c) Revenue recognition (continued)**

**(i) Interest income and expenses**

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments.

**(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.

**(d) Translation of foreign currencies**

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

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.

**(e) Currency printing and minting expenses**

Notes printing and coins minting expenses which include ordering, printing, minting, freight, insurance and handling costs are expensed upon issuance of currency into circulation.

**(f) 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. 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 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

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(f) Employee benefits (continued)**

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 income statement over the remaining working lives of the employees participating in the scheme.

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

**(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 balance sheet date is recognised as an expense accrual.

**(g) 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	over the estimated future lives which range from ten to twenty-five years
Motor vehicles, furniture and equipment	over periods ranging from two to five 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, plant and equipment in use.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**



**CENTRAL BANK OF KENYA**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**(g) Property and equipment (continued)**

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, plant 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 income statement 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 income statement 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.

**(h) 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 income statement.

Amortisation is calculated using the straight line method to write down the cost of intangible assets to the residual values over the estimated useful life as follows:

Computer software	-	over periods ranging from two to five years
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**(i) Impairment of non-financial assets**

Impairment of assets is assessed at each balance sheet date or more frequently where any events or changes in circumstances dictate for indications of impairment. If significant indications are present, these assets are subject to an impairment review by estimating the recoverable amount. An impairment loss is charged to income statement when the carrying amount of an asset exceeds the recoverable amount.

Previously recognised impairment loss of related asset may be reversed in part or in full when a change in circumstances leads to an increase of the recoverable amount. The carrying amount of the asset will only be increased up to the amount that it would have been had the original impairment not been recognised. For the purpose of measuring and accounting for impairment loss; either fair value or value in use of an asset is compared with carrying amount.

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES**

**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) 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.

**(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 classifies its financial assets in the following categories: loans and advances and investments that are held to maturity. The Bank determines the classification of its investments at initial recognition.

**(1) *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**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial Instruments (continued)**

**(2) *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 income statement. The losses arising from impairment of such investments are recognised in the income statement 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.

**(3) *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 income statement 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.

**(4) *Financial assets at fair value through income statement: 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 income statement. 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 income statement.

The gains and losses on investments held to maturity and loans and receivables are recognized in the income statement when the investments are derecognized.

**CENTRAL BANK OF KENYA**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**  
**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) 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 income statement 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 balance sheet 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**

Loans are stated at outstanding amount less provision for impairment.

A review for impairment is carried out at each financial year-end. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

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

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (which is the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss is recognised in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss is recognized in the income statement.

**(k) 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.

**CENTRAL BANK OF KENYA**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(k) Amounts Repayable under Repurchase Agreements (REPOs) (continued)**

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 Government loan 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). 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 REPOs as collateralized loans for accounting purposes. In this case, a REPO is recorded as a secured advance and is shown separately as REPO Agreement.
- (ii) REPOs continue to be recognised in the balance sheet 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 income statement

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

**(l) 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.

**(m) 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 to fund certain activities 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. Subsequent to year end, the deposits are currently computed at 4.5% of each commercial bank's deposits it has taken from the public; previously the rate was 5%. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

**(n) Dividends payable**

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

**CENTRAL BANK OF KENYA**  
**ACCOUNTING POLICIES**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(o) Provisions**

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

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

**(p) 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.'

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 balance sheet. 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.

**(q) Other assets**

Other assets are stated at fair value and subsequently at amortised cost using effective interest rate method less allowance for impairment. Due to their short term nature, the nominal value or cost are considered to approximate the fair value and as such stated at cost less any impairment loss.

**(r) Other liabilities**

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



**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(s) 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.

**(t) 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.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>2 INTEREST INCOME</b>		
Cash and cash equivalents ( Note 2a)	21	70
Held to maturity investments (Note 2b)	6,889	10,241
Loans and advances (Note 2c)	1,821	1,797
Held for trading investments (Note 2d)	<u>121</u>	<u>-</u>
	<b><u>8,852</u></b>	<b><u>12,108</u></b>
<b>2(a) Interest income from cash and cash equivalents</b>		
Interest on Sterling Pound deposits	3	6
Interest on US Dollar deposits	5	48
Interest on Euro deposits	9	10
Income from IMF	<u>4</u>	<u>6</u>
	<b><u>21</u></b>	<b><u>70</u></b>
<b>2(b) Interest income from held to maturity investments</b>		
Interest on Sterling Pound term deposits	3,436	5,143
Interest on US Dollar term deposits	2,060	4,032
Interest on Euro term deposits	<u>1,393</u>	<u>1,066</u>
	<b><u>6,889</u></b>	<b><u>10,241</u></b>
The weighted average interest rates for term deposits were		
US Dollar	1.72%	4.75%
UK Sterling Pounds	2.48%	5.90%
Euro	2.58%	4.44%
<b>2(c) Interest income from loans and advances</b>		
Interest on loan due from Government (Note 18)	1,025	1,061
Interest on Government overdraft	466	291
Interest on staff loans	75	73
Interest on reverse REPOs	70	107
Interest on local commercial banks overnight loans	45	68
Interest on foreign commercial banks overnight loans	26	120
Other interest income	<u>114</u>	<u>77</u>
	<b><u>1,821</u></b>	<b><u>1,797</u></b>
<b>2(d) Interest income from held for trading investments</b>		
Interest income - World Bank RAMP	<u>121</u>	<u>-</u>

