CENTRAL BANK OF KENYA

TWENTY EIGHTH ANNUAL REPORT FOR THE FINANCIAL YEAR ENDED 30TH JUNE, 1994

Central Bank of Kenya

BOARD OF DIRECTORS

Micah Cheserem
Governor and Chairman

Prof. Philip M. Mbithi
Director

Dr. Thomas N. Kibua
Deputy Governor

Benjamin Kipkulei
Permanent Secretary
Treasury, ex-officio Director

Thomas M. Kithinji
Director

Prof. George I. Godia
Director

John H. Mramba
Director

LETTER OF TRANSMITTAL

Central Bank of Kenya
September 22, 1994

Hon. Musalia Mudavadi, M.P.
Minister for Finance
P.O. Box 30007
NAIROBI

Dear Sir,

Twenty Eighth Annual Report of the Central Bank of Kenya

In accordance with Section 54 of the Central Bank of Kenya Act, I have the honour to present to you Sir, the Twenty Eighth Annual Report of the Central Bank of Kenya for the financial year ended June 30, 1994 together with the Statement of Audited Accounts.

Yours faithfully,

MICAH CHESEREM
Chairman of the Board of Directors
and Governor of the Central Bank of Kenya

CONTENTS

Board of Directors and Senior Management

Directors

Directors		Date of Appointment
Mr. Micah Cheserem	Chairman and Governor	July 24, 1993
Dr. Thomas N. Kibua	Deputy Governor	July 1, 1993
Mr. Benjamin Kipkulei	PS.Treasury, Ex-Officio	May 17, 1994
Prof. Philip M. Mbithi	Director	Jan. 9, 1992
Mr. Thomas M. Kithinji	Director	Nov. 15, 1993
Prof. George I. Godia	Director	May 1, 1994
Mr. John H. Mramba	Director	July 1, 1994

Senior Management

Mr. Joseph K. Waiguru	Bank Secretary
Mr. Reuben M. Marambii	Chief Banking Manager
Mr. Daniel K. Kiangura	Director, Management Information Services
Mr. Alfred A. Wanguria	Director, Bank Supervision
Mr. Joseph K. Kinyua	Director of Research
Mr. Jones M. Nzomo	Director of Finance

CHAPTER 2

Administrative Developments

2.1 Board of Directors

Two new Directors were appointed to join the Board of Directors of the Bank during fy 1993/94. Mr. T.N. Kithinji was appointed in November 1993 to replace Mr. Joseph Arap Leting. On May 1, 1994 Prof. G.I. Godia was appointed in place of Mr. T.S. Kaloki. On May 17, 1994, Mr Benjamin Kipkulei joined the Board on being appointed Permanent Secretary to the Treasury following the retirement of Dr. Wilfred Koinange. The Bank wishes to welcome Mr. Kipkulei, Mr. T.M. Kithinji and Prof. Godia to the Board. The Bank also wishes to thank Mr. Kaloki and Dr. Koinange and to record its appreciation for their invaluable contributions in the Board.

2.2 Staff Training and Development

The most notable development in the Banks'training programmes in the year was the launching of the first issue of the Training Calendar by the Governor. The Calendar outlined a comprehensive training programme for the entire period. The training Calendar would ensure that the Bank's training programme in the year is tailored to its manpower and skills requirement. Meanwhile, a number of staff attended various courses and workshops organised locally and abroad during fy 1993/94. A total of 726 members of staff attended local courses and another 74 attended overseas courses. The Bank also sent 9 officers to the East African Central Banking course in Kampala, Uganda, and to workshops on Bank Supervision in Bostwana, Zimbabwe, Tanzania, United States and Pakistan. Besides, the Bank continued to encourage staff to pursue privately professional courses relevant to the operations of the Bank.

CHAPTER 3

Summary of Monetary and Financial Policies taken in FY 1993/94

Date		Policy Action	Objective
1993			
July	29	Cash ratio raised from 8 to 10 per cent.	Correct excess expansion in net domestic assets
August	5	Paper eligible for rediscounting restricted by lowering maturities (a) Treasury bills (half way) (b) Treasury bonds (45 days or less)	Promote sound banking practice
		Securities eligible as collateral for overnight loans restricted to Treasury bills and Treasury bonds	Correct excess expansion in net domestic assets
August	6	A two-way foreign exchange auction system introduced	Enhance Central Bank's effectiveness in forex market stabilization
August	9	Nairobi Clearing House: new arrangements effected	Eliminate automatic provisions of Central Bank credit to banks
August	30	Registration of Foreign Exchange Certificate holders with banks in order to buy them back at negotiated or market price	Restore public confidence in the economic reform process
September	30	Registration of Foreign Exchange Certificate by banks with Central Bank	Restore public confidence in the economic reform process
October	18	The shilling exchange rate allowed to float freely	Encourage market allocation of foreign exchange and promote efficient utilisation of scarce resources
October	21	Cash ratio raised from 10 to 12 per cent with balance above the minimum requirement to earn interest at 35 per cent per annum.	Correct excess expansion in net domestic assets

November	8	Central Bank started daily foreign exchange transactions with commercial banks.	To stabilise foreign exchange market
		Commercial banks allowed to continue purchasing foreign exchange for oil and petroleum products from the market and Central Bank.	
		Central Bank continued entering into forward contracts for purchase of oil and related products but at market rates.	
December	1	Credit guidelines abolished.	To remove distortion in credit allocation and promote efficient utilisation of financial resources
		Cash ratio raised from 12 to 14 per cent with excess balances paid 35 per cent interest per annum.	To correct excess expansion in net domestic assets
December	14	Removal of restrictions on remittances of profits, dividends and expatriate earnings	To promote foreign investment
		Residents allowed to borrow abroad up to US$1 million	To promote investment
1994			
February	7	Cash ratio increased from 14 to 16 per cent with interest paid on bank balances with the Bank in excess of 10 per cent reduced from 25 to 20 per cent.	To correct excess expansion in net domestic assets
February	21	Foreign exchange retention raised to 100 per cent	To promote exports
		Residents allowed to open foreign currency accounts with banks in Kenya.	To deepen external sector reforms
		Restrictions on local borrowing by foreign controlled companies removed	To encourage investment
		Foreigners allowed to pay hotel bills and air tickets in either foreign or Kenya currency	To promote tourism
		Residents allowed to borrow from abroad with no limit to finance investment Kenya	To encourage investment
		Foreigners allowed to open foreign currency accounts with Kenya banks	To encourage investment
		Persons leaving Kenya allowed to carry Kenya currency upto a maximum of shs 100,000	To promote cross border trade

March	21	Liquidity ratio for commercial banks and non-bank financial institutions to be maintained at 5 and 10 percentage points respectively above the current commercial banks cash ratio requirement.	To harmonize liquidity ratio with the cash ratio requirement
		Cash ratio raised from 16 to 20 per cent, and interest payment on commercial bank deposits at the Bank withdrawn.	Correct excess expansion in net domestic assets
April	13	Open Market Operations sale of Treasury bills to be at least 0.5 per cent below the weekly average tender rate.	To stabilize interest rates
April	18	Commercial banks to borrow from the Bank for a maximum of 4 consecutive days and no more than 10 days in any one month	To promote prudent banking business
June	30	Kenya accepted obligations of Article VIII of the Articles of Agreement of the International Monetary Fund	To promote full convertibility of the Kenya shilling

World Economic Developments

4.1 Introduction

The world economy recovered slightly with real output growing by 2.3 per cent in 1993 compared with 1.8 per cent in 1992 (Table 1). This reflected gains achieved in the year in the developing countries. As a result, the volume of world trade edged by 5.2 per cent, up from 4.2 per cent in 1992. Unemployment rate in industrial countries rose from 7.8 in the previous year to 8.2 per cent in 1993. Inflation in these countries declined from 3.3 in 1992 to 2.9 per cent in 1993 but rose from 38.7 per cent to 45.9 per cent in developing countries.

