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LETTER OF TRANSMITTAL TO THE HONOURABLE MINISTER FOR FINANCE

In accordance with Section 54 of the Central Bank of Kenya Act, I have the honour to present to you the Annual Report and Statement of the Audited Accounts of the Central Bank of Kenya for the financial year ended June 30, 2000.

The underlying inflation rate rose to 8.3% in the financial year from 5% the previous year. Although the rate exceeded the 5% target the Central Bank managed to contain it within single digits by intervening in the money market through open market operations. Budgetary operations, however, contributed to inflationary pressures. The fiscal deficit was higher than anticipated mainly as a result of poor revenue performance as the anticipated economic recovery was adversely affected by drought.

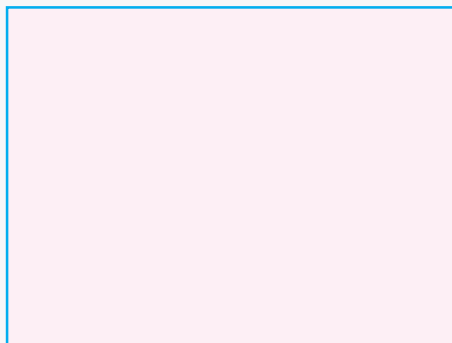
The balance of payments position recorded a surplus compared to a deficit last year. The favourable outcome in the balance of payments was due to an improvement in the current account which more than offset the deterioration in the capital account. The improvement in the current account reflected better performance in the services account which more than offset the widening deficit in the merchandise account. The decline in the capital account reflected mainly a decrease in official long-term capital inflows.

The overall performance of the banking sector was fair during 1999. The sector enjoyed relative stability in comparison to 1998. Three out of the five banks which had been placed under statutory management were successfully restructured. One non-bank financial institution was however placed under statutory management in September 1999.

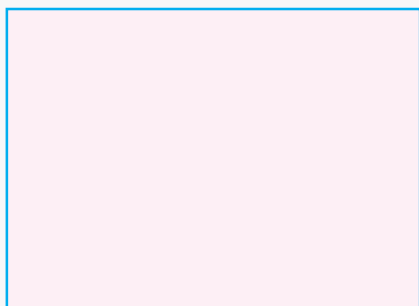
The Year 2000 (Y2K) millennium rollover in the banking sector was smooth with no major hitches.

MICAH CHESEREM
GOVERNOR

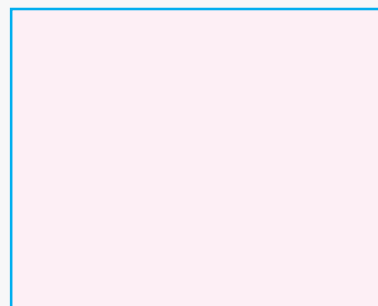
BOARD OF DIRECTORS



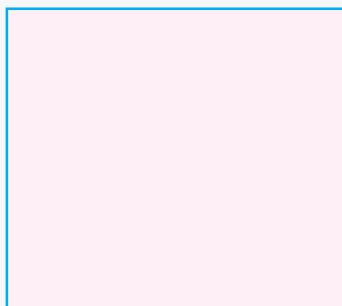
MICAH CHESEREM
*Governor and Chairman
Central Bank of Kenya*



DR. THOMAS KIBUA
*Deputy Governor
Central Bank of Kenya*



MARTIN ODUOR-OTIENO
*Permanent Secretary
Ministry of Finance*



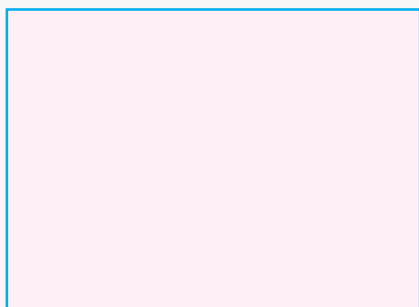
THOMAS KITHINJI
*Chairman and Chief Executive
Skylark Africa Insurance Brokers*



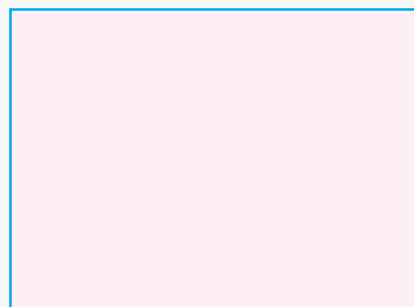
DR. RICHARD LEAKEY
*Secretary to the Cabinet and
Head of Civil Service*



JOHN MRAMBA
*Chairman, Communication
Concepts Ltd.*



PROF. FRANCIS KIBERA
University of Nairobi



ANDREW WANYANDEH
Businessman

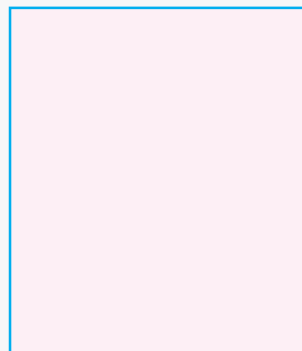
SENIOR MANAGEMENT



MAURICE KANGA
Director, Research



DANIEL KIANGURA
*Director, Management
Information Services*



JOSEPH KINYUA
Director, Financial Markets



MICHAEL CHERWON
Director, Finance



JOHN GIKONYO
*Bank Secretary & Director,
Human Resources*



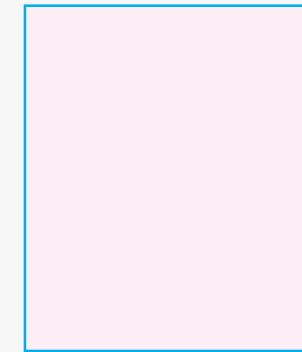
JONES NZOMO
Director, Banking



JOHN MURUGU
Director, Bank Supervision



JACINTA MWATELA (Mrs.)
Director, Supplies & Services



JAMES OGUNDO
*Director, Kenya School of
Monetary Studies*



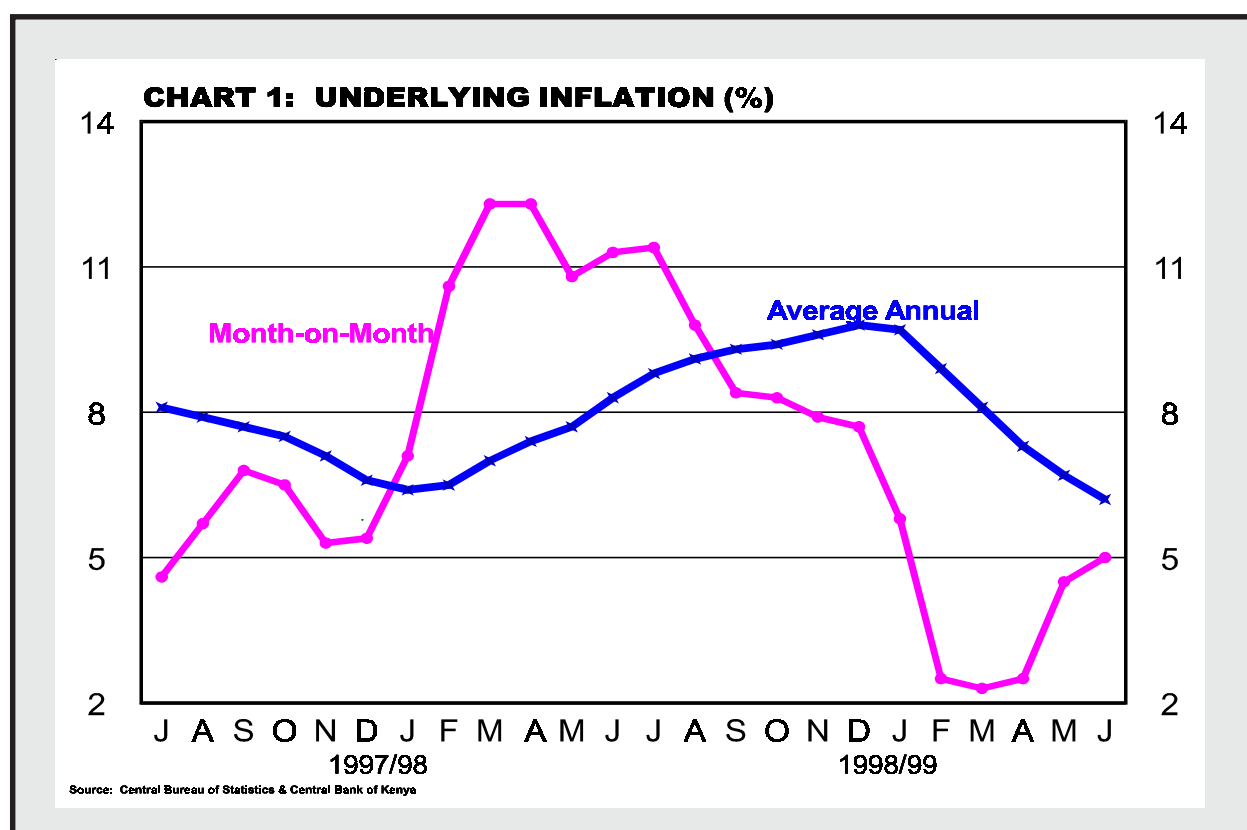
NICHOLAS KIRITU
Chief Internal Auditor

Inflation

Inflation was confined within single digits during the financial year 1999/2000. On a month-on-month basis, the underlying inflation, that is, the inflation caused by monetary and fiscal policies, was 8.3% in June 2000 and above the policy target of 5%. The overall inflation, which measures inflation arising from both policy and non-policy factors such as drought induced changes in food prices, was 6% in June 2000 compared with 1.8% in June 1999.

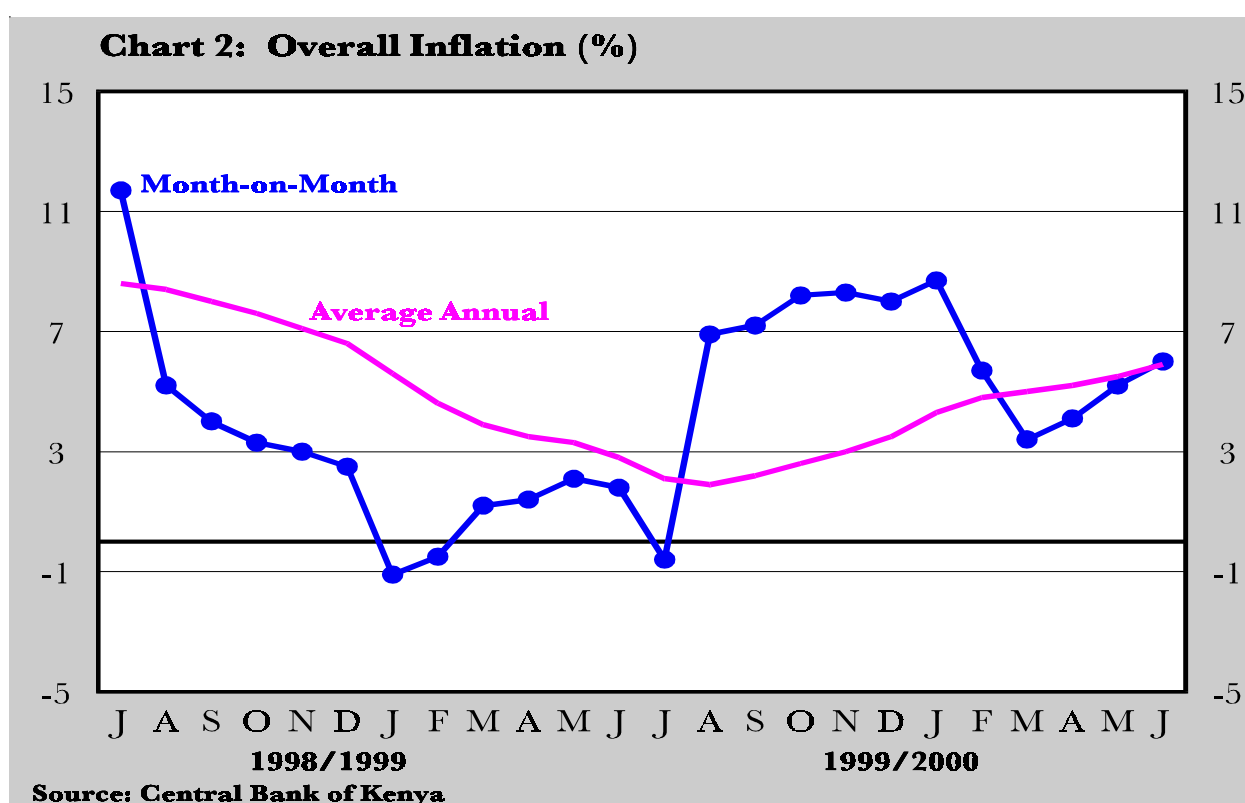
Underlying Inflation

The underlying month-on-month inflation increased from 4.9% in July 1999 to 8.3% in June 2000 against the target of 5% for the financial year. The underlying average annual inflation also increased from 5.7% in July 1999 to 6.7% and 7.3% in March and June 2000, respectively. The increase in the underlying inflation was due to the shilling exchange rate depreciation and the associated increases in cost of fuel products over the review period that affected prices of most consumer items. The tight monetary policy stance maintained during the period, however, helped contain the underlying inflation within single digits (Chart 1).