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 \$ 200 million for the Programme.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>2(e) Additional disclosure on income by source</b>		
Foreign investments earnings	7,058	10,431
Local investments earnings	1,719	1,604
Other interest earnings	<u>75</u>	<u>73</u>
	<u><b>8,852</b></u>	<u><b>12,108</b></u>
<b>3 INTEREST EXPENSE</b>		
Interest on monetary policy issues/ REPOs	334	1,640
Interest paid to IMF	<u>98</u>	<u>76</u>
	<u><b>432</b></u>	<u><b>1,716</b></u>
<b>4 COMMISSION AND FEES INCOME</b>		
Commission on sale of Government securities	3,000	3,150
Poverty Reduction and Growth Facility (PRGF)		
(IMF-GoK) Commission	5	4
Others	<u>—</u>	<u>2</u>
	<u><b>3,005</b></u>	<u><b>3,156</b></u>
<p>The Bank earns a commission of 1.5% from the Government 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.</p>		
<b>5 FOREIGN EXCHANGE GAIN/(LOSS)</b>		
Foreign exchange dealing profit (Note 5a)	1,470	1,319
Foreign exchange translation gain/(loss) (Note 5(b))	<u>11,992</u>	<u>-1,265</u>
	<u><b>13,462</b></u>	<u><b>54</b></u>
<b>5(a) Foreign exchange dealing profit</b>		
Gains on sale of foreign exchange to Government	1,227	1,230
Foreign exchange dealing profit on commercial	<u>243</u>	<u>89</u>
	<u><b>1,470</b></u>	<u><b>1,319</b></u>
<b>5(b) Foreign exchange translation (loss)/gain</b>		
Revaluation gain/(loss) on current accounts	-1,242	9
Revaluation gain/(loss) on foreign deposits	15,546	-532
Revaluation loss on IMF accounts	-2,318	-771
Others	<u>6</u>	<u>29</u>
	<u><b>11,992</b></u>	<u><b>-1,265</b></u>
<b>Exchange rates</b>	<b>KShs</b>	<b>KShs</b>
US Dollar	77.05	64.6
GBP	128.83	128.77
Euro	108.9	101.99

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

	<b>2009</b>	<b>2008</b>
<b>Foreign Currency Investment mix</b>		
US Dollar	42%	39%
GBP Sterling Pound	35%	57%
Euro	<u>23%</u>	<u>4%</u>
	<u>100%</u>	<u>100%</u>

The foreign currency investment mix is determined by the Investment Committee and is revised from time to time in line with the Bank's monetary objectives.

**6 OTHER OPERATING INCOME**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Recovery on impaired loan (Note 6a)	3,141	-
Actuarial gain on retirement benefit obligations	1,370	-
KSMS hospitality services	185	159
Miscellaneous income	90	132
KSMS tuition fees and other charges	37	33
Rent received	16	16
Proceeds from disposal of property and equipment	<u>10</u>	<u>81</u>
	<u>4,849</u>	<u>421</u>

	<b>US\$</b>	<b>KShs</b>
	<b>Million</b>	<b>Million</b>
<b>6 (a) Recovery on impaired loan</b>		
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	<u>-</u>	<u>-104</u>
	<u>45</u>	<u>3,141</u>