4.2 Developments in Industrial Countries

Output in major industrial nations as a group grew by 1.4 per cent in 1993 compared with 1.7 per cent in the previous year. The slowdown reflected decreases in output in Germany, France, and Italy by an average of 0.9 per cent in the year and a near zero growth in Japan's output. In the United States, the United Kingdom and Canada output grew by 3.0, 1.9 and 2.4 per cent, respectively.

Unemployment in the industrial countries rose from 7.8 per cent in 1992 to 8.2 per cent in 1993 but inflation declined from 3.3 to 2.9 per cent over the same period. Inflation eased in France, Japan, United States, Germany and Italy in the year, but rose in Canada, from 1.5 per cent to 1.9 per cent in 1993.

With regard to external sector developments, industrial countries as a group had their current account reverting to a surplus of US$ 12.1 billion from a deficit of US$ 43.2 billion in 1992 (Table 2). The United States current account worsened recording the highest deficit.

On the money market, long term interest rates in the G-7 countries fell from 7.9 per cent in 1992 to 6.5 per cent, as represented by the United States. In Japan they rose from 5.1 per cent in 1992 to 5.8 per cent in 1993 while in the United States they fell from 7.0 per cent to 5.9 per cent. Short term interest rates in G-7 countries increased from 6.3 percent in 1992 to 6.5 percent in 1993.

In the currency market, the United States dollar depreciated against the pound sterling, the deutschemark and the French franc by 4.0, 2.1, 1.5 per cent respectively during 1993, but appreciated by 0.4 per cent against the Japanese yen.

Table 1

SELECTED ECONOMIC INDICATORS

	1989	1990	1991	1992	1993*
	(Annual percentage change)				
World real output	3.3	2.0	0.6	1.8	2.3
Industrial countries	3.2	2.1	0.2	1.6	1.2
Developing countries	4.0	3.7	4.2	5.9	6.1
Consumer price inflation					
Industrial countries	4.6	5.2	4.5	3.3	2.9
Developing countries	61.9	65.4	35.7	38.8	45.9
Labour					
Industrial countries					
Employment growth	1.8	1.2	0.5	0.1	0.6
Unemployment rates (%)	6.3	6.2	7.1	7.8	8.2
Interest rates	(In percent)				
Long-term[1]	8.1	9.0	8.3	7.9	6.5
United States	8.5	8.6	7.9	7.0	5.9
Japan	5.1	7.0	6.3	5.1	5.8
Short-term[1]	8.7	9.2	7.8	6.3	6.5
United States	9.1	8.2	5.8	3.7	3.2
Japan	5.3	7.6	7.2	4.3	2.8

[1]The average for the group of seven industrial countries.
*Provisional.

Source: The International Monetary Fund, World Economic Outlook, May 1994.

4.3 Developments in Developing Countries

The developing countries' economies as a group improved in 1993 with their output increasing by 6.1 per cent compared with 5.9 per cent in 1992. This was due to the continued good performance of the Asian economies whose output grew by 8.4 per cent. Output in Africa also improved, increasing by 1.1 per cent in 1993 compared with 0.4 per cent. Inflation in developing countries as a group increased from 38.8 per cent in 1992 to 45.9 per cent in 1993. This was as a result of inflation in sub-Saharan Africa, Latin America and Eastern Europe which increased from 40, 169.2, 20 per cent in 1992 to 44, 180.4, and 24.6 per cent respectively in 1993.

On the external sector, developing countries' current accounts deteriorated. These countries' current account deficit as a group widened from US $ 67.1m in 1992 to US $104.6m in 1993 (Table 2). The external debt of developing countries as a group increased from US $ 1,407 billion in 1992 to US $ 1,488 billion in 1993, but declined as a proportion of GDP from 33.5 per cent in 1992 to 32.5 per cent in 1993. The total debt service ratio of these countries was 8.2 per cent in 1993, more or less the same as in the previous year. This was mainly due to restructuring agreements concluded in 1992 and 1993, for debt amounting to US $ 48 billion owed to commercial banks in Western Hemisphere and debt reliefs given to low income countries in sub-Saharan Africa.

Table 2

SELECTED EXTERNAL SECTOR INDICATORS

	1989	1990	1991	1992	1993
Current account balance	**(In billions of US aollars)**				
Industrial Countries	−84.1	-110.1	−32.1	−43.2	12.1
United States	−101.1	−91.9	−8.3	−66.4	−109.2
Japan	51.3	−15.1	−65.9	−67.8	−21.9
Germany	57.4	47.3	−19.9	−25.3	−21.9
United Kingdom	−36.9	−32.6	−13.5	−17.6	−16.0
Developing countries	−16.9	−11.6	−87.9	−67.1	−104.6
Africa	−7.3	−3.0	−4.6	−7.5	−8.5
Asia	−0.8	−2.7	−2.7	−4.5	−25.1
Middle East and Europe	−1.8		−61.1	−20.3	−27.8
Western Hemisphere	−8.6	−6.0	−19.6	−34.8	−43.3
Other categorization					
Fuel exporters	−10.7	−1.1	−76.6	−46.9	−48.5
Non fuel exporters	−6.2	−12.7	−14.4	−20.2	−56.2
Market borrowers	0.1	5.0	−18.0	−30.2	−52.6
Official borrowers	−14.4	−11.0	−11.2	−14.2	−16.1
External debt service[1]	**(In per cent of exports of goods and services)**				
Developing countries	8.2	8.1	8.4	8.1	8.2
Africa	13.2	13.1	14.2	14.1	15.4
Asia	6.4	5.6	5.4	5.4	5.5
Middle East and Europe	7.5	8.3	8.7	5.7	5.0
Western Hemisphere	11.9	12.6	15.3	18.2	18.9
Sub-Saharan Africa	10.2	8.1	8.5	11.3	12.8
Oil exporting countries	9.2	9.3	11.7	12.0	10.8
Non oil developing countries	7.9	7.6	7.3	6.9	7.4

[1]Amortization.