Overall Inflation

The overall month-on-month inflation accelerated from a low of negative 0.6% at the beginning of the financial year to 8.7% in January 2000, but fell to 3.4% in March before rising again to 6.0% in June 2000. The overall average annual inflation increased throughout the financial year reaching 4.3% in January, 5.0% in March and 5.9% in June 2000. The acceleration of the overall inflation during the financial year followed the effects of the shilling exchange rate depreciation and the increased cost of food items resulting from poor agricultural production, occasioned by the prolonged drought.

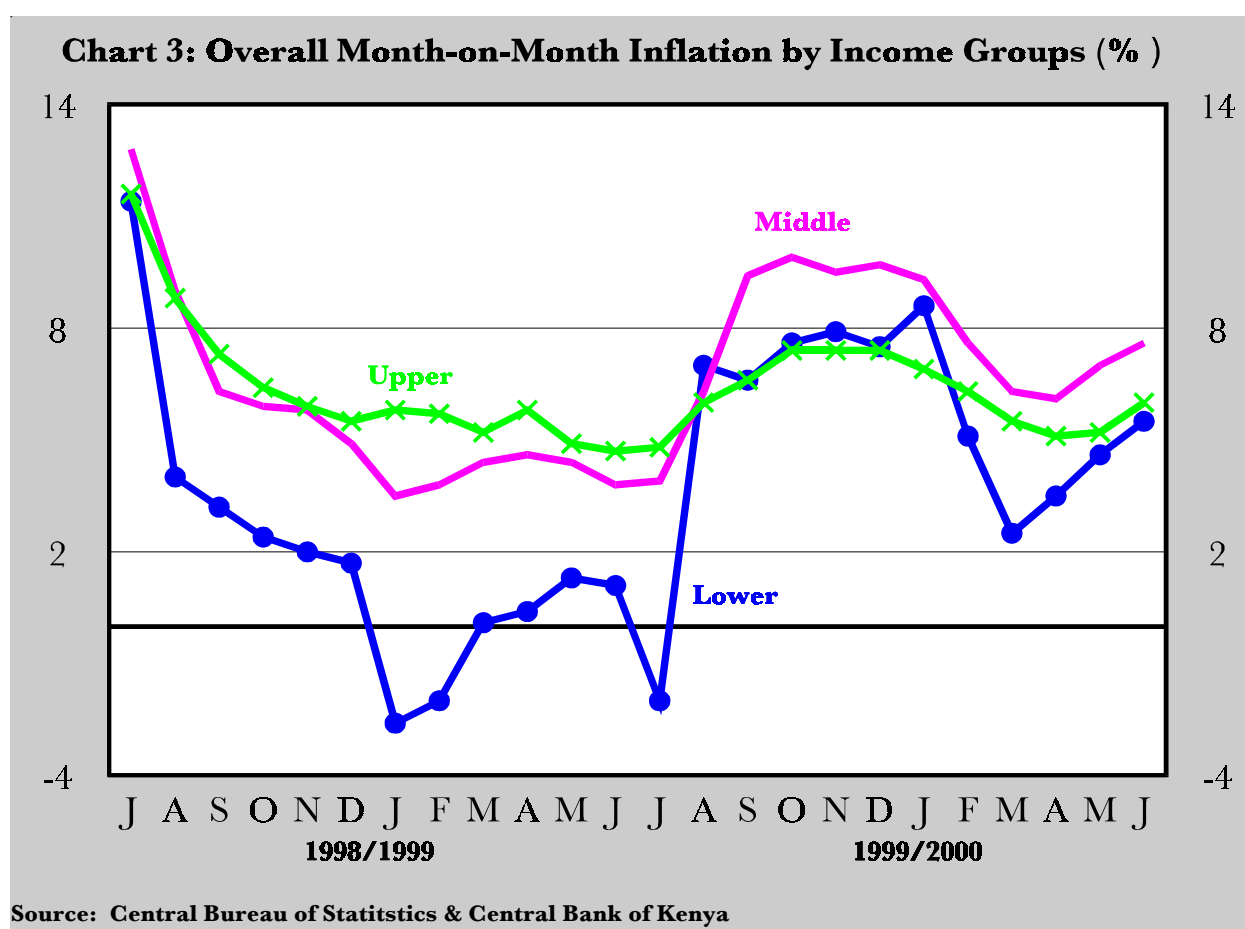


Impact of Inflation on Income Groups in the Financial Year

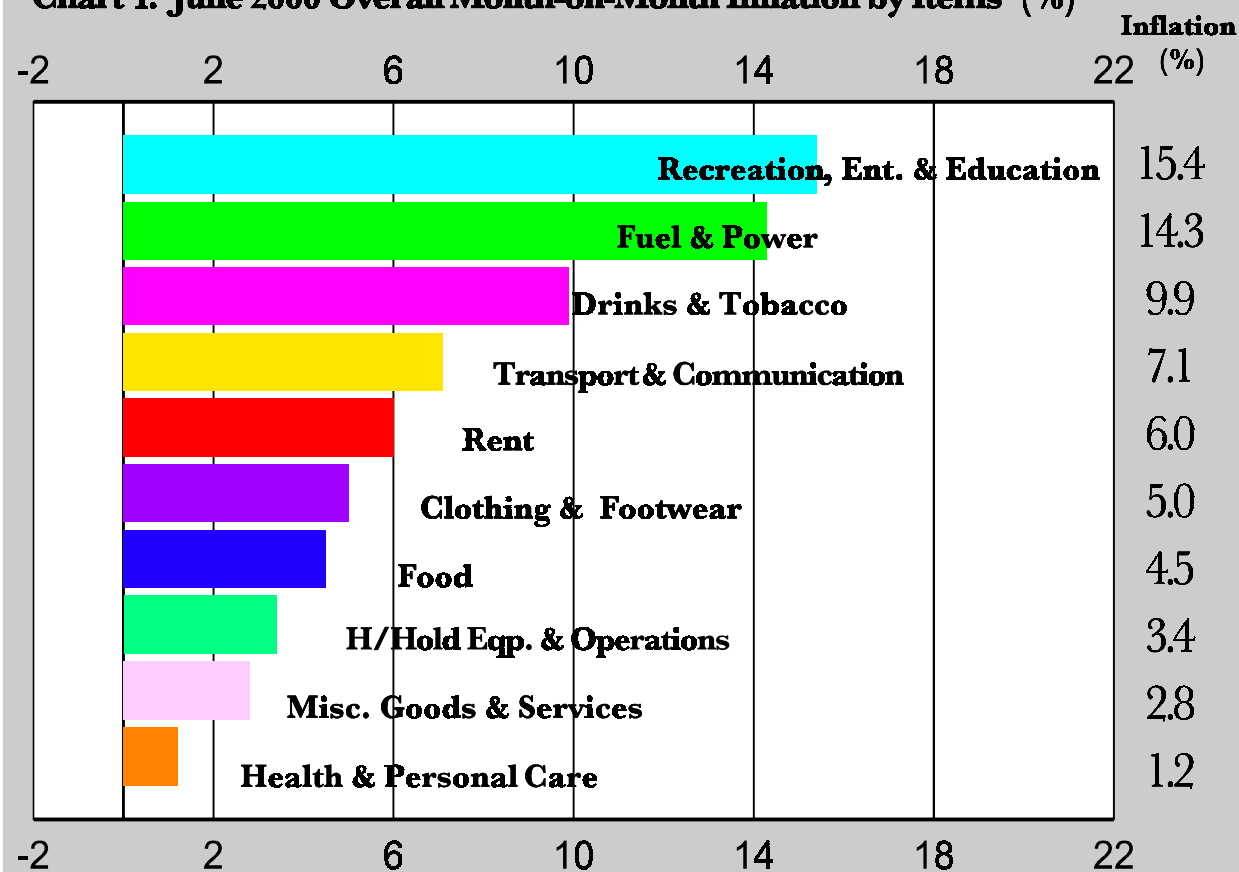
The impact of inflation on the three income groups, in the financial year to June 2000, was as follows:

- Lower income group inflation accelerated from negative 2.0% in July 1999 to 8.6% in January 2000, but fell to 2.5% in March, before rising again to 5.5% in June;

- Middle income group inflation increased from 3.9% in July to 9.9% and 9.3% in October 1999 and January 2000, respectively, but fell to 6.3% in March before rising to 7.6% at the end of the financial year; and
- Inflation for the upper income group increased from 4.8% in July 1999 to 7.4% in December, but eased to 5.1% in April 2000 before rising to 6.0% in June (Chart 3).



During the financial year, inflation in fuel products, recreation, entertainment and education, accelerated to double digits. Drinks, tobacco and transport services also experienced relatively high inflation. Inflation in food, the highest weighted item in the consumer price index, accelerated from negative 4.1% in July 1999 to 4.5% in June 2000 (Chart 4).

Chart 4: June 2000 Overall Month-on-Month Inflation by Items (%)

Source: Central Bureau of Statistics & Central Bank of Kenya

Outlook for Inflation in Financial Year 2000/2001

The current upward trend in inflation is expected to continue in the short-run, if the drought and the shilling depreciation persists. Inflation is, however, expected to ease in the medium-term, with the month-on-month underlying inflation forecast at below the 5% target by June 2001.

The forecast fall in inflation to within target is expected, mostly, from prudent management of monetary policy that will seek to constrain growth in money supply (M3) to no more than 7.8%, in the financial year, in line with the expected slowdown in economic growth. The impact of the tight monetary policy stance on inflation will be reinforced by the envisaged stability of the shilling as investor confidence builds up and foreign capital inflows improve. The fiscal measures contained in the 2000/01 Budget, particularly the reduction of duty on various industrial raw materials and inputs and the suspension of import duty on maize, are also expected to ease inflationary pressures.

Interest Rates

Interest rates rose and later declined during the twelve months to June 2000 compared to the general decline in the year to June 1999. The increase in interest rates during the first half of the year reflected higher borrowing by the Government from the domestic money market to finance the budget deficit (Table 1 and Chart 5).

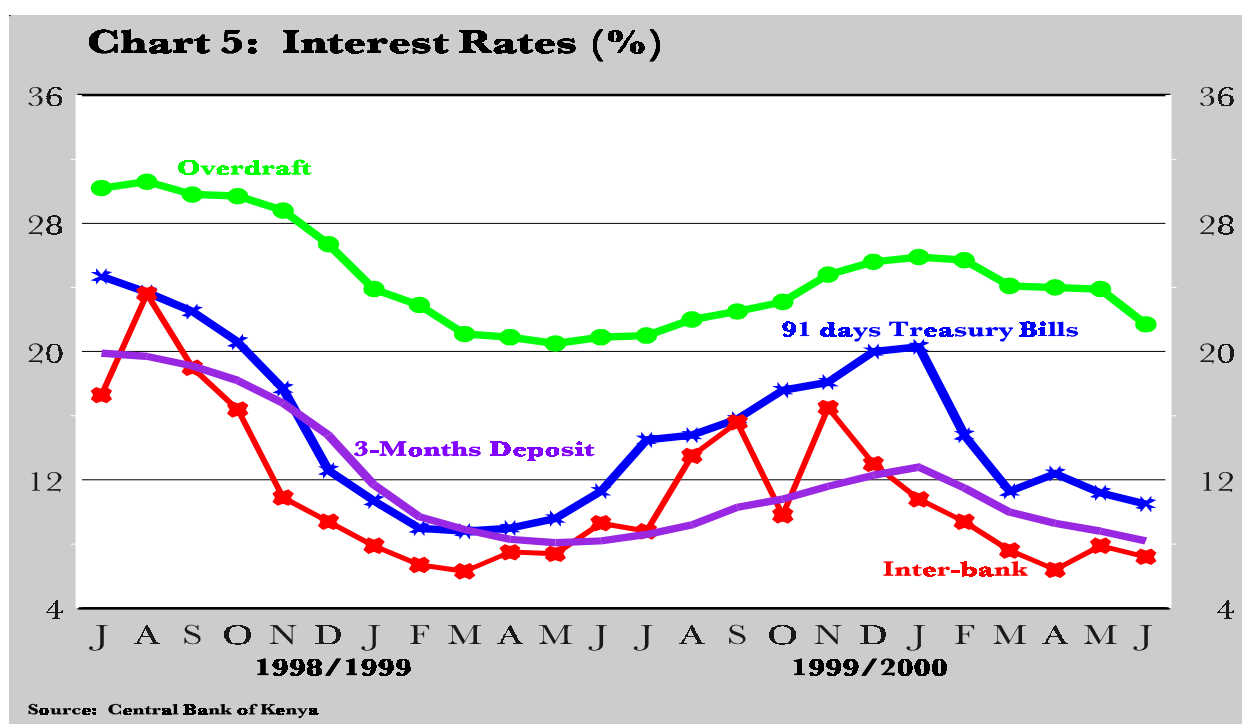
Table 1
Interest Rates (%)