The recovery on impaired loan 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 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 has now, with the sale of the hotel, been extinguished from the books of the Bank.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**7 OPERATING EXPENSES**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Staff costs (Note 7a)	3,260	3,261
Currency expenses (Note 7b)	1,260	403
Property maintenance expenses (Note 7c)	660	519
Depreciation on property and equipment (Note 15)	231	144
Amortisation on intangible assets (Note 17)	28	31
Other expenses (Note 7d)	1,057	659
Auditors' remuneration	4	4
Banking expenses	4	4
Operating lease rentals	<u>3</u>	<u>3</u>
	<b><u>6,507</u></b>	<b><u>5,028</u></b>
<b>7(a) Staff costs</b>		
Personnel emoluments	2,925	3,010
Medical benefit	135	115
Staff training and development costs	188	123
Directors' expenses	<u>12</u>	<u>13</u>
	<b><u>3,260</u></b>	<b><u>3,261</u></b>
<b>7(b) Currency expenses</b>		
Notes production	1,108	330
Coins production	140	59
Notes issue	7	10
Coins issue	<u>5</u>	<u>4</u>
	<b><u>1,260</u></b>	<b><u>403</u></b>
<b>7(c) Property maintenance expenses</b>		
Upkeep of property	234	241
Security of premises	193	154
Property renovation	121	30
Electricity	71	46
Others	<u>41</u>	<u>48</u>
	<b><u>660</u></b>	<b><u>519</u></b>
<b>7(d) Other expenses</b>		
Transport and travelling	125	98
Office expenses	126	107
Postal service expenses	88	93
Legal and professional fees	105	8
Other administrative expenses	<u>613</u>	<u>353</u>
	<b><u>1,057</u></b>	<b><u>659</u></b>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**8 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Cash and cash equivalents ( Note 8a)	8,975	10,318
Held for trading investments (Note 8b)	15,449	-
Held to maturity investments (Note 8c)	222,276	213,140
Gold holdings	<u>34</u>	<u>28</u>
	<u>246,734</u>	<u>223,486</u>
<b>8(a)</b> Cash and cash equivalents		
Special project accounts	4,695	4,451
Current account	2,598	4,423
Domestic forex currency cheque clearing	1,676	1,438
Forex travellers cheques	<u>6</u>	<u>6</u>
	<u>8,975</u>	<u>10,318</u>
<b>8(b)</b> Held for trading		
US Dollar deposits	925	-
Fixed income securities	14,469	-
Accrued interest	<u>55</u>	<u>-</u>
	<u>15,449</u>	<u>-</u>
<b>8(c)</b> Held to maturity investments		
Term deposits (Note 8 c(i))	221,824	210,866
Accrued interest on term deposits	<u>452</u>	<u>2,274</u>
	<u>222,276</u>	<u>213,140</u>
<b>8 c(i)</b> Term deposits		
Dollar deposits	90,534	106,367
Sterling Pound deposits	80,649	68,799
Euro deposits	<u>50,641</u>	<u>35,700</u>
	<u>221,824</u>	<u>210,866</u>



**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**9 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.

	SDR Million	2009 KShs Million	SDR' Million	2008 KShs Million
<b>Assets</b>				
IMF balances( SDR asset account)	<u>8</u>	<u>914</u>	<u>2</u>	<u>206</u>
<b>Liabilities</b>				
International Monetary Fund Account No. 1	20	3,128	20	2,134
International Monetary Fund Account No. 2	-	3	-	-
International Monetary Fund – PRGF Account	281	33,599	122	16,510
International Monetary Fund loans to Government of Kenya	<u>6</u>	<u>718</u>	<u>10</u>	<u>1,053</u>
	<u>307</u>	<u>37,448</u>	<u>152</u>	<u>19,697</u>
Security at 30 June	<u>238</u>	<u>28,079</u>	<u>246</u>	<u>24,015</u>

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 36.9 million respectively, are accounted for in the books of the Government of Kenya.

**10 ITEMS IN THE COURSE OF COLLECTION**

	2009 KShs Million	2008 KShs Million
Items in the course of collection	<u>1,430</u>	<u>2,885</u>

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

**11 ADVANCES TO BANKS**

REPO Treasury Bills	9,552	-
REPO Treasury Bonds	5,437	7,042
Treasury Bonds Discounted	10	1,467
Treasury Bills Discounted	9	-
Accrued interest	<u>3</u>	<u>33</u>
	<u>15,011</u>	<u>8,542</u>

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

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**12 LOANS AND ADVANCES**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Irrecoverable amount from banks under liquidation	3,767	8,337
Government overdraft account (see below and Note 28)	5,124	-
Loan from IMF to the Government of Kenya (Note 28)	718	1,053
Advances to employees		
Salary advance	178	176
Car loans	379	350
Housing scheme	1,746	1,736
Development loan	<u>189</u>	<u>160</u>
	12,101	11,812
Provision for loan impairment (banks & staff)	<u>-3,784</u>	<u>-8,352</u>
Net advances as at 30 June	<u><u>8,317</u></u>	<u><u>3,460</u></u>

Movement in the loan impairment allowance is as follows:

At start of the year	(8,352)	(8,281)
Additional impairment allowance made during the year	-63	-78
Irrecoverable amount on sale of the Hotel	1,490	-
Recoveries on sale of the Hotel in the year (Note 6a)	3,141	-
Other recoveries	<u>-</u>	<u>7</u>
At end of the year	<u><u>-3,784</u></u>	<u><u>-8,352</u></u>

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at 5% of the Gross Recurrent Revenue as reported in the latest audited financial statements. The limit stands at KShs 16,882,643,732 based on the Government financial statements for 2006/2007, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 14,818,512,441 based on the Government financial statements for 2005/2006.