Source: The IMF, World Economic Outlook, May 1994.

4.4 *Regional Co-operation*

In 1993, Preferential Trade Area for Eastern and Southern Africa (PTA) countries continued to forge closer economic co-operation. The highlight of PTA activities during the year was the 13th meeting of PTA Heads of states held in Kampala, Uganda where the Treaty transforming the PTA to a Common Market for Eastern and Southern Africa (COMESA) was signed. The Treaty will come into force after ratification. To maximise benefits from COMESA, the Heads of state of Kenya, Uganda and Tanzania signed a co-operation agreement at the end of 1993.

4.5 *Outlook for 1994/95*

The improvement in the world economy is expected to continue in 1994. World output is projected to grow by 3.0 per cent compared with 2.3 per cent in 1993. The recovery is expected to be more broadly based both in industrial and developing countries.

CHAPTER 5

Domestic Economic Developments

5.1 *Introduction*

The Kenyan economy slowed down further in 1993. The real gross domestic product (GDP) grew by only 0.1 per cent compared with 0.5 per cent in 1992. The decline was virtually in all sectors. Inflationary pressures remained high during most of the year.

5.2 *Domestic Production*

The poor performance in nearly all sectors of the economy in 1993 resulted in a 0.1 per cent growth in overall real GDP compared with 0.5 per cent in 1992 and 2.7 per cent in 1991 (Table 3). This particularly reflected contraction in agricultural and building and construction activity. Agricultural output declined by 4.1 per cent in 1993 compared with a 3.7 per cent decline in 1992. Building and construction also shrunk by 6.7 per cent in 1993 compared with 5.5 per cent in 1992 (Table 3 and Chart 1). This resulted from reduced investment in construction in both public and private sectors. The same trend was evident in manufacturing, mining and quarrying and electricity and water supply. Service sectors such as trade, restaurant and hotel (Chart 2) and transport and storage grew modestly.

The poor performance is attributed to reduced effective demand, partly due to the general downward trend in the economies of our major trading partners and high input costs. The financial sector, however, grew strongly by 7.5 per cent in 1993, compared with 6.9 per cent in 1992. The impressive growth is explained by substantial earnings from investment in short-term government paper whose return rose from about 13 per cent in April 1993 to an average of 60 per cent during the rest of the year. The expanded scale of activities following the liberalization of the the trade and payments system in 1993 also boosted activity in this sector.

5.3 *Domestic Demand*

Nominal aggregate demand is estimated to have increased by 20.1 per cent in 1993 compared with 14.0 per cent in 1992 (Tables 4 and 5). Most of the expansion in aggregate demand was in private sector consumption which accelerated from 21.5 per cent in 1992 to 25.8 per cent in 1993. The expansion in public sector consumption decelerated sharply from 10.3 per cent in 1992 to 1.7 per cent in 1993. The sharp deceleration in the growth in public sector consumption is attributed to the tight fiscal policy that entailed cuts in government expenditure to reduce the budget deficit.

Table 3

SECTORAL GROWTHS AND SHARES OF GDP AT CONSTANT 1982 PRICES
(per cent)

	1991[1]	1992[1]	1993[2]	Contributions to GDP in 1993
A. Monetary Economy	**2.1**	**0.4**	**0.1**	**94.5**
Agriculture	-1.1	-3.7	-4.1	25.1
Forestry	8.4	4.2	-1.2	1.1
Fishing	-2.2	-6.9	-7.1	0.3
Mining & quarrying	6.4	-8.0	2.0	0.3
Manufacturing	3.8	1.2	1.8	13.8
Building & construction	-3.7	-5.5	-6.7	2.6
Electricity & water	5.2	-1.9	0.9	1.1
Trade, restaurant & hotels	1.3	1.5	0.1	11.1
Transport, storage & communications	3.8	1.7	0.8	6.1
Financial services	6.1	6.9	7.5	9.4
Ownership of dwellings	2.6	1.6	0.2	5.5
Government services	3.6	2.4	2.0	16.1
Other services[2]	3.8	2.4	0.8	3.4
B. Traditional Economy	**2.1**	**1.2**	**0.9**	**5.5**
C. Total GDP growth	**2.1**	**0.5**	**0.1**	**100.0**

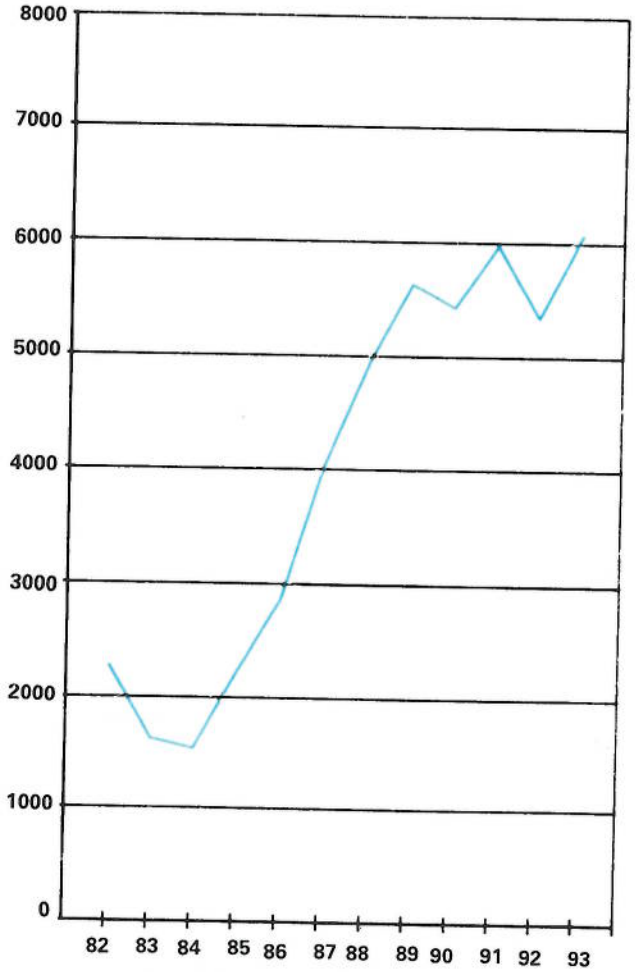
[1]Revised.

[2]Estimates.

Source: Economic Survey, 1994.