	1999						2000					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Overdraft	21.0	22.0	22.5	23.1	24.8	25.6	25.9	25.7	24.1	24.0	23.9	22.9
91-days Treasury bill	14.5	14.8	15.8	17.6	18.1	20.0	20.3	14.8	11.3	12.4	11.2	10.5
182-days Treasury bill	12.4	15.2	15.4	16.1	17.6	18.8	19.7	15.2	11.6	-	11.7	-
1 year Treasury bond	9.1	-	11.1	12.1	-	16.5	16.3	14.9	20.1	-	-	16.3
Inter-bank rate	8.8	13.5	15.2	9.8	16.5	13.0	10.8	9.4	7.6	6.4	7.9	6.7
3 months deposits	8.6	9.2	10.3	10.8	11.6	12.3	12.8	11.5	10.0	9.3	8.8	7.8
Savings	5.1	4.8	5.3	5.7	6.0	6.2	6.4	6.0	5.1	5.3	4.8	4.8

Source: Central Bank of Kenya

However, the trend reversed in the second half of the year:

- There was excess liquidity in the domestic money market from November 1999 through April 2000. The excess liquidity reflected increases in the precautionary demand for reserves by the banking institutions due to the need to hedge against the risk of collapse of computerised banking services at the turn of the last Century. In addition, there was an unusually large demand by the non-bank public for cash to finance end year festivities.
- There was slowdown in demand for bank credit by the private sector due to slack economic growth during the fiscal year.
- Speculative bidding for the weekly issues of Government Treasury bills also accelerated the decline in the Treasury bill interest rate. The Central Bank and the Treasury however moderated the decline in the Treasury bill rate following the ongoing rationalization of the weekly borrowing requirement by Government.



Developments in the interest rates were as follows:

- The interest rate on the 91 days Treasury bill rose from 11.4% in June 1999 to 20.3% in January 2000 before declining gradually to 10.5% in June 2000.
- The overnight inter-bank interest rate fell to 6.7% in June 2000 from 9.3% in June 1999.
- The trends of commercial banks' interest rates reflected the movement in the interest rate on the 91 days Treasury bill:
 - Interest on 3-month term deposits with commercial banks rose from 8.2% in June 1999 to 12.8% in January 2000 before declining to 7.8% in June 2000.
 - The overdraft rate rose from 21% in June 1999 to 25.9% in January 2000 and thereafter declined gradually to 22.9% by June 2000.
 - The savings deposit rate increased from the 4.6% in June 1999 to 6.4% in January 2000 before a gradual decline to 4.8% by June 2000. However, with inflation running at 8% by June 2000, the interest rate on savings was negative in real terms.

The level of interest rates in the months ahead will largely be determined by the improvement in efficiency of banking services, economic recovery and the stance of monetary policy in containing inflation.

Exchange Rate

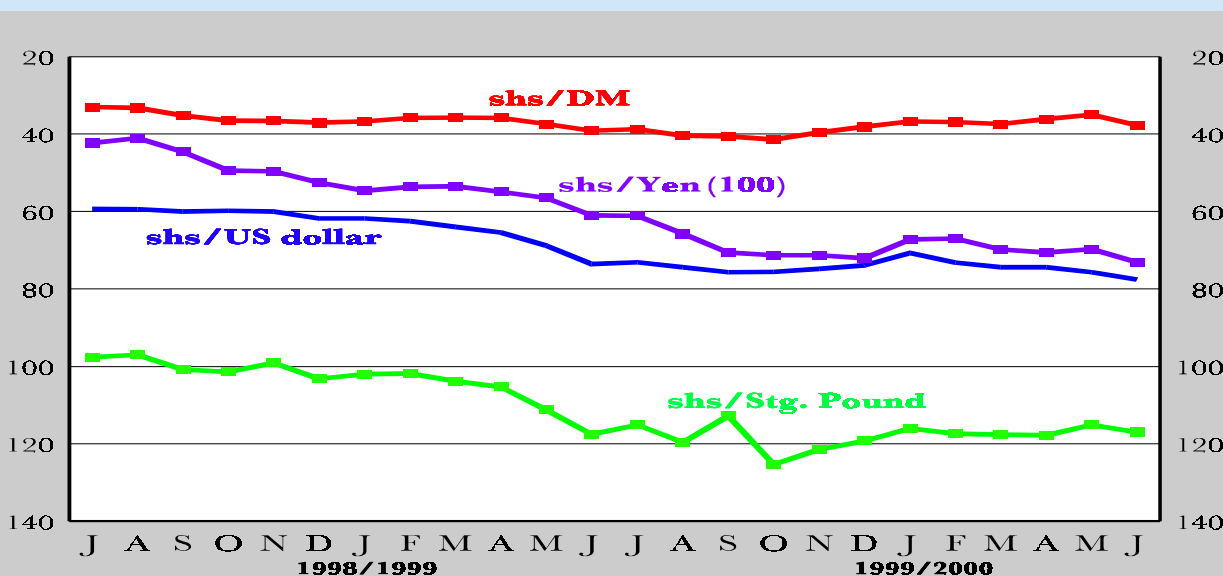
The shilling exchange rate had a mixed performance in the year to June 2000. Against the US dollar and the yen, the shilling weakened by 5.3% and 19.8%, respectively, compared with losses of 21.6% and 41.2% in the previous year (Table 2 and Chart 6). Meanwhile, the shilling gained by an average of 2.5% against the other major currencies, notably, the Sterling pound, Deutschemark and the Euro.

Kenya Shilling Exchange Rate

Table 2

	1998			1999			2000		% Change Jun-99 - Jun-00
	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun	
Kshs/US\$	61.2	60.5	61.8	61.8	73.6	73.9	70.7	77.5	5.3
Kshs/Stg.£	100.1	99.8	103.2	102.0	117.5	119.3	116.0	117.0	-0.4
Kshs/DM	33.8	33.8	37.0	36.7	39.1	38.1	36.7	37.7	-3.6
Kshs/Yen (100)	47.2	43.2	52.5	54.6	61.0	72.1	67.2	73.1	19.8
Kshs/Euro	68.7	68.0	69.5	71.8	76.4	74.9	71.8	73.7	-3.5

Chart 6



Source: Central Bank of Kenya

Consequently, the trade-weighted average shilling exchange rate weakened by 3.5% compared with 16.1% in the preceding year. In real terms, however, the shilling remained stable compared with a depreciation of about 13.6% in the previous year, owing to higher domestic inflation in the year.

The underlying economic conditions affecting the shilling exchange rate during the year included:

- Low domestic interest rates on Government paper which discouraged capital inflows. The 91 day Treasury bill fell to 10.2% in June 2000 from 20.9% in June 1999;
- Expectations of further shilling exchange rate depreciation following the delay in donor funding and impact of drought; and
- Strong Central Bank commitment to greater flexibility in the determination of the exchange rate by market forces. During the year, the Central Bank participation in the foreign exchange market was only restricted to servicing the Government's external debt.

In the international currency market, the US dollar had mixed performance in the year. It gained against the euro and the sterling pound by 12.2% and 3.0% , respectively, compared with losses of 2.5% and 0.1% in the previous year. Against the Japanese yen, however, the US dollar weakened by 13.0% compared with a loss of 2.4% in the previous year (Table 3 and Chart 7).

The strengthening of the US dollar against the euro and the sterling pound reflected the following:

- Continued strong economic growth and low-inflation in the United States of America.
- Rise in US trend productivity growth relative to that of the euro area, which caused investment capital to flow into the USA.
- Concerns that the formulation and transmission of monetary policy within the Euro-zone would become more complicated as the number of countries joining the Euro area increases.
- An increase in interest rates by Federal Reserve Bank during the year.
- Relatively low interest rates in the United Kingdom. The Bank of England has steadily maintained interest rates at 6.0% in an attempt to make the sterling pound relatively weak and therefore make exports more competitive and also to reverse the slowdown in economic growth.

The weakening of the US dollar against the yen, on the other hand, reflected Japan's increased trade surplus during the year as US trade deficit widened.

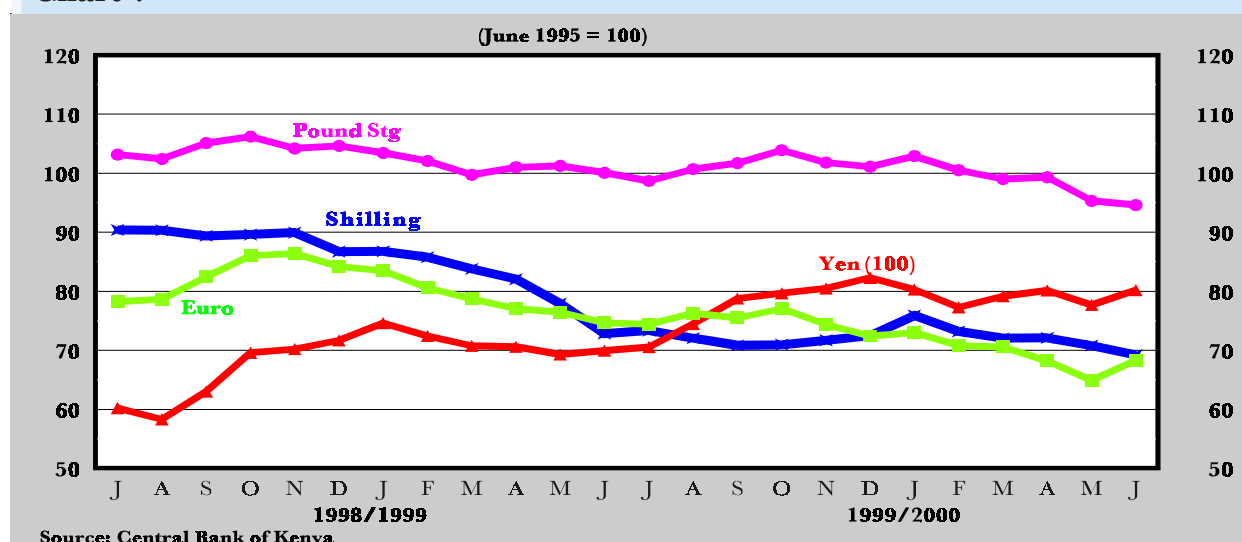
Major International Currencies Against the US Dollar

Table 3

	1998			1999			2000	
	Jan	Jun	Dec	Jan	Jun	Dec	Jan	Jun
Pound Sterling	0.611	0.606	0.599	0.606	0.626	0.620	0.609	0.663
Deutschemark	1.812	1.791	1.671	1.684	1.884	1.943	1.926	2.056
100 Japanese Yen	129.7	140.2	117.8	113.2	120.7	102.6	105.1	105.3
Uganda Shilling*	1147.4	1230.3	1365.8	1365.4	1445.3	1501.8	1505.7	1575.8
Tanzania Shilling*	630.6	663.3	678.6	681.6	716.2	797.5	799.1	799.6
Euro	0.927	0.916	0.854	0.861	0.963	0.988	0.984	1.053

* units of currency per Kenya shilling

Chart 7



Further depreciation of the shilling is expected in the first quarter of the financial year 2000/01 as the full impact of the drought is manifested in the increased demand for foreign exchange to finance food and power-related imports. The expected inflows associated with the IMF's Poverty Reduction and Growth Facility (PRGF) are, however, likely to moderate the shilling depreciation and eventually result in a modest appreciation of the exchange rate towards the end of the financial year 2000/01.

Government Fiscal Operations

The 1999/2000 budget emphasized the need for the Government to keep public expenditure in line with public revenues with the aim of ultimately achieving a surplus and thereby reducing the large domestic debt (Table 4). The budget projected, on a cash basis, a deficit of shs 4.0bn or 0.5% of GDP which was to be realized through adoption of stringent fiscal restraint as revenue performance was expected to be poor in line with the anticipated slow economic recovery. While revenue performance fell below target as the anticipated economic recovery was hampered by drought, the Government was able to contain its expenditure to below budgetary estimate during the fiscal year. This resulted in an overall budget surplus of shs 1.9bn or 0.2% of GDP, an improvement over the projected shs 4.0bn budget deficit.

Revenue and Grants

Total Government revenue excluding grants in 1999/2000 fiscal year amounted to shs 177.0bn or 22.8% of GDP. This was a decline over the 1998/99 level of shs 196.3bn or 26.5% of GDP. The poor revenue performance was mainly due to a shs 11.9bn decline in non-tax receipts as tax revenue collections improved. The performance of taxes was as follows:

- Value added tax improved from shs 39.2bn in 1998/99 to shs 41.0bn following the rationalisation of the VAT rate which mitigated the impact of a 1% reduction in the standard VAT rate from 16% to 15%.
- Revenue from import and excise duty remained unchanged at shs 57.1bn. Import duty recorded a shs 0.2bn increase which was however offset by a shs 0.2bn decline in excise duty. The improvement in import duty was mainly attributed to greater efficiency in collection, which has greatly reduced duty evasions.
- Income tax receipts however amounted to shs 54.4bn which was shs 0.8bn lower than the previous year. This reflected a decline in corporate taxes as most companies registered lower profits during the period.