**13 OTHER ASSETS**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Prepayments	972	966
Deferred currency expenses	1,580	-
Advances	<u>318</u>	<u>275</u>
	<u><u>2,870</u></u>	<u><u>1,241</u></u>

The policy of the Bank is to recognise currency notes expenses upon issuing out of currency notes for circulation. The expense is amortised over the lifespan of the respective bank notes as follows:

Notes	Depreciation
KShs 50 and KShs 100	Over one year on a prorata basis
KShs 200, 500 and 1,000	Over two years on a prorata basis

In prior years, the policy of the Bank was to recognise currency notes expenses on receipt from the printers. Costs on coins are expensed upon delivery of the currency stock from the minters.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**12 LOANS AND ADVANCES**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Irrecoverable amount from banks under liquidation	3,767	8,337
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**13 OTHER ASSETS**

	<b>2009</b>	<b>2008</b>
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**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**14 RETIREMENT BENEFIT ASSET**

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

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

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
Present value of funded obligations	9,582	10,496
Fair value of plan assets	<u>-11,678</u>	<u>-12,136</u>
Present value of net asset	-2,096	-1,640
Unrecognised actuarial gain	<u>671</u>	1,585
Asset in the balance sheet	<u>-1,425</u>	<u>-55</u>

The amounts recognised in the income statement are as follows:

Current service costs	453	532
Interest costs	921	847
Expected return on plan assets	-1,085	-955
Net gains recognised in the year	-65	-5
Adjustment for previous year values	-135	-
Past service cost	<u>-1,138</u>	<u>-</u>
Total expenses included in operating expenses	<u>-1,049</u>	<u>419</u>

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

Net liability at start of period	-55	-240
Net expense recognised in the income statement	-1,051	419
Employer contributions	<u>-319</u>	<u>-234</u>
Net liability at end of period	<u>-1,425</u>	<u>-55</u>
Actual return on plan assets	<u>-380</u>	<u>1,679</u>

The principal actuarial assumptions at the balance sheet date were:

	<b>2009</b>	<b>2008</b>
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 STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**15 PROPERTY AND EQUIPMENT**

	Land and buildings KShs million	Motor vehicles KShs million	Furniture and equipment KShs million	Total KShs million
<b>30-Jun-09</b>				
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	168	2,651	3,764
Charge for the year	9	39	183	231
Eliminated on disposal	-	(32)	-	(32)
At end of the year	954	175	2,834	3,963
<b>Net book value at 30 June 2009</b>	<b>34</b>	<b>21</b>	<b>979</b>	<b>1,034</b>
<b>30-Jun-08</b>				
Cost				
At start of year	1,004	184	3,065	4,253
Additions	-	54	66	120
Disposals	(17)	(23)	(1)	(41)
At end of the year	987	215	3,130	4,332
Depreciation				
At start of the year	953	157	2,552	3,662
Charge for the year	9	34	100	143
Eliminated on disposal	(17)	(23)	(1)	(41)
At end of the year	945	168	2,651	3,764
<b>Net book value at 30 June 2008</b>	<b>42</b>	<b>47</b>	<b>479</b>	<b>568</b>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**16 PREPAID OPERATING LEASE RENTALS**

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

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>Cost</b>		
At 30 June	<u>300</u>	<u>300</u>
<b>Amortisation</b>		
At 1 July	22	18
Amortisation for the year	<u>3</u>	<u>4</u>
At end of the year	<u>25</u>	<u>22</u>
Net carrying value at end of the year	<u>275</u>	<u>278</u>

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.

**17 INTANGIBLE ASSETS**

	<b>Software</b>	<b>Work-in-Progress</b>	<b>2009</b>	<b>2008</b>
	<b>KShs</b>	<b>KShs</b>	<b>Total</b>	<b>Total</b>
			<b>KShs</b>	<b>KShs</b>
<b>Cost</b>				
At 1 July	180	-	180	180
Additions	<u>37</u>	<u>351</u>	<u>388</u>	<u>-</u>
At end of the year	<u>217</u>	<u>351</u>	<u>568</u>	<u>180</u>
<b>Amortisation</b>				
At 1 July	162	-	162	131
Amortisation for the year	<u>28</u>	<u>-</u>	<u>28</u>	<u>31</u>
At end of the year	<u>190</u>	<u>-</u>	<u>190</u>	<u>162</u>
Net carrying value at end of the year	<u>27</u>	<u>351</u>	<u>378</u>	<u>18</u>

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



**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**18 DUE FROM GOVERNMENT OF KENYA**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
At start of the year	34,439	35,549
Receipts during the year	<u>-1,110</u>	<u>-1,110</u>
At end of the year	<u>33,329</u>	<u>34,439</u>

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.

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.

**19 CURRENCY IN CIRCULATION**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Kenya notes	104,002	95,992
Kenya coins	4,034	3,753
Commemorative coins	<u>6</u>	<u>5</u>
	<u>108,042</u>	<u>99,750</u>
Balance at the beginning of the year	99,750	89,799
Deposits by banks	-283,489	-269,105
Withdrawals by banks	<u>291,781</u>	<u>279,056</u>
Balance at the end of the year	<u>108,042</u>	<u>99,750</u>

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/= and 50/=.