Chart 1

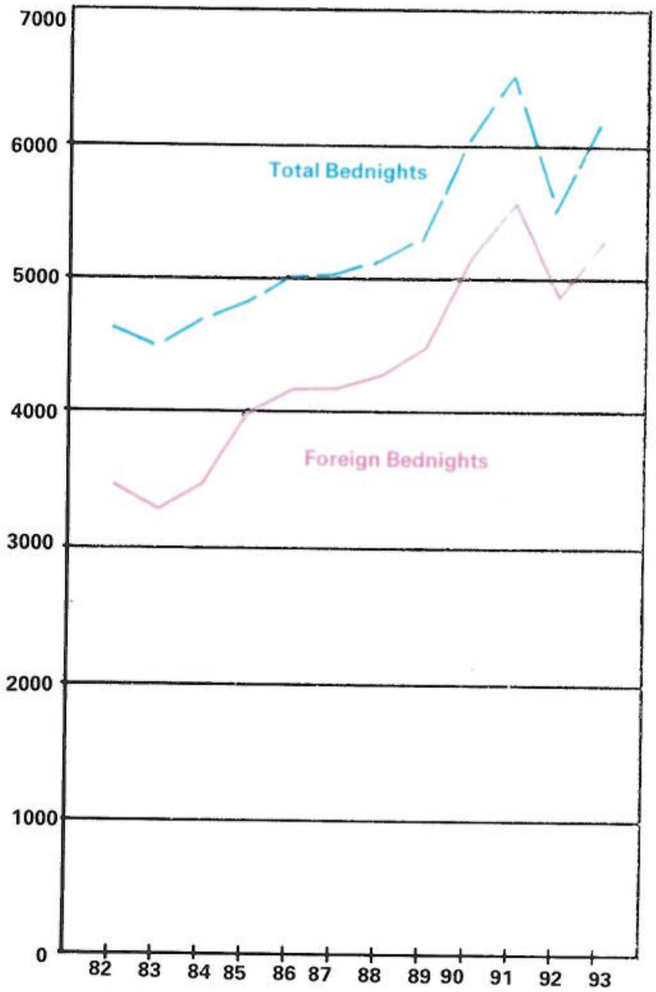
APPROVED CONSTRUCTION PLANS FOR NAIROBI AND OTHER TOWNS
(shillings million)



Source: Central Bureau of Statistics.

Chart 2

TOURISM: NUMBER OF BEDNIGHTS OCCUPIED
(Thousands of Bednights)



Source: Central Bureau of Statistics.

Table 4

AGGREGATE DEMAND
(shillings million unless otherwise stated)

	1991[1]	1992[1]	1993[2]	% change 1992	% change 1993
Total consumption	**177,043**	**210,822**	**255,158**	**19.1**	**21.0**
Private consumption	139,437	169,346	212,980	21.5	25.8
Public consumption	37,606	41,475	42,178	10.3	1.7
Gross investment	**47,022**	**44,678**	**51,719**	**-5.0**	**15.8**
Gross fixed capital formation	42,671	43,780	49,474	2.6	13.0
Private sector	23,521	24,460	29,313	4.0	19.8
Public sector	19,150	19,320	20,162	0.9	4.4
Change in stocks	4,351	898	2,245	-79.4	150.0
Total expenditure	**224,065**	**255,499**	**306,877**	**14.0**	**20.1**
Memorandum items:					
Investment Financing					
External Grants	6,602	6,280	9,692	-4.9	54.3
Net external borrowing	5,790	-3,742	-10,123	-164.6	170.6
Domestic savings	34,629	41,541	52,149	21.7	23.8
Total	47,022	44,079	51,719	-5.0	15.8
Ratio of domestic savings to GDP (at market prices)	15.6	17.2	16.2	-5.8	—

[1]Revised.

[2]Provisional.

Source: Economic Survey, 1994.

Table 5

AGGREGATE DEMAND IN CONSTANT 1982 PRICES
(shillings million)

	1991[1]	1992[1]	1993[2]	% change 1992	% change 1993
Gross Fixed Capital Formation	15,246.6	14,361.6	12,008.0	-5.8	-16.4
Changes in Stock	1,798.8	468.4	1,171.0	-74.0	150.0
Total Investment	**17,045.0**	**14,830.0**	**13,179.0**	**-13.0**	**-11.1**
Public Consumption	17,960.4	19,600.2	21,035.0	9.1	7.3
Private Consumption	62,050.6	65,970.2	68,795.6	6.3	4.3
Total Consumption	**80,011.0**	**85,570.4**	**89,830.6**	**6.9**	**5.0**
Total Expenditure	**97,056.4**	**100,400.4**	**103,009.6**	**3.4**	**2.3**

[1]Revised.

[2]Estimates.

Source: Central Bureau of Statistics.

5.4 Employment, Wages and Consumer Prices

Wage employment expanded by only 0.9 per cent in 1993 compared with 1.4 per cent in 1992 and 2.3 per cent in 1991, due to the low level economic activity. A total of 244,400 new jobs were created in 1993 (Table 6). Most of these new jobs were in the informal sector which absorbed 29,000 new entrants into the labour market in the year.

The overall wage bill increased by 14.7 per cent in 1993 compared with 15.1 per cent in 1992. The public and private sector wage bills declined from 9.0 and 21.4 per cent in 1992 to 8.5 and 20.5 per cent, respectively in 1993. Average earnings in the private sector, however, improved rising by 16.5 per cent in 1993 compared with 15.6 per cent in 1992.

5.5. Consumer Prices

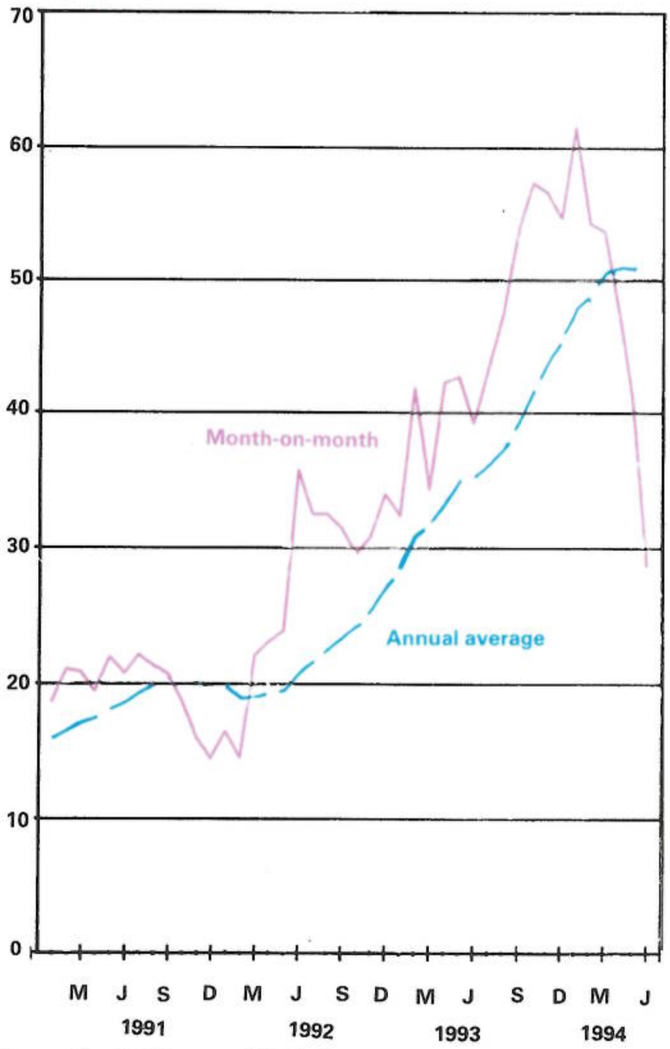
The average annual inflation, measured by the consumer price index, accelerated from 27.3 per cent in 1992 to 45.6 per cent in 1993 (Table 6 and Chart 3). Similarly the month-on-month inflation rose from 34.0 per cent in 1992 to 54.7 per cent in 1993. The rapid increase in inflation was attributed to the depreciation of the shilling, shortage of food supply, the progressive removal of price controls and the liquidity overhang injected in the economy in 1992 and through the first quarter of 1993.