The Government also collected other receipts during the year comprising:

- Non-tax receipts which amounted to shs 10.0bn compared with shs 21.9bn in 1998/99. The decline followed a fall of shs 14.6bn in investment income particularly from the Central Bank following freezing of part of Government debt at the Bank to non-interest bearing debt for use by the Bank for monetary policy operations.
- User charges, fees and other levies amounted to shs 14.5bn and were shs 8.2bn lower than in the last fiscal year.

Table 4: Budget Out-turn (Shs Bn)

	FY 1998/1999		FY 1999/2000		Printed Est.	Over(+)/ Below (-)
	Jun-99		Jun-00			
	Actual	Share (%)	Actual*	Share (%)		
1. TOTAL REVENUE & GRANTS	201.2		181.2		198.8	-17.6
Revenue	196.3	97.6	177.0	97.7	193.0	-16.0
Ordinary Revenue	173.6	86.3	162.5	89.7	174.6	-12.1
Tax Revenue	151.6	75.4	152.5	84.1	162.0	-9.5
Income Tax	55.2	27.5	54.4	30.0	58.7	-4.3
Value Added Tax	39.2	19.5	41.0	22.6	41.3	-0.3
Import Duty	28.4	14.1	28.6	15.8	30.7	-2.0
Excise Duty	28.7	14.3	28.5	15.7	31.4	-2.9
Non Tax Revenue	21.9	10.9	10.0	5.5	12.7	-2.7
Investment Income	14.9	7.4	0.3	0.2	1.9	-1.5
Others	7.0	3.5	9.7	5.3	10.8	-1.1
Appropriations-in-Aid	22.7	11.3	14.5	8.0	18.4	-3.9
External Grants	4.9	2.4	4.2	2.3	5.8	-1.6
2. TOTAL EXPENDITURE AND LENDING	197.3		176.9		201.7	-24.8
Recurrent Expenditure	165.3	83.8	158.3	89.5	162.2	-3.9
Domestic Interest	31.7	16.1	22.1	12.5	19.8	-12.7
Foreign Interest due	8.3	4.2	8.6	4.9	9.2	-11.2
Wages and Salaries	63.3	32.1	67.0	37.9	67.7	-0.7
Others	62.0	31.4	60.6	34.3	65.6	20.6
Development Expenditure	32.0	16.2	18.6	10.5	39.5	-20.9
3. DEFICIT (-) ON A COMMITMENT BASIS (1-2)	3.8		4.3		-2.9	7.2
as a ratio of GDP (%)	0.5		0.5		-0.4	
4. ADJUSTMENT TO CASH BASIS	-6.1		-2.7		-1.1	
5. DEFICIT (-) ON A CASH BASIS	-2.3		1.6		-4.0	5.6
As a ratio of GDP (%)	-0.3		0.2		-0.5	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	0.0		-0.3		0.0	
7. FINANCING	2.3		-1.9		4.0	-5.9
Domestic (Net)	11.1		17.5		13.7	3.8
Central Bank	-0.4		-10.0			
Commercial Banks	12.8		3.2			
Other domestic sources:	-1.3		24.3			
Non Banks	-1.3		18.7			
Capital Receipts (privatisation)	0.0		5.7		1.5	4.2
External (Net)	-8.8		-19.4		-9.7	9.7
Loan Disbursements	12.2		8.8		22.5	-13.7
Loan Repayments	-21.0		-28.2		-32.2	-4.0

* Provisional

Source: Treasury and Central Bank of Kenya

In addition to the revenue, the Government received external grants during the year amounting to shs 4.2bn, representing a shs 0.7bn decline over the last fiscal year.

Expenditure and Net Lending

During the fiscal year, the Government adopted stringent expenditure controls and consequently expenditure and net lending declined to shs 176.9bn, 22.8% of GDP from shs 197.3bn or 26.7% of GDP in 1998/99. The decline reflected the following developments:

- Recurrent expenditure fell by shs 7.0bn to shs 158.3bn and comprised:
 - Expenditure on wages and salaries of shs 67.0bn compared with shs 63.3bn in the previous fiscal year.
 - Interest payments of shs 30.7bn compared with shs 40.0bn in 1998/99. Interest on domestic debt amounted to shs 22.1bn while shs 8.6bn was foreign interest payments.
- Development expenditure amounted to shs 18.6bn and was shs 13.4bn lower than in the last fiscal year.

Financing

Government fiscal operations in 1999/2000 resulted in a shs 1.9bn budget surplus on a cash basis representing 0.2% of GDP. This reflected an improvement in fiscal performance compared with 1998/99 when Government fiscal operations in absolute terms resulted in a deficit of shs 2.3bn or 0.3% of GDP. Net foreign financing during the review period amounted to a net repayment of shs 19.4bn. The budget surplus reduced the resource gap for the year to shs 17.5bn compared with shs 11.1bn in 1998/99. The resource gap was financed entirely from domestic sources comprising:

- Domestic borrowing of shs 11.8bn of which borrowing from commercial banks and non-bank public amounted to shs 3.2bn and shs 18.7bn respectively while borrowing from the Central Bank declined to a net repayment of shs 10.0bn; and
- Privatization proceeds of shs 5.7bn from the ongoing Government divestiture programme.

Domestic Debt

Total domestic debt increased by shs 12.9bn or 8.6% to shs 163.4bn at end of June 2000 from shs 150.5bn in June 1999 (Table 5). The increase arose from higher domestic borrowing requirements in the absence of external financing resources as the Government continued to make net external debt repayments throughout the financial year. The situation was exacerbated by depreciation of the shilling which increased the external

Table 5: Government Domestic Debt

	June 1999		June 2000	
	shs bn	%	shs bn	%
Overdraft/Advances	9.0	6.0	15.2	9.3
Treasury Bills	101.7	67.6	131.0	80.2
Treasury Bonds	28.2	18.7	36.9	22.6
Government Stocks	3.4	2.3	3.0	1.8
Non-interest bearing debt	31.9	21.2	20.0	12.2
Less Deposits	18.1	12.0	37.0	22.7
Less Advances to Parastatals	5.7	3.8	5.7	3.5
NET DOMESTIC DEBT	150.5	100.0	163.4	100.0

Source: Treasury & Central Bank of Kenya

debt service in shilling terms thereby necessitating higher domestic borrowing. The increase in domestic debt arose from the following changes in its structure during the year:

- Overdraft at the Central Bank increased to shs 6.5bn in June 2000 from shs 5.6bn in June 1999 but remained within the statutory limit of shs 6.9bn.
- Outstanding Government securities increased by shs 37.6bn during the year mainly as a result of conversion of part of Government non-interest bearing debt into Treasury bills.
- Cleared items awaiting debiting to the Paymaster General Account increased by shs 5.3bn from shs 0.7bn to shs 6.0bn.

The increase in domestic debt was however partially offset by the following:

- An increase of shs 18.9bn in Government deposits from shs 18.1bn to shs 37.0bn;
- A decline of shs 11.9bn in Government non-interest bearing debt from shs 31.9bn in June 1999 to shs 20.0bn in June 2000 following conversion of part of the debt to Treasury bills by the Central Bank for use in its monetary policy operations; and
- A shs 0.1bn decline in commercial banks advances to Government from shs 2.7bn to shs 2.6bn.

Domestic debt remained heavily skewed towards short-term debt instruments throughout the review period. This was attributed to the volatility in the 91-days Treasury bill rate, the benchmark on which interest on other Government securities is determined. The fluctuations discouraged investment in the longer maturity 182-days bill whose demand completely fizzled out in February 2000. Investment in the longer-term Treasury bonds was also adversely affected as interest on these instruments adjust to changes in the 91-days Treasury bill rate with a lag. The following developments occurred in the Government securities market:

- The outstanding stock of Treasury bills increased by shs 29.3bn to shs 131.0bn in June 2000.
- Treasury Bonds increased by shs 8.7bn to shs 36.9bn.
- Government stocks fell by shs 0.4bn to shs 3.0bn. This was due to a redemption during the year in line with the policy of phasing them out by 2010.

Domestic Debt Service

Government domestic debt service in the 1999/2000 fiscal year amounted to shs 22.1bn compared with shs 31.7bn in 1998/99. The decline reflected the fall in the 91-days Treasury bill rate in the twelve months to March 2000 when it averaged 14.8% compared with 19.1% in the twelve months to March 1999. The impact of the lower domestic interest rates was however dampened by increased domestic borrowing during the year.

Of the shs 22.1bn domestic debt service, interest payments on Treasury bills were shs 16.8bn or 76.0% of the total. Interest paid on Treasury bonds and Government overdraft was shs 4.1bn and shs 0.8bn respectively while interest payments on outstanding Government stock were shs 0.3bn during the year.

As a proportion of Government expenditure, domestic interest payments in the year were 12.5% compared with 16.1% and 15.6% in 1998/99 and 1997/98 respectively. The decline in domestic debt service released resources towards other uses including servicing of external debt which would have called for more domestic borrowing in view of the decline in the Government revenue during the fiscal year.

Balance of Payments

The overall balance of payments in the year to June 2000 recorded a surplus of US\$ 212m compared with a deficit of US\$ 63m in the year to June 1999. The favourable development in the balance of payments was due to improved performance of the current account, which more than offset the deterioration in the capital account (Table 6 and Chart 8).

The Current Account

The current account deficit narrowed to US\$ 22m (0.4% of GDP) in the year to June 2000 from US\$ 419m (5.0% of GDP) in the year to June 1999. The improvement in the current account reflected better performance in the services account which more than offset the widening in the trade deficit.

Merchandise Trade

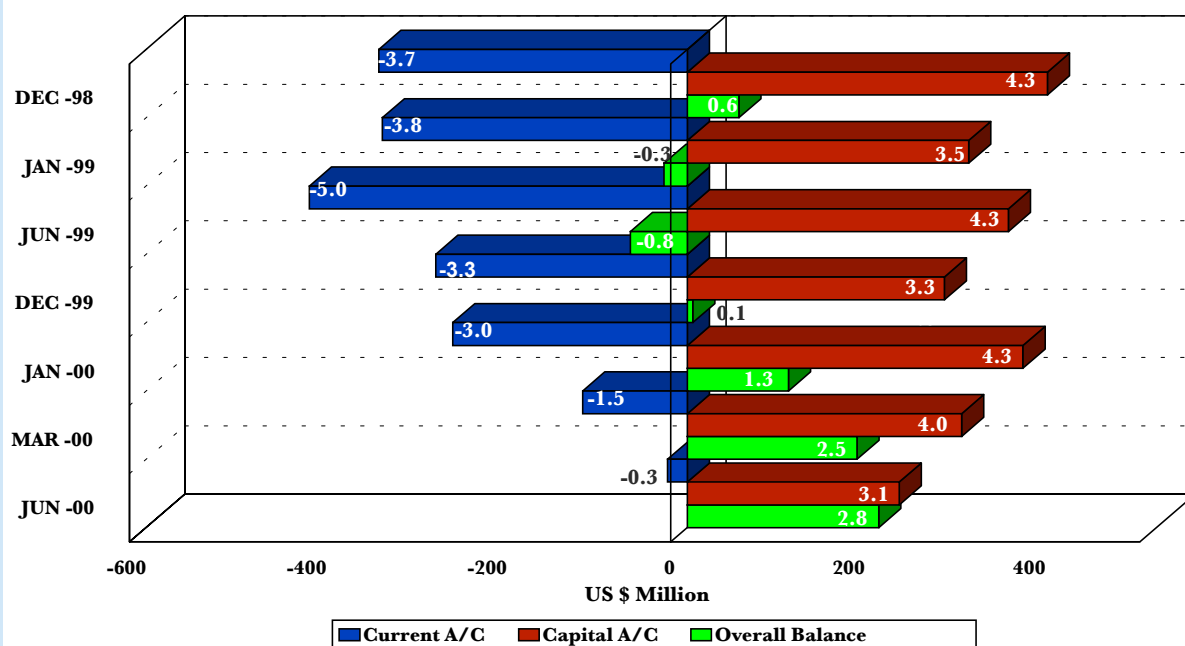
The period July 1999 to June 2000 recorded declines in both imports and export following the weak economic performance. Exports declined by 16% while imports fell by 8%. The accelerated decline in exports relative to imports in the year to June 2000 led to a widened trade deficit of US\$ 1,258m compared with US\$1,205m in the same period of the previous year.