Coins: 40/=, 20/=, 10/=, 5/=, 2/=, 1/=, /50, /10 and /05.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

<b>20 DEPOSITS</b>	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Local commercial banks (Note 20 a)	51,901	53,868
Local banks forex settlement accounts (Note 20 b)	1,297	1,239
External banks forex settlement accounts	89	21
Other public entities and project accounts	8,181	8,506
Government of Kenya (Note 20 c)	<u>64,169</u>	<u>67,507</u>
	<u>125,637</u>	<u>131,141</u>

**20(a) Local commercial banks**

Clearing accounts	7,974	4,166
Cash reserve ratio	43,927	49,002
Open Market Operations (OMO) deposits	<u>-</u>	<u>700</u>
	<u>51,901</u>	<u>53,868</u>

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.

**20(b) Local banks forex settlement accounts**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Euro	228	162
Dollar	952	950
Sterling Pound	<u>117</u>	<u>127</u>
	<u>1,297</u>	<u>1,239</u>

**20(c) Government of Kenya**

Paymaster General	23,785	21,183
Treasury Funding Account	15,747	35,515
The Exchequer Account	18,417	7,990
Others	<u>6,220</u>	<u>2,819</u>
	<u>64,169</u>	<u>67,507</u>

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 STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**21 AMOUNTS REPAYABLE UNDER REPURCHASE AGREEMENTS**

This is money mopped up from commercial banks by the Bank for monetary policy purpose (liquidity management) and is shown in the books of the Bank as a liability to the commercial banks. The money is secured by the Bank using treasury bills and bonds that are described technically as Repos (or repurchase agreements). The balance at year end was nil (2008: KShs 1,807 million) due to the Bank injecting liquidity (reverse Repo) into the economy in contrast to mop-up activities in 2008.

<b>22 OTHER LIABILITIES</b>	<b>2009 KShs million</b>	<b>2008 KShs million</b>
Impersonal accounts	325	3,467
Sundry creditors	663	662
Refundable deposits	421	234
Development deposits	<u>79</u>	<u>100</u>
	<u>1,488</u>	<u>4,463</u>

**23 PROVISIONS**

Leave accrual	66	36
Gratuity to staff members	<u>31</u>	<u>30</u>
	<u>97</u>	<u>66</u>

**24 SHARE CAPITAL**

Authorised share capital	<u>5,000</u>	<u>5,000</u>
Issued and fully paid	<u>5,000</u>	<u>1,500</u>

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

**25 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.

**26 DIVIDENDS**

The directors recommend the payment of KShs 7.2 billion dividend for the year ended 30 June 2009 (2008: KShs 4 billion).

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**27 (a) NOTES TO THE CASH FLOW STATEMENT**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>Cash flows from operating activities</b>		
Net profit for the year	23,229	8,995
Adjustments for:		
Depreciation of property and equipment	231	143
Amortization of prepaid operating leases	3	4
Amortization of intangible assets	28	31
Revaluation of currency production costs	1,522	-
Exchange rate effects	(13,462)	(54)
Gain on disposal of property and equipment	(10)	(81)
Revaluation (surplus)/ deficit in defined benefit scheme	<u>(1,370)</u>	<u>185</u>
<b>Operating profit before working capital changes</b>	<b>10,171</b>	<b>9,223</b>
Net (increase)/decrease in loans and advances	(4,857)	282
Decrease in amounts repayable under repurchase agreements	(1,807)	(13,819)
(Decrease)/increase in deposits	(5,504)	39,802
Increase in balance with International Monetary Fund	17,751	3,957
Decrease/(increase) in project accounts	(244)	34
Decrease/(increase) in accrued interest on balances due from banking institutions	1,767	(1,142)
Decrease/(increase) in items in the course of collection	1,455	(2,296)
(Increase)/decrease in other assets	(1,626)	318
(Decrease) / increase in other liabilities	<u>(2,945)</u>	<u>2,801</u>
<b>Net cash generated by operations</b>	<b><u>14,161</u></b>	<b><u>39,160</u></b>

**(b) Cash and cash equivalents**

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

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Term deposits	221,824	210,866
Current accounts	2,598	4,423
Domestic forex cheques clearing	1,676	1,438
Travellers Cheques	6	6
Gold holdings	<u>34</u>	<u>28</u>
	226,138	216,761
Investment in Government securities	15,010	8,539
Investments with RAMP	<u>15,394</u>	<u>-</u>
	<b><u>256,542</u></b>	<b><u>225,300</u></b>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**28 RELATED PARTY TRANSACTIONS**

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

**(i) Loans**

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 12) include advances to employees that as at 30 June 2009 amounted to KShs 2,493 million (2008: KShs 2,422 million). The advances are at preferential rates of interest determined by the Bank.