5.6 Prospects for 1994

The economy is expected to improve with real GDP forecast to grow by 2.5 per cent in the year. This growth is expected to come mainly from the agriculture, manufacturing and the services sectors buoyed by improved investment in response to the economic reforms put in place. The economy is also expected to benefit from the anticipated recovery of Kenya's major trading partners.

Chart 3

CHANGES IN CONSUMER PRICE INDEX
(Per cent)



Source: Central Bureau of Statistics.

Table 6

EMPLOYMENT, WAGES AND CONSUMER PRICES
(annual percentage changes)

	1991	1992	1993[1]
Employment[2]			
Total persons engaged	6.7	7.7	8.9
Wage employment	2.3	1.4	0.9
Private sector	2.4	5.0	3.5
Public sector	2.2	-2.3	-1.9
Small scale enterprises & self employed	8.6	10.2	11.9
Wages			
Total wage bill	12.2	15.1	14.7
Private sector	12.9	21.4	20.5
Public sector	11.6	9.0	8.5
Average wage earnings	9.7	13.5	13.7
Private sector	10.2	15.6	16.5
Public sector	9.2	11.6	10.6
Prices[3]			
Average annual	19.6	27.3	45.6
Month-on-month	14.5	34.0	54.7
3-Month Annualized (End of Period)	5.2	13.6	15.9

[1]Provisional.

[2]Revised series.

[3]Weighted changes in the Revised Nairobi Consumer Price Indices.

Source: Economic Survey, 1994.

Budgetary Developments

6.1 The 1993/94 Budget Outturn

The budgetary operations of the Government in fy 1993/94 resulted in a cash deficit of 6.2 per cent of GDP. While this was an improvement over the previous year's performance, the deficit exceeded the 3.0 per cent target for the year by a large magnitude despite better performance in revenue. This was due to higher recurrent expenditure and lower than estimated receipts of external grants. Most of the new expenditure in the year was in education, agriculture, health and security. The allocations for Consolidated Fund Services also increased significantly.

To finance the deficit, the Government borrowed shs 27,286m from the nonbank sector and shs 560m from external sources while it repaid the banking system shs 2,811m (Table 7 and Chart 4).

6.2 Revenue and Grants

Total revenue and grants amounted to shs 106,848m or 36.2 per cent higher than in 1992/93. The increase was attributed to good performance in ordinary revenue, particularly income tax. Income tax rose by 83.2 per cent during the year to shs 36,570m owing to the combined effects of the re-introduction of the PIN, tax amnesty, the collection of corporation tax from parastatals which previously were exempted and the effect of the introduction of the instalment payment of corporation tax. Revenue from VAT and Customs and Excise duties also improved significantly owing to 25 per cent surcharge on import duties and enhanced collection effort. Receipts from other taxes also did well in the year due to dividend payments made by a number of parastatals and improved recovery of arrears of payments made by the Government to external creditors on behalf of some parastatals.

Foreign grants amounted to shs 4,025m or 54.3 and 66.5 per cent lower than in the previous year and the budget estimate, respectively.

6.3 Expenditure and Net Lending

Total expenditure and net lending, including adjustment float, in fy 1993/94 amounted to shs 131,883m, an increase of 29.0 per cent above the level in the previous year. As a proportion of GDP, however, the expenditure shrunk from 36.0 per cent of GDP in fy 1992/93 to 33.0 per cent in the review year. Recurrent expenditure amounted to shs 104,199m or 44.5 per cent above the level in 1992/93. The substantial increase reflected large interest payments on domestic debt, higher operating expenditures for maintaining security, purchase of drugs, maintenance of roads and holding of by-elections. Expenditure on Kenya missions abroad also increased substantially due to depreciation of the shilling exchange rate.

Table 7

SUMMARY OF GOVERNMENT FISCAL OPERATIONS
(shillings million)

	1992/93 Actual	1993/94 Printed Budget	1993/94 Actual	1994/95 Printed Budget
Revenue and grants	**78,469**	**101,408**	**106,848**	**142,908**
Recurrent revenue	69,668	89,385	102,823	126,367
Ordinary revenue	55,779	87,484	98,837	120,889
Direct taxes	19,959	24,875	36,570	37,358
Income tax	19,959	24,875	36,570	37,358
Other direct taxes	—	—	—	—
Indirect taxes	38,779	54,667	56,763	74,695
Customs, excise and export duties	15,511	25,086	25,763	42,055
Value added tax	22,143	28,366	29,049	30,563
Other indirect taxes	1,125	1,215	1,793	2,077
Non-tax revenue	7,041	7,942	5,504	8,836
Appropriations-in-Aid[1]	3,882	1,901	3,986	5,972
Grants	8,808	12,023	4,025	16,047
Expenditure & net lending	**93,400**	**110,542**	**126,788**	**145,267**
Recurrent expenditure	72,089	84,750	104,199	104,643
Development expenditure and net lending	21,311	25,792	22,589	40,624
Float adjustment [rev (+)/exp (−)]	−8,808	—	−5,095	—
Overall surplus(+)/deficit(−)	**−23,739**	**−9,134**	**−25,035**	**−2,359**
Financing	**23,739**	**9,134**	**25,035**	**2,359**
Foreign borrowing (net)	6,360	6,574	560	3,254
Domestic borrowing	17,379	2,560	24,475	−895
Non-bank Sector	25,376	8,680	27,286	3,294
Banking System[2]	−7,997	−6,120	−2,811	−4,189
Memorandum Item:				
Overall surplus(+)/deficit(−) (per cent of GDP)	−8.4	−3.0	−6.2	−2.5

[1]Includes export compensation of shs 813m.

[2]Excludes debt of parastatal assumed by the Government.

Sources: The Treasury and the Central Bank.