Table 6: Balance of Payments (US\$ M)

	1997/98	1998/99	1999/00*
1. Overall Balance (2+3)	-194	-63	212
2. Current Account	-138	-419	-22
Trade Balance	-1,055	-1,205	-1,258
Exports	2,006	1,927	1,623
Imports	3,061	3,132	2,881
Services (net)	917	786	1,236
<i>of which tourism</i>	350	254	306
3. Capital Account	-56	356	235
Official	-178	-199	-177
Inflows	248	258	264
Outflows	426	457	441
Private & net errors and omissions	122	554	412
Memorandum:			
Gross Reserves	1,083	997	1,208
Official	771	657	808
<i>in months of import cover</i>	3.0	2.5	3.4
Commercial Banks	311	340	401

* Provisional

Source: Central Bank of Kenya

Chart 8: Overall Balance of Payments and Its Components (US\$ M)

Source: Central Bank of Kenya

Exports

Despite the weakening of the Kenya shilling against the major currencies in the year to 2000, export performance declined by 16%. The decline was evident in all export categories. Coffee and tea, Kenya's traditional exports accounting for about 47% of all exports, fell by 5% and 2%, respectively, during the year. The fall in earnings from coffee emanated mainly from slump in world prices from US\$ 2,805 per tonne in the year to June 1999 to US\$ 1,917 in the year to June 2000. Output of coffee, however, improved by 34.9% to 78,048 tonnes in the twelve months to June 2000 from 57,837 tonnes in the year to June 1999. Consequently, coffee export earnings fell to US\$ 154m in the year to June 2000 from US\$ 162m in the previous year.

Earnings from tea exports also fell following decline in volume owing to poor weather conditions in the second half of the year. World prices for tea, however, increased from US\$ 1,770 per tonne in the year to June 1999 to US\$ 2,032 in the year to June 2000. Earnings from tea were US\$ 490m in the year to June 1999 compared with US\$ 480m in the year to June 2000.

Partly due to poor weather conditions, exports of non-traditional commodities, particularly horticulture, declined despite the measures put in place to enhance their competitiveness in world markets. Earnings from horticulture fell to US\$ 161m in the year to June 2000 from US\$ 193m in the year to June 1999.

The share of merchandise exports from Kenya to United States declined by 12.1% while exports to European countries increased by 5.9%. The growth

of exports to the regional market, especially to Uganda and Tanzania, also declined by 2.8%. Kenya continued to maintain its share of exports to the new markets, especially Middle and Far East as well as Australia but its share of exports to South Africa declined.

Imports

All categories of imports except oil declined in the year to June 2000 mainly due to sluggish performance in economic activity. Chemicals, manufactured goods, machinery and transport equipments declined by 8%, 14% and 5%, respectively. Decline in imports was also noticed in the case of other categories of imports. Oil imports, however, rose by 40 % and reflected the substantial increase in international oil prices during the year.

The share of imports from traditional sources such as Europe, the United States (USA), Italy, France, Japan and Arab emirates declined by 10.4% while those from non-traditional sources such as Saudi Arabia and South Africa increased by 3.8%. Imports from South Africa, in particular, showed a dramatic rise of 20% during the year.

Invisibles

Invisible receipts recorded a growth rate of about 57% during the year to June 2000. The growth in invisibles was supported by a rise in tourism earnings, buoyant private transfer receipts and reduction in interest payments. Tourism earnings rose by US\$ 52m to US\$ 306m from US\$ 254m in the year to June 2000 owing mainly to lifting of visa requirements, improved security situation and positive publicity abroad. Tourist arrivals, which had suffered a serious setback since 1997, showed a modest recovery in 1999/2000. It grew by 13% compared with the decline of 10 % in the previous year. This trend is expected to accelerate in 2000/2001.

Transfer earnings rose by US\$ 263m from US\$ 541m to US\$ 804m, mainly due to the increase in private grants. The rise in private transfer receipts from US\$ 472m to US\$ 163m was attributed to the compensation paid to the 1998 bomb blast victims. These receipts are expected to remain buoyant in 2000/2001 following appeals for emergency food relief as a result of drought that has prevailed since the beginning of the year 2000.

Official interest payments, on the other hand, declined by US\$ 59m from US\$ 187m in the year to June 1999 to US\$ 128m in the year to June 2000 following a gradual decline in the stock of external debt. Payments of investment income, a smaller component of invisible payments, together with the repatriation of dividends and profits from foreign investments in the country, however, rose from US\$ 26m in the year to June 1999 to US\$ 36m in the year to June 2000.

Capital Account

The capital account declined to a surplus of US\$ 235m in the year to June 2000 from a surplus of US\$ 356m in the year to June 1999. The decline in the capital account mainly reflected decline in private capital inflows by US\$ 142m. Official long-term capital inflows increased marginally by US\$ 6m from US\$ 258m in the year to June 1999 to US\$ 264m in the year to June 2000. Most of these inflows are project loans. No program loans were received during the year. Official capital outflows declined marginally from US\$ 457m in the year to June 1999 to US\$ 441m in the year to June 2000. The decline in private capital inflows was mainly a reflection of the following factors:

- Decline in interest rates that consequently reduced the yields on the Treasury bills thereby making foreign investment in Treasury bills less attractive. Interest rates on 91- day Treasury bill dropped from an average of 14.5% in July 1999 to 10.5% in June 2000.
- Fall in share prices at the Nairobi Stock Exchange (NSE). The NSE Share Index fell by 25.5% to 2052.9 in June 2000 from 2756.43 in June 1999 thereby making foreign investment in the capital markets also less attractive.

Foreign Exchange Reserves

Following favourable developments in the balance of payments, foreign exchange reserves of the banking system rose by US\$ 211m to stand at US\$ 1256m (equivalent to 5.0 months of imports of goods and non-factor services) at end June 2000 compared with US\$ 997m at end June 1999. Out of the total reserves, gross official foreign exchange reserves were US\$ 808m at end of June 2000 compared with US\$ 657m a year earlier. The foreign exchange reserves of commercial banks were US\$ 401m at end of June 2000 compared with US\$ 340m at end of June 1999.

External Debt

External debt indicators moved favourably, reflecting repayments of scheduled external debt obligations and substitution, on a relatively small scale of debt-creating capital flows for non-debt creating inflows such as the foreign direct investment. Kenya's stock of external debt, excluding Government Guaranteed loans, declined from US\$5,136m at end-June 1999 to US\$ 4,515m at end-June 2000. The decrease of external debt resulted in a fall in the external debt- to-GDP ratio to 45.3% in June 2000 from 50.6% at the end of June 1999 (Table 7).

Table 7: Distribution Of External Public Debt

	June 1999		June 2000*	
	shs bn	%	shs bn	%
BILATERAL	113.0	30.2	107.9	30.7
MULTILATERAL	228.2	60.9	221.3	62.9
COMM. BANKS	32.4	8.6	21.8	6.2
EXPORT CREDIT	1.0	0.3	1.0	0.2
TOTAL	374.5	100.0	352.0	100.0

* Provisional

Source: Treasury and Central Bank of Kenya

Kenya's external debt is characterized by high share of multilateral and bilateral debt, which accounts for over two-thirds of the total long-term debt. As at June 2000, multilateral debt accounted for 62.9%, bilateral debt accounted for 30.7%, commercial debt accounted for 6.2% while suppliers credit accounted for 0.2%.

External Debt Service

Government external debt service (including payments to the IMF) in the 1999/2000 financial year amounted to shs 42.8bn equivalent to US\$ 575.5m. This represented a 30.9% increase in shilling terms over debt service in the 1998/99 fiscal year when the Government paid out shs 32.7bn or US\$ 519.3m as external debt service. As a proportion of revenue, external debt service in 1999/2000 stood at 24.2% compared with 16.7% in 1998/99. The increase in external debt service in shilling terms followed a 3.5% depreciation of the shilling against major world currencies during the year. Of the shs 42.8bn debt service, principal repayments accounted for shs 32.9bn while shs 9.9bn were interest payments.

Debt service payments to bilateral creditors were shs 13.5bn, accounting for 31.5% of total payments while multilateral creditors and commercial banks accounted for shs 16.4bn and shs 12.9bn or 38.3% and 30.2% of the payments, respectively.

Monetary Developments

The conduct of monetary policy during the twelve months to June 2000 was challenging due to an escalation of inflation and volatility in interest rates. The underlying inflation, which measures inflation that can be influenced through monetary policy, rose on a month on month basis from 5% in June 1999 to 8.3% in June 2000 compared with the target 5%. The increase in inflation was attributed to excess reserves held by commercial banks at the Central Bank in the current and the last financial year and the depreciation of the shilling exchange rate. The Bank, however, managed to alleviate partially the increase in the rate of inflation by intervening in the money market through open market operations. These operations, which were geared towards minimising excess liquidity, were dominated by sales of Government Treasury bills to commercial banks.

Money supply aggregates remained within targets during the twelve months to June 2000 mainly due to the slowdown in private sector demand for bank credit, which was in turn attributed to the slowdown in economic growth. However, the reserve money which is the base through which the Bank influences the money supply was roughly on target in the June to October 1999 period but exceeded average monthly targets thereafter. The commencement of excess balances can be traced from November 1999 to January 2000 when the non-banking public demand for cash to finance end year festivities rose sharply. In addition, during this period, the banks and non bank financial institutions precautionary demand for reserves (cash and deposits at the Central Bank) increased as the institutions hedged against the risks of failure of computerised bank services at the dawn of the new millennium (21st Century). The Central Bank embarked on sustained mop up operations to sterilize the excess liquidity from February through June 2000.

Reserve Money Management

Reserve money comprises currency in circulation and deposits placed by commercial banks and NBFIs at the Central Bank to meet the cash ratio and daily bank clearing requirements. The Central Bank managed reserve money through open market operations during financial year 1999/2000. Throughout the year the Central Bank intervention was dominated by sales of existing Treasury bills to commercial banks as the Bank sought to bring the average reserve money to its target. The net sales rose initially from shs

5.3bn in June 1999 to shs 11.8bn in July 1999 and thereafter declined before rising again to shs 11.2bn in April 2000. The net Treasury bill sales stood at shs 8.9bn by end of June 2000.

Reserve money increased by shs 2.9bn or 4% to shs 75.7bn during the twelve months to June 2000 compared with shs 5.7bn or 7.2% decline in the year to June 1999. The increase in reserve money comprised shs 1.4bn increase in currency in circulation, shs 1.6bn increase in commercial bank deposits at the Central Bank and shs 0.1bn decline in the deposits of NBFIs. The expansion of reserve money was reflected in an increase of shs 17bn or 46.3% to shs 53.8bn in the net foreign assets (NFA) as net domestic assets (NDA) declined by shs 14.1bn or 39.1% to shs 22bn.

The NFA accumulation was attributed to net purchase of foreign exchange from the inter bank market as the Government ran arrears in external debt repayment. Meanwhile, the decline in NDA was reflected in all components, namely:

- Net credit to Government, which declined by shs 9.9bn or 33.6% from shs 29.6bn in June to shs 19.7bn by end June 2000. The decline in net credit to the Government was attributed to a build up of Government deposits at the Central Bank.
- Net advances to commercial banks, which fell by shs 1.3bn resulting in an indebtedness of the Bank to commercial banks of shs 5.6bn by end June 2000. This outcome was attributed to liquidity management operations of the Bank.
- Other net domestic assets, which declined by shs 2.9bn or 26.5% to shs 7.9bn by end June 2000.