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>(ii) Loans to executive directors</b>		
At start of the year	1	2
Loans advanced during the year	10	-
Loan repayments	<u>-2</u>	<u>-1</u>
At end of the year	<u>9</u>	<u>1</u>
<b>(iii) Loans to key management personnel</b>		
At start of the year	18	22
Loans advanced during the year	41	34
Loan repayments	<u>-20</u>	<u>-23</u>
At end of the year	<u>39</u>	<u>33</u>
<b>(iv) Directors' emoluments:</b>		
Fees to non executive directors	25	13
Other remuneration to executive directors	<u>50</u>	<u>35</u>
	<u>75</u>	<u>48</u>
<b>(v) Remuneration to senior management</b>	<u>148</u>	<u>134</u>
<b>(vi) Post –employment pension</b>	<u>2</u>	<u>2</u>
<b>(vii) Government of Kenya</b>		

Transactions entered into with the Government include:

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

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

Due from Government of Kenya (Note 18)	33,329	34,439
Overdraft account (Note 12)	5,124	-
Loan from IMF to the Government of Kenya (Note 9)	718	1,053
Government of Kenya deposits (Note 20)	<u>64,169</u>	<u>67,507</u>

**CENTRAL BANK OF KENYA  
NOTES TO THE FINANCIAL STATEMENT  
FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**28 RELATED PARTY TRANSACTIONS (continued)**

**(viii) 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 13 million (2008: KShs 15million).

**(ix) 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.

**29 RISK MANAGEMENT**

**(i) 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:

**a) 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.

**b) 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.

**c) 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.



**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**29 RISK MANAGEMENT(continued)**

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.

**ii) 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.

**iii) 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:

- 1) Credit risk
- 2) Market risk
  - Interest risk
  - Foreign currency exchange risk
- 3) Liquidity risk

Non financial Risks include:

- 4) Operational risk
- 5) Human resource risk
- 6) Legal risk
- 7) Reputation risk

**Financial Risks**

**a) 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.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**29 RISK MANAGEMENT (continued)**

**a) Credit risk (continued)**

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%.

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:

	<b>2009</b>	<b>2008</b>
	<b>KShs Millions</b>	<b>KShs Millions</b>
<b>Assets</b>		
Republic of Kenya	65,736	51,612
United Kingdom	194,138	124,291
Rest of Europe	31,343	95,413
United states of America	20,481	3,338
Rest of the World	<u>21</u>	<u>524</u>
	<b><u>311,717</u></b>	<b><u>275,178</u></b>
<b>Liabilities</b>		
Republic of Kenya	<b><u>311,717</u></b>	<b><u>275,178</u></b>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**b) 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 2009**

	<b>3 months or less KShs million</b>	<b>Between 3-12 months KShs million</b>	<b>Over 1 year KShs million</b>	<b>Non- interest bearing KShs million</b>	<b>Total KShs million</b>
<b>Assets</b>					
Balances due from banking institutions and gold holdings	242,039	-	-	4,695	246,734
International Monetary Fund (SDR Account)	914	-	-	-	914
Items in the course of collection	-	-	-	1,430	1,430
Advances to Banks	15,011	-	-	-	15,011
Loans and advances	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	-	1,110	32,219	-	33,329
<b>Total assets</b>	<u>258,038</u>	<u>2,044</u>	<u>39,528</u>	<u>12,107</u>	<u>311,717</u>
<b>Liabilities and equity</b>					
Currency in circulation	-	-	-	108,042	108,042
Deposits	125,637	-	-	-	125,637
International Monetary Fund	-	-	-	37,448	37,448
Amounts repayable under repurchase agreements	-	-	-	-	-
Other liabilities	-	-	-	1,585	1,585
Equity and reserves	-	-	-	39,005	39,005
<b>Total liabilities and equity</b>	<u>125,637</u>	<u>-</u>	<u>-</u>	<u>186,080</u>	<u>311,717</u>
<b>Interest sensitivity gap 2009</b>	<u>132,401</u>	<u>2,044</u>	<u>39,528</u>	<u>-173,973</u>	<u>-</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**c) Interest risk (continued)**