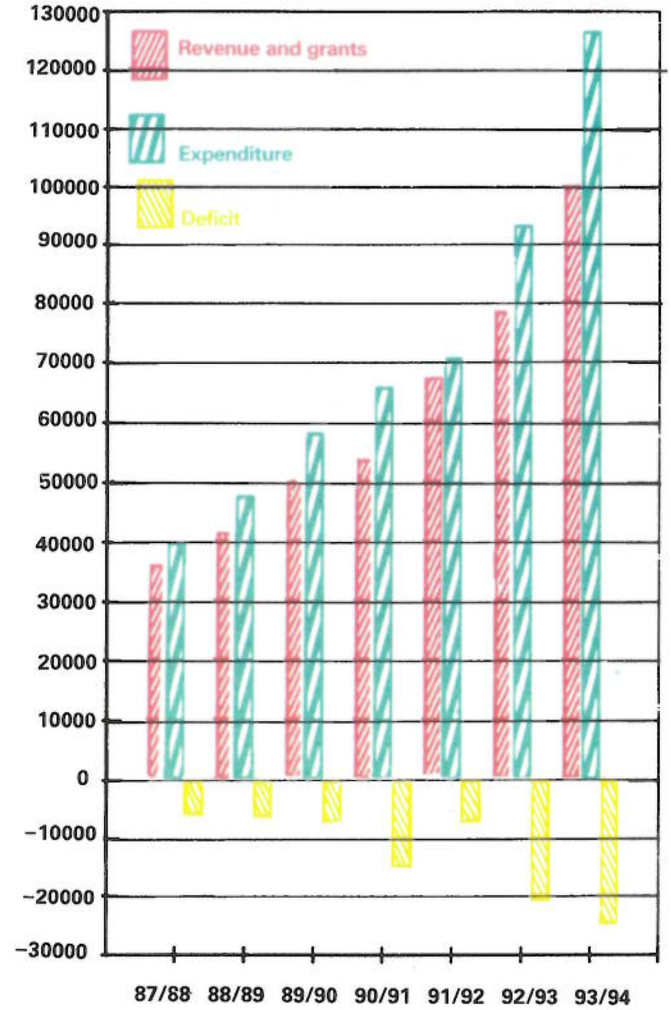
Development expenditure and net lending amounted to shs 22,589m. This was 6.0 per cent higher than in 1992/93, but 12.4 per cent below the budget estimate. The increase in development expenditure was attributed to expenditures for settlement of pending bills on construction projects, dredging of Kilindini Harbour, payment to Kenya Railways, expenses related to famine relief programmes and the purchase of communication equipment for the police department. Rehabilitation of the Mombasa Airport and the Kenya Meat Commission plant also contributed to the increase in Government's development expenditure in the year.

6.4 The Financing of the Deficit

The budget deficit was financed mainly from the domestic sources. The Government borrowed shs 27,286m and shs 560m from the domestic nonbank and external sources, respectively, but reduced its indebtedness to the banking system by shs 2,811m.

Chart 4

GOVERNMENT REVENUE AND EXPENDITURE
(shillings million)



Source: Treasury.

6.5 *Public Debt*

As the fiscal agent of the Government, the Central Bank continued to manage domestic debt, selling Government securities to finance the budget deficit, refinance maturing debt and manage domestic liquidity. The Bank also continued to monitor movements in the Paymaster General and the Exchequer Accounts, rediscount securities and effect interest payments on the domestic debt. The Government debt operations resulted in the increase in the gross domestic debt to shs 163,767m in June 1994 from shs 114,009m in June 1993 (Table 8). The instruments traded during the year included Treasury bills, Treasury bonds and Government Bearer bonds. External debt on the other hand increased by shs 560m in the year to shs 272,128m. Consequently, gross public debt rose by shs 50,318m to shs 435,895m in June 1994. However, when adjusted for Government deposits and Sinking Fund holdings of shs 30,237m and shs 55,520m in 1992/93 and 1993/94 respectively, the increase in the public debt was only shs 25,035m.

Total service payments on government and parastatal guaranteed debt was shs 15,501m in fy 1992/93 or 6.7 per cent lower than in the previous year. The debt service ratio also declined to 11.5 per cent from 24.0 per cent in fy 1991/92 (Table 9). The lower ratio was due to accumulation of debt service arrears and the depreciation of the shilling which raised the value of export proceeds in shilling terms.

Table 8

OUTSTANDING DEBT BY HOLDER
(shillings million)

As at 30th June	1988	1989	1990	1991	1992	1993	1994[1]
Domestic Debt	**46,587**	**50,752**	**54,359**	**65,482**	**72,847**	**114,009**	**163,767**
Long-term Debt	14,128	11,651	11,312	10,702	9,680	8,852	28,252
Sinking Funds	1,516	1,489	1,444	1,388	1,307	1,192	1,192
Central Bank[2]	5,432	3,432	3,432	3,432	3,265	3,258	22.658
Other public entities	6,520	5,977	5,690	5,322	4,641	4,003	4,003
Comm. Banks	109	109	109	101	101	100	100
Other Domestic	551	644	637	459	366	299	299
Short & medium term debt	32,459	39,101	43,047	54,780	63,167	105,157	135,515
Sinking Fund	208	295	394	497	731	522	339
Central Bank	8,026	12,150	14,682	21,770	19,682	29,668	27,745
Other public entities	10,817	12,934	13,804	14,002	16,230	19,584	19,584
Comm. Banks	5,475	5,854	5,304	7,698	9,829	18,306	23,485
Other Domestic	7,951	7,868	8,863	10,813	16,695	37,077	64,362
Foreign Debt	**53,819**	**53,525**	**68,380**	**89,179**	**122,269**	**271,568**	**272,128**
International Dev. Institutions	22,978	25,069	36,407	49,388	60,855	130,184	130,452
Other Foreign	30,841	28,456	31,973	39,791	61,414	141,384	141,676
Total	**100,406**	**104,277**	**122,739**	**154,661**	**195,116**	**385,577**	**435,895**

[1]Provisional.

[2]Includes direct advances to Kenya Government amounting to shs 200m.

Sources: Central Bank of Kenya and Economic Survey (1994).

Table 9
EXTERNAL PUBLIC DEBT SERVICE PAYMENTS
(shillings million)

End June	1986	1987	1988	1989	1990	1991	1992	1993[1]
Government	4,741	5,166	5,677	7,376	7,461	2,285	11,978	9,469
Parastatal (guaranteed debt)	3,928	4,219	3,754	2,232	3,392	4,416	4,637	6,032
Total debt service	**8,669**	**9,385**	**9,431**	**9,608**	**10,853**	**16,701**	**16,615**	**15,501**
Memo. items								
Debt Service ratio	28.6	33.5	28.0	24.0	21.0	27.6	24.0	11.5[2]

[1]Provisional.

[2]This is understated because it excludes external payment arrears.

Sources: Economic Survey (1994); and the Treasury, External Debt Division.

6.5.1 *Treasury Bills*

Treasury bills sales increased substantially during the year mainly because of greater reliance on the instrument to mop up excess liquidity in the economy. Treasury bills worth shs 322,627m were sold while bills worth shs 302,936m were redeemed in the year. As a result, the stock of Treasury bills rose from shs 63,919m in June 1993 to shs 83,610m in June 1994. To accommodate the diverse liquidity preferences of investors, Treasury bills were diversified during the year by introducing 30 -, 60 - and 180-day bills.