Money and Credit

Growth in the money supply, M3, increased by shs 0.6bn or 0.2% in the year to June 2000 compared with shs 18.6bn or 6.4% expansion in the year to June 1999 (Table 8). The deceleration in money supply growth was mainly attributed to slack demand for bank credit due to the slowdown in the economy. The increase in M3 was wholly in shs 18.4bn or 38.3% accumulation of the NFA, which fully offset the the impact of shs 17.9bn or

Table 8: Money Supply and Its Sources (Annual Basis), Kshs Bn

	1999 June	2000 June	Change		Target	Dev.
			Absolute	%	Jun '00	
1. Money supply						
Money supply, M2 1/	292.2	292.0	-0.2	-0.1		
Money supply, M3 (2+3) 2/	309.8	310.4	0.6	0.2	320.2	-9.8
Money supply, M3X 3/	340.6	347.7	7.1	2.1		
Money supply, M3XT 4/	391.6	413.9	22.3	5.7	424.9	-12.8
2. Net foreign assets 5/	48.1	66.5	18.4	38.3	64.3	2.2
Central Bank and Treasury	36.7	53.8	17.0	46.3	51.3	2.5
Commercial banks	11.4	12.7	1.4	11.9	13.0	
NBFIs	-0.1	0.0	0.0	-74.0		
3. Net domestic assets (3.1+3.2)	261.7	243.9	-17.9	-6.8	255.9	-12.0
3.1 Domestic credit (3.1.1+3.1.2)	373.5	382.2	8.7	2.3	381.7	0.5
3.1.1 Government (net)	95.8	92.4	-3.4	-3.5	85.8	6.7
From Central Bank (net)	29.7	19.6	-10.1	-33.9	19.3	0.3
Overdraft to Government	5.6	6.5	0.9	16.1	6.9	-0.4
Cleared items awaiting posting to PMG	0.7	6.0	5.4	822.7	0.6	5.5
Rediscounted Securities	0.1	1.5	1.5	2314.3	0.0	1.5
Treasury Bills	2.3	10.6	8.3	358.9	6.8	3.8
Treasury Bonds	0.0	0.0	0.0	0.0	0.0	0.0
Non-interest Bearing Govt. Debt	34.6	26.3	-8.3	-24.0	30.1	-3.8
Government Deposits	-13.6	-31.4	-17.8	131.1	-25.1	-6.2
From Commercial Banks & NBFIs (net)	66.1	72.8	6.7	10.1	66.5	6.3
Commercial Banks	64.3	70.9	6.5	10.2		
NBFIs	1.8	1.9	0.2	9.3		
3.1.2 Private sector and other public sector:	277.7	289.8	12.1	4.4	295.9	-6.2
From Central Bank	1.3	1.4	0.0	1.7		
From Commercial banks	247.3	262.5	15.2	6.2		
From NBFIs	29.1	25.9	-3.2	-10.9		
3.2 Other assets net	-111.7	-138.4	-26.6	23.8	-125.8	-12.6
4. Reserve money	72.8	75.7	2.9	4.0	73.5	2.2
Cash in till	4.8	4.4	-0.4	-7.9	6.2	-1.8
Currency outside banks	36.6	38.4	1.8	4.9	37.3	1.1
Deposits with CBK	31.4	32.9	1.5	4.8	30.0	2.9
Memorandum items						
Treasury bills outstanding	101.7	131.0	29.3	28.9		

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

1/ Money Supply, M2, is money supplied by Central Bank and commercial banks. It comprises currency outside banking institutions, other non-banking institutions' deposits with the Central Bank, demand, savings and time deposits as well as certificates of deposits held by the private sector and parastatals with commercial banks. It excludes deposit placement of the central and local Government.

2/ Broad money, M3, comprises M2 and call, 7-days, savings and time deposits as well as certificates of deposit held by the private sector and parastatals with NBFIs. M3 excludes deposits of both the central and local Government with NBFIs, and all cross deposits of both commercial banks and NBFIs.

3/ Broad money, M3X, comprises M3 plus foreign currency deposits held by residents with banking institutions.

4/ Broad money, M3XT, includes M3X and outstanding Government Treasury securities with the non-banking public.

5/ NFA at constant exchange rate of shs 62.025 to the US dollar (September 30th, 1997).

Source: Central Bank of Kenya

6.8% fall in the NDA of the banking system. The decline in the NDA largely reflected:

- A decline of shs 26.6bn in other domestic assets;
- A decline of shs 3.4bn in credit to Government; and
- An increase of shs 12.1bn in credit to private and other public sectors.

The NFA accumulation by the banking system during the twelve months to June 2000 occurred at the Central Bank through purchases of foreign exchange from the inter bank market and through running arrears on external debt repayment by Government. Reflecting these developments the NFA of the banking system increased from shs 48.1bn in June 1999 to shs 66.5bn in June 2000, which was shs 2.2bn above the target for June 2000.

At shs 310.4bn, money supply (M3) was shs 9.8bn within the shs 320.2bn target for end June 2000. The confinement of M3 within target reflected the general slowdown in credit demand by the private sector, a shift into foreign currency denominated accounts by residents following the depreciation of the shilling exchange rate, and enhanced preference for holding Government securities by the non banking public. Consequently, broader money supply (M3XT), defined to include M3, residents' foreign currency deposits and non banking public holding of Government paper increased by shs 22.3bn on account of:

- An increase of shs 6.6bn in currency substitution by residents;
- An increase of shs 15.0bn in non banking public holding of Government securities; and
- An increase of shs 0.6bn in M3.

Cash and Liquidity of Banks and NBFIs

The banking sector was relatively stable in the 12 months to June 2000 (Table 9 and Charts 9 and 10). Banking institutions met the liquidity and cash ratio requirements as follows:

- The average liquidity ratio for the twelve months was 43% for commercial banks and 52% for NBFIs compared with 20% minimum requirement
- The average cash ratio was 12.4% for commercial banks and 13.1% for NBFIs compared with the monthly 12% minimum requirement over the same period.

Banking Institutions Cash And Liquidity Ratios

Table 9

	1999						2000					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Cash Ratio (%)												
Commercial Banks	12.5	12.0	12.0	12.5	12.0	12.5	12.3	12.4	12.1	14.1	12.6	12.0
NBFIs	12.5	12.9	12.8	13.3	13.4	13.0	15.3	12.7	12.8	13.1	13.0	13.1
Banking System	12.5	12.4	12.4	12.9	12.7	12.8	13.8	12.6	12.5	13.6	12.8	12.5
Minimum Requirement	12	12	12	12	12	12	12	12	12	12	12	12
Liquidity Ratio (%)												
Commercial Banks	41	43	42	42	41	40	41	43	44	46	45	45
NBFIs	53	52	50	49	50	54	52	54	54	52	51	48
Minimum Requirement	20	20	20	20	20	20	20	20	20	20	20	20
Mortgage Finance Cos.	25	24	23	22	21	22	22	25	27	27	27	27
Building Societies	49	47	47	46	48	22	46	44	44	42	42	43
Minimum Requirement	20	20	20	20	20	20	20	20	20	20	20	20

Chart 9

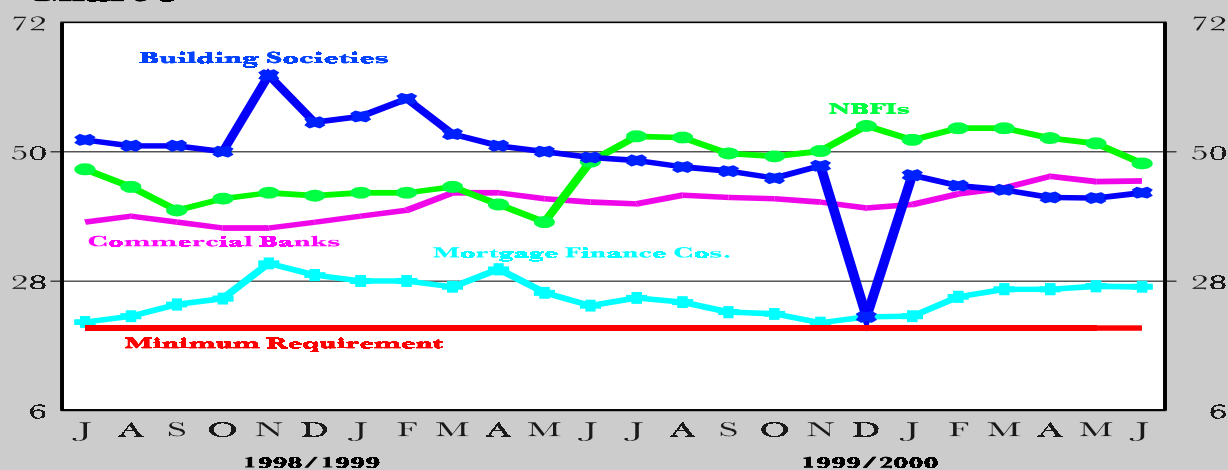
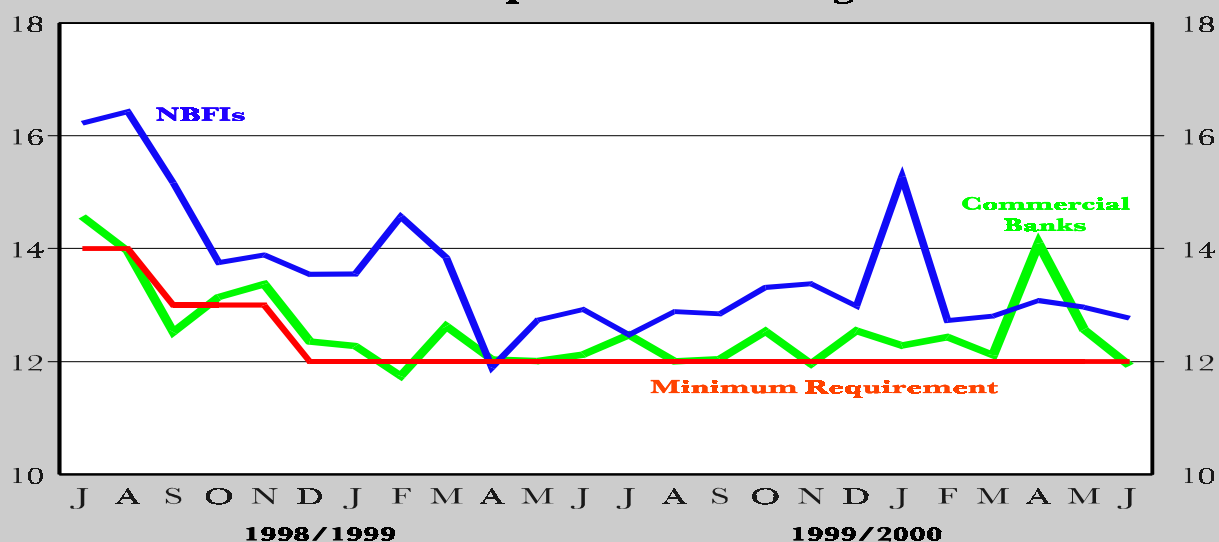


Chart 10: Cash Ratio Deposits for Banking Institutions

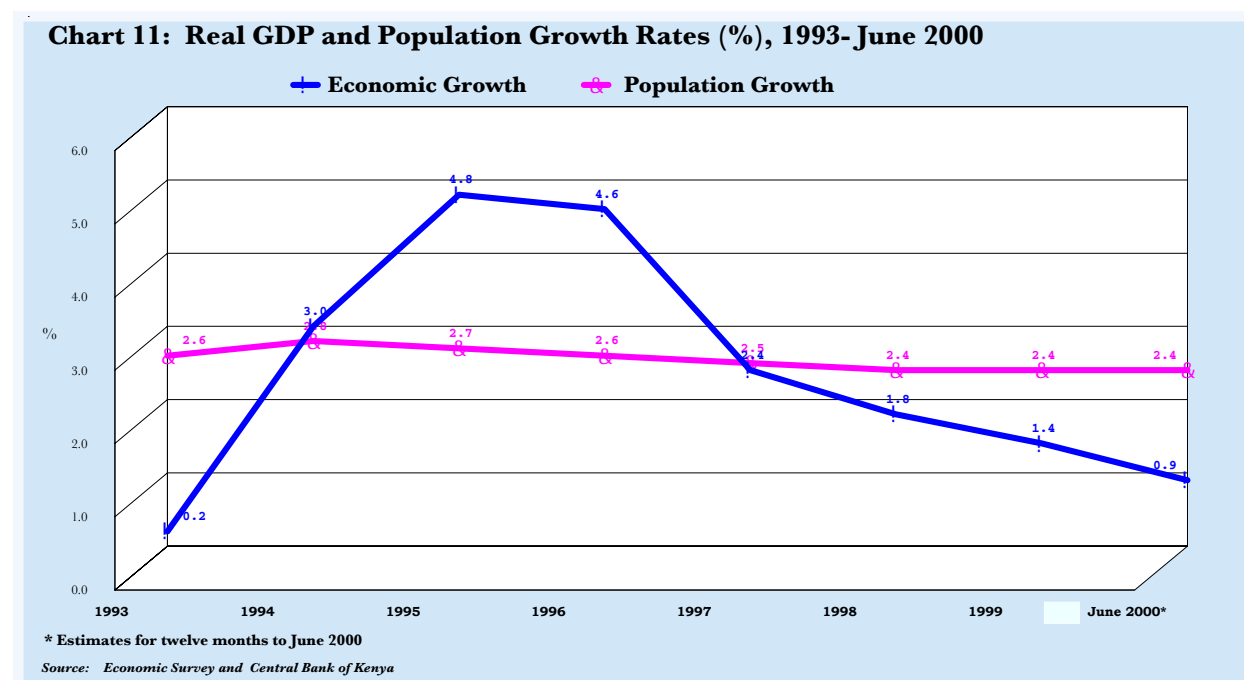


Source: Central Bank of Kenya

Production

Overall Growth

The slowdown in economic growth that began in 1997 continued in 1999. The growth of real Gross Domestic Product (GDP) decelerated to 1.4% from 1.8% in 1998 and further to 0.9% in the twelve months to June 2000 (Chart 11). The deceleration was in all sectors of the economy, except the transport sector, which grew by 0.2 of a percentage point over the previous year. Notable declines were recorded in agriculture, manufacturing and services sectors.



Consequent to the decline in GDP growth, annual growth of modern sector employment decelerated to 0.5% in 1999, from 1.1% in 1998. Although the growth in population in 1999 remained unchanged at 2.4% as in 1998, the slowdown in economic growth implied increases in unemployment and poverty in the country.