**As at 30 June 2008**

	<b>3 months or less KShs million</b>	<b>Between 3-12 KShs million</b>	<b>Over 1 year KShs million</b>	<b>Non- interest bearing KShs million</b>	<b>Total KShs million</b>
<b>Assets</b>					
Balances due from banking institutions and gold holdings	219,035	-	-	4,451	223,486
International Monetary Fund(SDR Account)	206	-	-	-	206
Items in the course of collection	-	-	-	2,885	2,885
Investment in government securities	8,539	-	-	-	8,539
Loans and advances	74	933	2,453	-	3,460
Other assets	-	-	-	1,244	1,244
Property, plant and equipment	-	-	-	568	568
Prepaid leasehold land	-	-	-	278	278
Intangible assets	-	-	-	18	18
Retirement benefit asset	-	-	-	55	55
Due from Government of Kenya	<u>-</u>	<u>1,110</u>	<u>33,329</u>	<u>-</u>	<u>34,439</u>
<b>Total assets</b>	<u>227,854</u>	<u>2,043</u>	<u>35,782</u>	<u>9,499</u>	<u>275,178</u>
<b>Liabilities and equity</b>					
Currency in circulation	-	-	-	99,750	99,750
Deposits	131,141	-	-	-	131,141
International Monetary Fund	-	-	-	19,697	19,697
Amounts repayable under repurchase agreements	1,807	-	-	-	1,807
Other liabilities	-	-	-	4,529	4,529
Equity and reserves	<u>-</u>	<u>-</u>	<u>-</u>	<u>18,254</u>	<u>18,254</u>
<b>Total liabilities and equity</b>	<u>132,948</u>	<u>-</u>	<u>-</u>	<u>142,230</u>	<u>275,178</u>
<b>Interest sensitivity gap 2008</b>	<u>94,906</u>	<u>2,043</u>	<u>35,782</u>	<u>-132,731</u>	<u>-</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**29 RISK MANAGEMENT (continued)**

**c) 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 2009 and 2008 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 2009 (continued)**

**c) 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
<b>Assets</b>							
Balances due from banking institutions	112,263	82,955	51,425	-	-	57	246,700
Special Drawing Rights	-	-	-	914	-	-	914
Gold holdings	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>34</u>	<u>-</u>	<u>34</u>
Total assets	<u>112,263</u>	<u>82,955</u>	<u>51,425</u>	<u>914</u>	<u>34</u>	<u>57</u>	<u>247,648</u>
<b>Liabilities</b>							
Balances due to IMF	-	-	-	37,448	-	-	37,448
Commissions for EEC Development Fund	-	-	79	-	-	-	79
Local Banks forex settlements	952	118	229	-	-	-	1299
Local bank guarantees	272	-	-	-	-	-	272
Forex bureaux deposits	<u>148</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>148</u>
Total liabilities	<u>1,372</u>	<u>118</u>	<u>308</u>	<u>37,448</u>	<u>-</u>	<u>-</u>	<u>39,246</u>
<b>Net balance sheet position 2009</b>	<u><b>110,891</b></u>	<u><b>82,837</b></u>	<u><b>51,117</b></u>	<u><b>-36,534</b></u>	<u><b>34</b></u>	<u><b>57</b></u>	<u><b>208,402</b></u>



**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

c) Foreign currency exchange rate risk (continued)

As at 30 June 2008 (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
<b>Assets</b>							
Balances due from banking institutions	73,789	108,802	40,326	-	-	541	223,458
Special Drawing Rights	-	-	-	206	-	-	206
Gold holdings	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>28</u>	<u>-</u>	<u>28</u>
Total assets	<u>73,789</u>	<u>108,802</u>	<u>40,326</u>	<u>206</u>	<u>28</u>	<u>541</u>	<u>223,692</u>
<b>Liabilities</b>							
Balances due to IMF	-	-	-	19,697	-	-	19,697
Commissions for EEC Development Fund	-	100	-	-	-	-	100
Forex bureaux deposits	<u>1,112</u>	<u>123</u>	<u>161</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,396</u>
Total liabilities	<u>1,112</u>	<u>223</u>	<u>161</u>	<u>19,697</u>	<u>-</u>	<u>-</u>	<u>21,193</u>
Net balance sheet position 2008	<u>72,677</u>	<u>108,579</u>	<u>40,165</u>	<u>-19,491</u>	<u>28</u>	<u>541</u>	<u>202,499</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**29 RISK MANAGEMENT (continued)**

**d) 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 2009 (continued)**

**e) Liquidity risk (continued)**

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 30 June 2009 to the contractual maturity date.

	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
<b>ASSETS</b>						
Balances due from banking institutions and gold holdings	25,790	220,910	-	-	34	246,734
International Monetary Fund (SDR Account)	914	-	-	-	-	914
Loans and advances	5,124	118	702	1,772	601	8,317
Advances to Banks against government securities	-	15,011	-	-	-	15,011
Items in the course of collection	1,430	-	-	-	-	1,430
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	-	-	1,110	4,440	27,779	33,329
<b>TOTAL ASSETS</b>	<u>33,258</u>	<u>238,909</u>	<u>1,812</u>	<u>6,212</u>	<u>31,526</u>	<u>311,717</u>
<b>LIABILITIES</b>						
Currency in circulation	-	-	-	-	108,042	108,042
Deposits	125,637	-	-	-	-	125,637
International Monetary Fund	-	-	413	1,535	35,500	37,448
Amounts repayable under repurchase agreements	-	-	-	-	-	-
Other liabilities	-	1,585	-	-	-	1,585
Equity and reserves	-	-	-	-	39,005	39,005
<b>TOTAL LIABILITIES AND EQUITY</b>	<u>125,637</u>	<u>1,585</u>	<u>413</u>	<u>1,535</u>	<u>182,547</u>	<u>311,717</u>
<b>Liquidity gap 2009</b>	<u>-92,379</u>	<u>237,324</u>	<u>1,399</u>	<u>4,677</u>	<u>-151,021</u>	<u>-</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**f) Liquidity risk (continued)**