Other measures to popularise Treasury bills were introduced in the year including the lowering of the minimum face value of the bills from shs 100,000 to shs 50,000 and appointment of the National Bank to market the bills on an agency basis. Central Bank branches were also authorised to receive and process Treasury bills tender applications. These measures, and the success in fighting inflation, made the average discount rate on the instrument fall from a record 70 per cent in June 1993 to 30 per cent in June 1994.

6.5.2 Treasury Bonds

During fy 1992/93 twelve issues of Treasury bonds were floated raising shs 33,315m. Treasury bonds worth shs 9,844m were redeemed during the year. Consequently, the stock of Treasury bonds outstanding increased from shs 21,482m in June 1993 to shs 44,953m in June 1994. This total included shs 24,000m taken up by the Central Bank in August 1993 following a restructuring of short-term Government debt held by the Bank. The stock of Government Bearer bonds, on the other hand, declined from shs 17,069m in June 1993 to shs 5,922m in June 1994 following the suspension of sales of this instrument in November 1993.

6.5.3 Government Stocks

During the year under review, the Government stocks worth shs 3,000m were redeemed while stocks worth shs 22,400m were sold to the Central Bank as part of the restructuring process of the Government's short- term debt held by the Bank. The outstanding stock therefore rose from shs 8,652m in June 1993 to shs 28,052m in June 1994.

6.5.4 Unsecured Borrowing from the Banking System

The unsecured Government debt held by the banking system declined further to shs 1,162m in June 1994 compared with the shs 2,819m in June 1993 and shs 13,250m in June 1992.

6.6 The 1994/95 Budget

The 1994/95 Budget projects a reduction in the budget deficit to shs 2,359m or 2.5 per cent of GDP from 6.2 per cent in fy 1993/94. This is expected to be achieved mainly through revenue raising and expenditure reducing measures. Total revenue is forecast to remain at 24 per cent of GDP while expenditure is forecast to decline to 26 per cent of GDP.

On the revenue side, much of the gain is expected to come from further streamlining of tax administration and the revision of tax rates. Notable proposals in the budget included the continued funding of recurrent expenditure budget of revenue departments at one per cent of their revenue targets and the reduction in customs tariff bands from 8 to 7. The luxury goods VAT rate was also lowered from 40 to 30 per cent to encourage compliance while taxes on a number of petroleum products were restructured and taken over by excise duty as the major tax vehicle. Other revenue raising measures announced included the extension of the coverage of the PIN system and the introduction of a withholding tax on gross payments exceeding shs 24,000 per month on contracts undertaken by individuals. Special rules were introduced to check tax evasion through transfer pricing between tax exempt EPZ enterprises and related resident companies. Licences and fees were also increased for banks, building societies, insurance companies and auctioneers as were trading licences and tourist enterprise fees.

On the expenditure side, much gain is expected to come from further retrenchment of the civil service, parastatal reform and introduction and vigorous implementation of the new expenditure control system. In this regard, the Government will issue quarterly expenditure ceilings for recurrent and development estimates. Ministries will be required to remain within the ceilings in their expenditure commitments. The Budget's emphasis is on enhancing efficiency in the utilisation of resources by increasing the share of operations and maintenance (O & M) expenditure in the recurrent budget than that of development expenditure and focusing on core Government functions.

CHAPTER 7

Monetary Conditions and Policy Developments

7.1 Introduction

During fy 1993/94, the Bank pursued a tight monetary policy in order to combat inflation, stabilise the shilling exchange rate, and ensure positive real interest rates. The main instruments of monetary policy which the Bank used in the year included open market operations and the cash ratio. Reflecting the tight monetary policy pursued in the year, the money supply (M2) expanded less rapidly than in fy 1992/93. This followed a large decline in growth in net domestic assets which offset the impact of the substantial increase in net foreign assets of the banking system. Meanwhile, credit to the economy from nonbank financial institutions (NBFIs) increased more rapidly than that of banks. Total deposits and actual liquidity ratios for both banks and NBFIs rose substantially during the year.

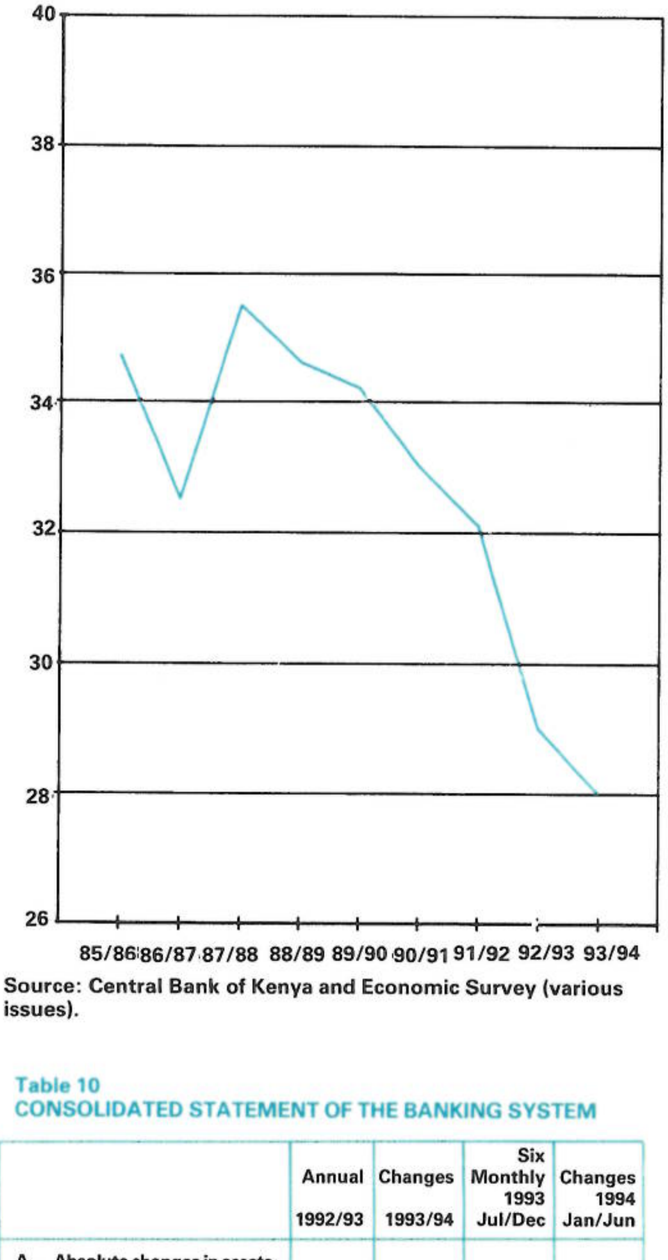
7.2 Money and Credit

7.2.1 Money supply

The money supply (M2) increased by 21.2 per cent in fy 1993/94 compared with 34.7 per cent in fy 1992/93 (Table 10). Inspite of the deceleration in the growth in M2, the income velocity of money continued to decline (Chart 5). The slowdown in the pace of monetary expansion reflected a 3.5 per cent fall in net domestic assets, which wholly offset the impact of the substantial increase in net foreign assets. The deceleration was more pro-

Chart 5

VELOCITY OF MONEY



Source: Central Bank of Kenya and Economic Survey (various issues).