Causes of Economic Slowdown

The weak economic performance is attributable to various factors which led to inadequate and high cost of investment in domestic production. These include the prolonged drought that adversely affected agriculture and power supply; crumbled infrastructure, particularly roads and inefficient telecommunication, port and railway services, inadequate water and power supplies; uncertainty and loss of investor confidence caused by insecurity; and inefficient delivery of public services. The net generation of electricity

for example declined by 8.8% to 2,169 Kilowatt hours in the first seven months of 2000 from 2,691 Kilowatt hours in the same period last year.

To address the deteriorating economic performance, the Government implemented various measures directed at removing structural bottlenecks, improving governance and creating an enabling environment for investment and economic growth. The measures include the following:

- Restructuring of the Government's tendering system including the appointment of three private sector representatives on the Central Tender Board, with one of them appointed the Board Chairman;
- Strengthening the Kenya Anti Corruption Authority (KACA) which is now fully operational;
- Blacklisting of corrupt contractors and the establishment of the Kenya Roads Board to oversee road repairs;
- Restructuring of the telecommunications, ports and railways sub-sectors. In the telecommunications sub-sector for instance, two cellular telephone operators have been licensed; and
- Suspension of customs duty on generators of at least 100 KVA capacity and the introduction of tax rebates on diesel used on them, to alleviate the problem of power shortage.

To reinforce the gains expected from the above measures, the Government, through the 2000/01 Budget, introduced further measures focused primarily on improving governance including the following:

- Re-constitution of the Local Authority Transfer Fund (LATF), that oversees allocation of funds to local authorities to comprise private and public sector representatives;
- Setting up a task force to implement Asset Register Systems in Government to allow control and monitoring of public assets against corruption;
- Allocation of more resources to training, equipment and for enhanced remuneration for security forces to improve security; and
- Public service reforms beginning financial year 2000/01 to improve efficiency in service delivery.

Further reforms geared to restoring economic growth, particularly the privatization of commercial public sector institutions are slated for the next three years, starting in financial year 2000/01.

The structural reforms and policy measures thus far implemented, and those underway as outlined in the Medium Term Expenditure Framework (MTEF) and the Interim Poverty Reduction Strategy Paper (IPRSP) stand to impact positively on the economy in the medium and the long-term. In addition, the commitment of the Central Bank and the Government to pursue prudent monetary and fiscal policies is expected to ensure a stable macroeconomic environment.

Sectoral Performance

Agriculture

Growth in agriculture, which contributed 24.5% of real GDP in 1999 compared with 24.6% in 1998 (Table 10), decelerated to 1.2% in 1999 from 1.5% in 1998. Growth in the sector is estimated to have declined further to 0.8% in the twelve months to June 2000. The slowdown in growth of the agricultural sector in 1999 and early 2000 reflects structural bottlenecks in production and marketing, including dilapidated infrastructure, low commodity prices, inadequate rainfall, particularly in major food crop areas, high cost of inputs and inefficiency of major marketing organizations.

Table 10: Gross Domestic Product & Sector Shares at Constant 1982 Prices

Main Sectors	Real GDP in shs m			Ann. GDP Growth (%)		shares of GDP(%)	
	1994	1999	Est. in Year to June '00	1999	Est. in Year to June '00	1994	1999
Agriculture	22,386	25,426	25,662	1.2	0.8	25.0	24.5
Manufacturing	12,212	13,732	13,706	1.0	0.7	13.6	13.2
Building & Construction	2,261	2,530	2,559	0.9	0.7	2.4	2.4
Trade, Restaurant and Hotel	10,176	12,948	13,108	2.0	1.9	11.4	12.5
Transport, Storage & Communication	5,474	6,202	6,224	1.4	0.9	6.1	6.0
Financial Services	8,597	10,904	11,063	2.0	1.9	9.6	10.5
Government Services	14,206	15,078	15,121	0.7	0.6	15.9	14.5
Others/1	14,179	16,882	16,544	1.4	0.3	14.9	15.4
TOTAL GDP (1982 prices)	89,492	103,702	103,982	1.4	0.9	100.0	100.0

1. Includes non-monetary, ownership of dwellings, mining and quarrying, electricity and water, forestry and fishing, domestic and other services less imputed bank charges.

Source: Central Bureau of Statistics and Central Bank of Kenya

The production of tea, wheat, sugar cane and maize declined substantially over the period while the production of coffee improved:

- Output of tea, a major foreign exchange earner, declined by 4.7% to 239,429 tonnes in the twelve months to June 2000 from 251,357 tonnes in the same period, the previous year. The average price of tea however increased by 15% to US\$ 2,032 per tonne from US\$ 1,770 in the period. Export earnings from the crop dropped by 2.0% to US\$ 480m from US\$ 490m in the period.
- Output of sugar cane declined by 2.7% to 4,496,360 tonnes in the twelve months to May 2000 from 4,622,880 tonnes in the same period, the previous year.
- Output of horticultural crops fell by 10% in the twelve months to June 2000. Earnings from horticulture fell to US\$ 161m from US\$ 193m in the period.
- Output of coffee however improved by 34.9% to 78,048 tonnes in the twelve months to June 2000 from 57,837 tonnes in the same period, the previous year. The gains in increased production were however offset by the decline in coffee prices. The average price of the crop dropped from US\$ 2,804 per tonne to US\$ 1,964 in the period. Consequently, export earnings decreased to US\$ 155m from US\$ 162m in the same period, the previous year.

In the food crop sub-sector, maize production fell by 8.4% to 25 million 90kg bags in 1999 from 27.3 million bags in 1998. The production of wheat also declined to 55,200 tonnes from 177,100 tonnes in the same period as a result of invasion by armyworms and poor producer price incentives. The livestock sub-sector however improved with milk production expanding by 42.9% to 180 million litres from 126 million litres in the same period, the previous year.

Manufacturing

Growth in the manufacturing sector, which accounted for 13.2% of GDP in 1999 compared with 13.3% in 1998, is estimated to have fallen to 0.7% in the twelve months to June 2000 compared with 1.0% in 1999 and 1.4% in 1998. The depressed performance resulted from investment constraints, increased competition from cheap imports, power and water shortages due to rationing, high overhead costs due to poor infrastructure and depressed domestic demand. The other factors accounting for the poor performance in

the sector, were the quota restriction for Kenyan garment exports to the U.S. and the ban on fish exports to the European Union that depressed the textiles and fish industries, respectively.

Building and Construction

Growth in the building and construction sector, which contributed 2.4% of GDP in 1999 compared with 2.5% in 1998, slowed down to 0.7% in twelve months to June 2000 from 0.9% in 1999 and 1.3% in 1998. The dismal performance was attributed to reduced public and private sector investments in building and construction activities due to budgetary constraints that have become increasingly acute since the suspension of donor funds in 1997. Total value of building plans approved by various urban centers fell by 5.7% in the period. Cement consumption declined by 5.0% to 933,824 tonnes in the twelve months to June 2000 from 983,008 tonnes in the same period of the previous year. As a result of reduced demand for cement, production declined by 12.3% to 1,088,275 tonnes in the twelve months to June 2000 from 1,240,542 tonnes in the twelve months to June 1999.

Notable investment projects were, however, realized in the roads sub-sector under the El-Nino Emergency Fund, the Kenya Urban Transport Infrastructure Programme (KUTIP) and in fuel retail stations.

Services Sector

Growth in services sector remained depressed in 1999 as follows:

- Expansion of output from trade, restaurant and hotels whose share of GDP improved to 12.5% in 1999 from 12.4% in 1998 decelerated to 1.9% in the twelve months to June 2000 compared with 2.0% in 1999. The poor performance in the sector is attributed to the sluggish economy that has depressed general trade activities. Recovery has however been noted in the tourism sub-sector, with the number of arrivals improving by 8.4% in 1999 compared with a decline of 10.6% in 1998. Tourism earnings also increased by 13% to US\$ 287m in the twelve months to June 2000 from US\$ 254m in the same period, the previous year. The improvement in the sub-sector is attributed to enhanced security and marketing.
- The Government sector, which contributed 14.5% of GDP in 1999 down from 14.9% in 1998, expanded by 0.7% in the twelve months to June 2000 compared with 0.8% in 1998. The slowdown in the sector is

expected to continue in line with Government downsizing measures, privatization and retrenchment aimed at enhancing efficiency in service delivery.

- Growth in the finance, insurance, real estate and business services decelerated to 1.9% in the twelve months to June 2000 from 2.0% in 1999 and 3.2% in 1998. The depressed performance in the sector is attributed mainly to the high level of bad and doubtful debts following imprudent lending practices of some banks and the economic slowdown that reduced the capacity of businesses to service loans. Insurance firms also experienced losses due to huge Court awards on injury and incidences of falsified claims.

Infrastructural Services

Transport, storage and communication services is estimated to have grown by 0.9% in the twelve months to June 2000 compared with 1.4% in 1999 and 1.2% in 1998 and 2.0% in 1997. The depressed performance in the sector reflects the operational inefficiencies and administrative problems in the roads and telecommunications sub-sectors. Growth in the sector is expected to pick up in the last quarter of the year 2000 due to the large investments in cellular phones and internet services, improvements in road and port services, upturn in tourism and distribution of relief food.

Investment and Saving

The slowdown in economic activity over the last three years is underlined by the continuing decline in investment as reflected by the consistent fall in the investment/GDP ratio to 16.1% from 21.8% in 1995 and 17.4% in 1998 (Table 11 and Chart 12). The continuing decline in investment reflects mainly the poor infrastructure, high cost of borrowing and security concerns that have collectively reduced investor confidence in the economy. The ratio of domestic saving to GDP also continued on a downward trend declining for the third successive year to 11.8% in 1999 from 15.4% in 1996. Domestic saving, however, financed the bulk of investment in 1999 as the share of foreign saving in total saving declined sharply to 27% in 1999 from 44% in 1998. While it is possible to improve economic growth through a more efficient use of existing resources, the economy requires an investment/GDP ratio of about 25%, sustained over time, to raise the growth rate of real GDP to about 6% per annum that is necessary to effectively address the twin problems of unemployment and poverty.

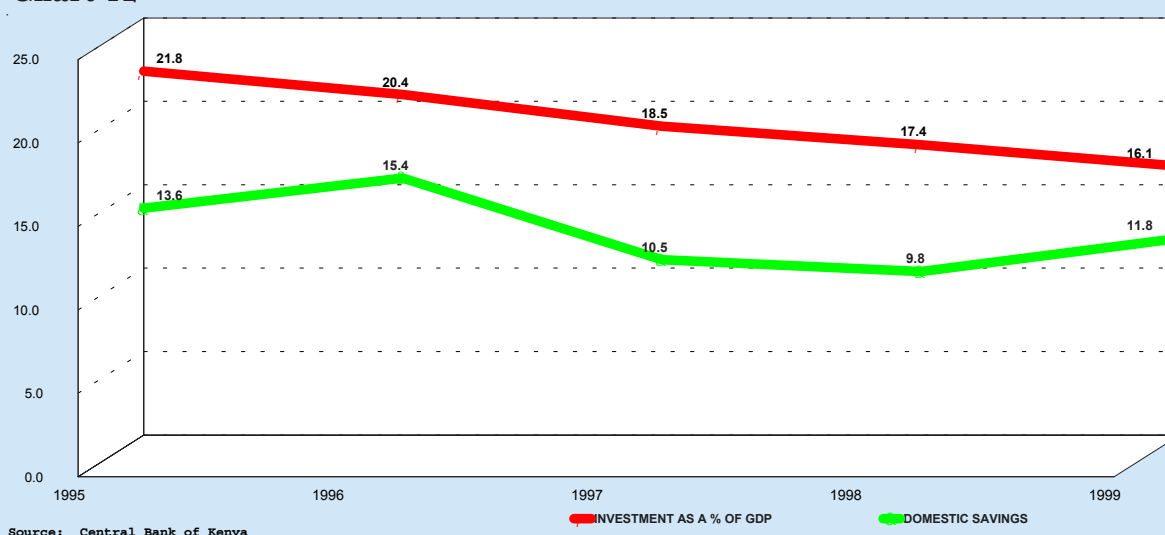
Investment And Savings, 1995-1999 (Shs M)**Table 11**

	1995	1996	1997	1998	1999
IN SHS MILLION					
1. Total Investment	101,516.6	107,469.6	115,270.0	120,068.2	120,356.2
Private	64,857.6	67,833.8	73,408.4	78,361.2	78,647.2
Public	36,659.0	39,635.8	41,861.6	41,707.0	41,708.8
FINANCING					
2. Foreign Borrowings	-20,620.0	4,198.8	26,829.2	28,806.4	-778.0
3. Domestic Savings/1	122,136.6	103,270.8	88,440.8	91,261.8	121,134.2
Private	139,294.0	123,651.3	121,895.3	127,410.8	155,899.7
Public	-17,158.0	-20,380.5	-33,454.5	-36,190.0	-34,765.5
% OF GDP					
4. Total Investment	21.8	20.3	18.5	17.3	16.1
Private	13.9	12.8	11.8	11.3	10.5
Public	7.9	7.5	6.7	6	5.6
FINANCING					
5. Foreign Borrowings	-4.4	0.8	4.3	4.2	-0.1
6. Domestic Savings/1	26.3	19.5	14.2	13.2	16.2
Private	29.9	23.4	19.6	18.4	20.8
Public	3.7	3.9	5.4	5.2	4.6
7. Memorandum Items					
GDP (mkt prices)	465,272	528,739	623,354	692,120	749,323

Notes

1. Figures adjusted from those published in Economic Survey, 2000

Source: Economic Survey, 2000 and calculations by CBK

Chart 12**Outlook for the Fiscal Year 2000/01**

The slowdown in economic growth is expected to continue in the financial year 2000/01. This poor outlook is based on the adverse effects arising from the severe drought being experienced in the country, the extensive repair work required to restore physical infrastructure, particularly roads, the intensified electricity rationing throughout the country and water rationing in key industrial and commercial towns. An upturn in growth is however, likely in the subsequent period, arising mainly from improvements in weather conditions and improved investor confidence induced by the on-going structural and policy reforms, but also the resumption of financial support by Kenya's development partners.