As at 30 June 2008

	On demand	Due within 3 months	Due between 3-12 months	Due between 1-5yrs	Due after 5 years	Total
	KShs million	KShs million	KShs million	KShs million	KShs million	KShs million
<b>ASSETS</b>						
Balances due from banking institutions and gold holdings	12,798	210,660	-	-	28	223,486
International Monetary Fund(SDR Account)	206	-	-	-	-	206
Loans and advances	41	118	701	1,772	828	3,460
Investments in government securities	-	8,539	-	-	-	8,539
Items in the course of collection	2,885	-	-	-	-	2,885
Other assets	-	1,244	-	-	-	1,244
Property, plant and equipment	-	148	366	54	-	568
Prepaid leasehold land	-	1	3	14	260	278
Intangible assets	-	9	9	-	-	18
Retirement benefit asset	-	-	-	-	55	55
Due from Government of Kenya	-	-	1,110	4,440	28,889	34,439
<b>TOTAL ASSETS</b>	<u>15,930</u>	<u>220,719</u>	<u>2,189</u>	<u>6,280</u>	<u>30,060</u>	<u>275,178</u>
<b>LIABILITIES</b>						
Currency in circulation	-	-	-	-	99,750	99,750
Deposits	131,141	-	-	-	-	131,141
International Monetary Fund	-	-	413	1,535	17,749	19,697
Amounts repayable under repurchase agreements	-	1,807	-	-	-	1,807
Other liabilities	-	4,529	-	-	-	4,529
Equity and reserves	-	-	-	-	18,254	18,254
<b>TOTAL LIABILITIES AND EQUITY</b>	<u>131,141</u>	<u>6,336</u>	<u>413</u>	<u>1,535</u>	<u>135,753</u>	<u>275,178</u>
<b>Liquidity gap 2008</b>	<u>-115,211</u>	<u>214,383</u>	<u>1,776</u>	<u>4,745</u>	<u>-105,693</u>	<u>-</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**29 RISK MANAGEMENT (continued)**

**Non-Financial Risk**

**f) 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).

**g) 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.

**h) 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.

**i) 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 2009 (continued)**

**30 SENSITIVITY ANALYSIS**

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.

**(i) Interest rate risk**

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. The Bank bases its analysis on the interest sensitivity gap (Note 29). 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:

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
Effect on profit before tax of a +13% change in interest rates	440	1,339
Effect on profit before tax of a -13% change in interest rates	(440)	(1,339)

**(ii) 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 29). 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.

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
Effect on profit before tax of a +7% change in exchange rates	16,093	13,250
Effect on profit before tax of a -7% change in exchange rates	(16,093)	(13,250)

**31 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 balance sheet date.



**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**31 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 2009 and 2008 were in the following ranges:

	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Government securities	6.64%	6.64%
Deposits with overseas correspondent banks		
- current accounts	0.0%	0.0%
- term deposits (USD)	1.72%	4.75%
- term deposits (Sterling Pounds)	2.48%	5.90%
- term deposits (Euro)F	2.58%	4.44%
Loans and advances - commercial banks	8.50%	8.50%
- Government of Kenya	8.50%	8.50%
- employees	3.0%	3.0%
Due from Government of Kenya	3.0%	3.0%
<b>Liabilities</b>		
- deposits	0.0%	0.0%

**32 CONTINGENCIES**

- (i) The Bank is party to various legal proceedings with potential liability of KShs 496.5 million as at 30 June 2009. 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. The directors are of the opinion that the liability will not crystallize because of the expected success of the request for waiver.

**33 COMMITMENTS**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
(a) Capital: Authorised and contracted for	<u>17</u>	<u>10</u>
(b) Capital: Authorised and not contracted for		
Office furniture	491	16
Office equipment	1,291	1,761
Computer equipment	1,136	1,372
Computer equipment - SIMBA Software	677	-
Computer equipment - SIMBA Hardware	261	-
Fixtures & fittings	158	121
Motor vehicles	53	143
Consultancy contracts	358	-
Plot acquisition & development	650	665
Others	<u>86</u>	<u>59</u>
	<b><u>5,161</u></b>	<b><u>4,137</u></b>

**CENTRAL BANK OF KENYA  
NOTES TO THE FINANCIAL STATEMENT  
FOR THE YEAR ENDED 30 JUNE 2009 (continued)**

**34 OPERATING LEASE COMMITMENTS**

**AS LESSEE:**

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

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
One year	11	11
Between two and five years	7	7
Over five years	<u>140</u>	<u>140</u>
	<b><u>158</u></b>	<b><u>158</u></b>

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

**35 EMPLOYEES**

The average number of employees during the year was 1,220 (2008: 1,255).

**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.

**37 COMPARATIVES**

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