Developments in the Banking Industry

The overall performance of the banking sector was fair during 1999. Profits in the sector declined for the second year running with aggregate profits of the banking industry before taxation standing at shs 158m compared with shs 4.4bn recorded in 1998. Forty-five banking institutions made profits of shs 10.5bn while eighteen institutions made losses of shs 10.3bn. The decline in profits was mainly attributed to the general economic slowdown which required higher provisions for non-performing loans. Non-performing loans at shs 97bn, were 16% above the level recorded in 1998 while provisions for bad and doubtful debts stood at shs 55bn compared with shs 41bn in 1998.

Provisional results for the six months ended June 2000 show improved performance of the banking sector. During the six months, 45 institutions made profits of shs 6.5bn while 16 institutions made losses of 1.3bn, resulting in an overall net position before tax of shs 5.2bn.

The sector, however, enjoyed relative stability compared with 1998, with only one non-bank financial institution being placed under statutory management by the Central Bank in September 1999. Three out of five banks under statutory management were restructured successfully with one re-opening in August 1999. The other two re-opened in January and April 2000, respectively. Two institutions, however, continued to remain under statutory management while one was placed under liquidation by the Deposit Protection Fund Board in May 2000.

The banking sector managed the year 2000 date change and roll-over smoothly with no significant hitches being experienced.

Banking Industry Structure

There were no substantial changes in the structure of the banking industry during the twelve months to June 2000 (Table 12).

The number of commercial banks declined to 51 in June 2000 as compared with 52 as at the end of June 1999 following approval for the merger of four banks into two banks and one new bank becoming operational. Additional approvals for the merger of another four banks into two banks was given towards the end of 1999 but the process had not been finalised by June 2000.

The number of NBFIs declined to 10 in June 2000 from 13 in June 1999 as a result of two of them merging with their parent banks and one converting into a commercial bank.

Table 12: Structure Of The Banking Industry In Kenya (Shs Bn)

Peer Group Range	Jun-99					Jun-00					Ann. Change (%)	
	Assets	Deposit	No. of	Mkt Share (%)		Assets	Deposit	No. of	Mkt Share (%)			
	Liabilities	Liabilities	Banks	Assets	Deposits	Liabilities	Liabilities	Banks	Assets	Deposits	Assets	Deposits
COMMERCIAL BANKS												
Over 10	283.5	209.7	9.0	70.6	71.6	274.8	208.2	8.0	67.7	70.7	-3.1	-0.7
5-10	43.3	29.9	7.0	10.8	10.2	54.1	33.5	8.0	13.4	11.4	24.9	12.0
3-5	33.5	21.7	9.0	8.3	7.4	40.3	27.9	11.0	9.9	9.4	20.3	28.6
1-3	34.3	26.5	17.0	8.5	9.0	30.7	21.8	16.0	7.6	7.4	-10.5	-17.7
Below 1	7.2	5.1	10.0	1.8	1.8	5.7	3.3	8.0	1.4	1.1	-20.8	-35.3
Total	401.8	292.9	52.0	100.0	100.0	405.6	294.7	51.0	100.0	100.0	1.0	0.6
NBFIs*												
Over 5	19.8	14.1	2.0	66.1	69.8	19.8	15.1	2.0	71.5	70.9	0.0	7.1
1-5	7.3	4.5	3.0	24.3	22.3	6.4	5.0	2.0	23.1	23.5	-12.3	11.1
0.5-1	2.5	1.2	4.0	8.3	5.9	0.7	0.5	1.0	2.4	2.4	-72.0	-58.3
0.2-0.5	0.0	0.0	0.0	0.0	0.0	0.6	0.4	2.0	2.2	1.9	600.0	400.0
0.1-0.2	0.3	0.1	2.0	1.0	0.5	0.1	0.1	1.0	0.4	0.4	-66.7	0.0
Below 1	0.1	0.3	2.0	0.3	1.5	0.1	0.2	2.0	0.9	0.9	0.0	-33.3
Total	30.0	20.2	13.0	100.0	100.0	27.7	21.3	10.0	100.0	100.0	-7.7	5.5

* Includes two mortgage finance companies

Source: Central Bank of Kenya

There was, substantial decline in the number of branches of banking institutions, which decreased from 677 to 512 during the year to June 2000. The four major banks accounted for the majority of branch closures.

The number of foreign exchange bureaux increased to 48 in June 2000 from 45 in June 1999. The increase followed the approval given by the Central Bank to three foreign exchange bureaux to commence business after satisfying set conditions for operations. The three bureaux were earlier granted licenses but were not allowed to commence business before meeting specific conditions set by the Bank. The moratorium declared in March 1999 on the licensing of new foreign exchange bureaux is, however, still in force. The moratorium was put in place to enable the Bank assess the existing bureaux in order to further streamline the laws and regulations governing their operations.

Asset and Deposits Liabilities

Assets of commercial banks in the year to June 2000 increased marginally by shs 3.8bn or 1.0% to shs 405.6bn from shs 401.8bn in June 1999. The highest increase in assets was in banks with asset size of between shs 5bn and 10bn. The assets of NBFIs including mortgage finance companies however decreased by shs 2.3bn or 7.7% to shs 27.7bn from shs 30.0bn. Similarly, deposits held by commercial banks rose by 0.6% to shs 294.7bn from shs 292.9bn in June 2000, while those of NBFIs increased by 5.5% to shs 21.3bn from shs 20.2bn in June 1999.

Eight commercial banks with an asset size of more than shs 10bn accounted for 67.7% of the total assets of commercial banks. Their share of deposits however stood at 70.7% in June 2000 compared with 71.6% in June 1999.

Among the NBFIs, the two largest institutions with an asset size of over shs 5bn accounted for 71.5% of total assets in the sub-sector having increased from 66.1% in June 1999. This was mainly attributed to the decrease in the number of NBFIs to 10 in June 2000 from 13 in June 1999.

Strengthening of the Banking and Financial System

During the year under review, the Central Bank continued to put in place a variety of measures to ensure continued stability of the banking sector. These include the following:

- Amendments to the Banking Act to facilitate effective supervision in the following major areas:
 - (i) Capital of banking institutions was redefined to conform to the Basle Capital Accord.
 - (ii) Minimum core capital for banks and mortgage finance companies was increased from shs 200m to shs 500m while that of non-bank financial institutions was raised from shs 150m to shs 375m. These increments will be gradual so that the new levels are achieved by 2005.
 - (iii) The corporate veil was lifted by requiring disclosure of ultimate beneficiaries of shares held by companies while beneficiaries of shares held through nominees would also be disclosed.
 - (iv) The monetary penalties to be levied for non-compliance with prudential requirements were gazetted.
- The Building Societies Act was also amended to ensure that building societies are subjected to similar conditions with Mortgage Finance Companies in the following areas:
 - (i) Core capital will be maintained as well a gearing ratio.
 - (ii) Directors will be subjected to “fit and proper” criteria.
 - (iii) Credit facilities to directors will be restricted.
 - (iv) Central Bank was granted powers to collect information.

- (v) Central Bank was granted powers to issue administrative sanctions.
- (vi) Liquidity ratios were harmonised with those of mortgage finance companies.
- Tripartite meetings were held between the banking institutions, their external auditors and Central Bank before the 1999 audited results were released, to agree on provisioning levels.
- The Central Bank continued to encourage the formation of credit reference and credit rating agencies in order to enhance credit risk assessment. The first credit reference bureau was launched in February 1999 while a credit rating agency began operations towards the end of 1999.
- A requirement was introduced that loans to directors must be at commercial rates.
- A system of vetting chief executives of banks by the Central Bank prior to being appointed was implemented.
- The Central Bank started formal presentation of inspection reports to the full board of directors of banking institutions aimed at ensuring that all board members get full information of inspection findings.
- A seminar for bank directors was held in August 1999 at the Kenya School of Monetary Studies to educate the directors on their roles.
- One commercial bank, licensed in 1998 to undertake micro-finance business, started operations towards the end of 1999.
- Banks adopted the International Accounting Standards (IAS) by implementing IAS 30 which is the standard that is applicable to banking institutions.
- The three East African Central Banks continued to implement measures aimed at harmonisation of banking laws, regulations and practices in the region. These areas include joint supervision, cross-border and consolidated supervision, improvement in corporate governance, information sharing on payment systems, foreign exchange management and the development of the micro-finance sector.
- Bearer Certificates of Deposits (BCDs) were phased out by the set target date of 31st December 1999.

Future Plans

To further stabilise the banking sector, the Central Bank, in consultation with the Ministry of Finance will take the following actions during year 2000/2001:

- Work towards full implementation of the Basel Committee's core principles for effective banking supervision.
- Enact procedures to facilitate smooth merging of banking institutions.
- Introduce provisions to empower Central Bank monitor changes in the ownership of banking institutions.
- Encourage the Government to fully divest itself from the banking industry.
- Propose enactment of legislation that will facilitate forwarding of information on loan defaulters to credit reference bureaus, in order to improve credit assessments of banking institutions.
- Put in place appropriate legislation to criminalise issuing of bouncing cheques.
- Develop regulatory framework for micro-finance business in collaboration with stakeholders in the micro-finance industry.
- Further strengthen Bank Supervision Department through training and equipment.
- Apply the revised banking laws including the levying of monetary penalties to enhance compliance.
- Further revision of the Building Societies Act in order to harmonise the operations of building societies with Mortgage Finance Institutions.

CENTRAL BANK OF KENYA

BALANCE SHEET AS AT 30 JUNE 2000

(in millions of Kshs)

	Note	June 2000	June 1999
ASSETS			
Foreign Exchange	8	62,290	46,797
Advances to Banks	9	3,272	905
Investment in Government Securities	10	3,051	1,682
Government of Kenya Overdraft	11	6,529	5,625
Clearing Account		6,018	652
Other Assets	12	1,825	2,854
Property and Equipment	13	3,687	3,727
Revaluation Account	6	19,642	20,642
Frozen Government Account	14	26,317	34,607
TOTAL ASSETS		132,631	117,491
LIABILITIES			
Currency in circulation		42,850	41,433
Deposits	15	83,112	65,014
Other liabilities	16	1,328	6,167
CAPITAL AND RESERVES			
Capital and Reserves		5,341	4,877
TOTAL LIABILITIES, CAPITAL AND RESERVES		132,631	117,491

Source: Central Bank of Kenya

CENTRAL BANK OF KENYA
PROFIT AND LOSS ACCOUNT FOR THE
YEAR ENDED 30TH JUNE 2000

(in millions of Kshs)

	1998/1999	1999/2000
REVENUE	15,270	7,883
Foreign Investment Earnings	2,269	2,837
Local Investment Earnings	8,123	1,244
Other	1,153	2,458
Revaluation Gain	3,725	1,344
EXPENDITURE	5,729	6,419
Administrative Expenses	2,231	2,651
Currency Expenses	919	605
Banking Expenses	79	1,241
Amortisation of Revaluation Loss	2,500	1,000
Provisions for bad and doubtful debts		
- Additions made during the year	-	922
NET SURPLUS	9,541	1,464
Appropriated as follows:		
Transferred to General Reserve Fund	1,041	464
Government of Kenya - Dividend	8,500	1,000
	9,541	1,464

Source: Central Bank of Kenya

MESSAGE FROM THE MANAGEMENT

- (a) The financial statements on pages 41 and 42 are extracts of the audited accounts of the Bank which were approved by the Board of Directors on 15th August 2000. To get a full picture of the Bank's performance, the full set of published accounts is available at our offices and can be viewed or obtained by any interested person(s).

- (b) The accounts were audited by Messrs. KPMG Peat Marwick and Bellhouse Mwangi Ernst and Young, the joint auditors of the Bank and received an unqualified opinion.