Table 10
CONSOLIDATED STATEMENT OF THE BANKING SYSTEM

	Annual Changes 1992/93	1993/94	Six Monthly Changes 1993 Jul/Dec	1994 Jan/Jun
A. Absolute changes in assets (shs m)				
Net foreign assets	6,981	25,932	22,490	3,442
Net credit to government	-7,995	-2,825	7,814	-10,640
Credit to private & other public sectors	10,337	8,437	174	8,263
Other items (net)	-17,616	9,315	10,298	-983
Total[1]	29,939	22,229	20,180	2,048
B. Percentage changes in money stock and selected assets				
Selected assets				
Net credit to Government	-26.0	-12.4	34.3	-34.7
Credit to other public sector	-18.1	44.9	28.2	13.1
Credit to private sector	19.9	10.6	-1.1	11.8
Total credit	2.6	6.1	8.7	-2.4
Net Domestic Assets	22.9	-3.5	-2.2	-1.3
Liabilities				
Narrow money (M1)	46.0	16.3	16.4	-0.1
Quasi-money	25.1	26.1	22.1	3.3
Total money supply (M2)	34.7	21.2	19.3	1.6

[1]Changes in M2.

Source: Central Bank of Kenya.

nounced in the January-June 1994 period, when total credit fell and net foreign assets increased less rapidly. In terms of the components of M2, quasi money accelerated while narrow money decelerated in fy 1993/94.

7.2.2 Credit

Total credit to the economy from the banking system increased by 6.1 per cent in fy 1993/94 compared with 2.6 per cent during fy 1992/93. The acceleration was in credit to the other public sectors, which rose by 44.9 per cent. Net credit to Government declined by 12.4 per cent compared with 26.0 per cent in fy 1992/93. Meanwhile, the growth in credit to the private sector decelerated, rising by 10.6 per cent in the year compared with 19.9 per cent over the same period in the previous year (Table 10).

The growth in credit extended to the economy by NBFIs accelerated to 45.4 per cent during fy 1993/94 from 14.8 per cent in the previous year (Table 11). The Government absorbed 72.5 per cent and the private sector 27.6 per cent of the increase in total credit. The growth in credit to the public sector recorded a decline of 8.1 per cent compared with a decline of 16.9 per cent in the previous year.

In the period under review credit to the economy from both commercial banks and NBFIs reflected sluggish demand as a result of the general slack in economic activity and to some extent owing to high lending rates prevailing during this period. Also apparent was a shift by the banking industry in favour of investment in high yield Treasury bills.

Table 11

SELECTED NON BANK ASSETS AND LIABILITIES

	Annual % change June'93	June'94	Level in June'94 (shs m)
Liabilities			
Government Deposits	-15.4	-15.6	346
Other public sector deposits	7.1	10.4	8,380
Private sector deposits	6.9	56.9	42,978
Total deposits	6.7	34.3	51,704
of which:			
Time	6.1	33.3	48,732
Savings	16.6	28.0	2,972
Assets			
Credit to government (net)	74.9	135.7	24,997
Credit to other public sector	-16.9	-8.1	418
Credit to private sector	4.1	16.9	38,162
Total credit	14.8	45.4	63,577

Source: Central Bank of Kenya.

7.3 Deposits and Liquidity of Commercial Banks and NBFIs

7.3.1 Deposits

Total deposits held with commercial banks rose by 24.0 per cent in fy 1993/94 compared with 41.4 per cent in fy 1992/93 (Table 12). The slowdown was largely in the deposits of the Government and other public sectors which decreased by 5.1 and

0.7 per cent, respectively, compared with increases of 43.6 and 21.1 per cent in fy 1992/93. Private sector deposits increased by 29.2 per cent compared with 45.3 per cent. Among the deposits components, demand deposits increased less rapidly while savings deposits accelerated. Meanwhile, growth in time deposits slowed down to 13.8 per cent in fy 1993/94, compared with 27.3 per cent in the previous year. However, the share of demand deposits in total commercial bank deposit decreased from 40.8 per cent in June 1993 to 40.3 per cent in June 1994. Part of the change is accounted for by reclassification of call and seven days notice deposits to time deposits. The share of time deposits dropped from 32.8 in June 1993 to 30.1 while that of savings rose from 26.4 per cent to 29.6 per cent in June 1994. This was partly due to loss of business to the Treasury bill market which was offering more attractive rates of return.

Deposits held with NBFIs rose by 34.3 per cent in the year ending June 1994 compared with 6.7 per cent in the previous year (Table 11). The growth was in the deposits of the private sector which rose by 56.9 per cent compared with 6.9 per cent in fy 1992/93. Government deposits continued to decline while other public sector deposits increased slightly. Both time and savings deposits increased more rapidly, while their shares in total deposits were 94.3 and 5.7 per cent at the end of June 1994 compared with 94.0 and 6.0 per cent in June 1993, respectively.

Table 12

ANALYSIS OF DEPOSITS OF COMMERCIAL BANKS

	Annual % Changes		Level in June'94 (shs m)
	June'93	June'94	
Government deposits	43.6	−5.1	2,821
Other public sector deposit	21.1	−0.7	12,080
Private sector deposits	45.3	29.2	96,604
Total deposits	41.4	24.0	111,506
of which:			
Demand	74.0	22.3	44,900
Time[1]	27.3	13.8	33,570
Savings	22.7	39.4	33,036

[1]Includes call and seven-day notice deposits.

Source: Central Bank of Kenya

7.3.2 *Liquidity*

The monthly average liquidity ratio for commercial banks stood at 49 per cent in June 1994, or 13 and 24 percentage points above the level in June 1993 and the minimum requirement, respectively. This reflected increases in commercial banks balances at the Central Bank, banks' balances abroad, and Treasury bill holdings which rose by 418.9, 14.0 and 12.0 per cent, respectively, during fy 1993/94 (Table 13). The cash balances of banks at the Central Bank as a proportion of their deposit liabilities rose from 4.6 per cent in June 1993 to 23.0 per cent in June 1994, following increases, in steps, in the minimum requirement from 6 per cent in April 1993 to 20 per cent in March 1994. The minimum liquidity ratio for banks was raised to 25 per cent on March 20, 1994.

Table 13

LIQUID ASSETS OF BANKS AND NON BANK FINANCIAL INSTITUTIONS
(shillings million)

	Jun'93	Jun'94*	Change Jun'93 Jun'94 (shs m)	Change Jun'93 Jun'94 %
Commercial Banks				
Vault and till cash[1]	4,006.6	3,946.4	−60.2	−1.5
Balances at Central Bank	3,880.7	20,137.8	16,257.1	418.9
Balances at banks in Kenya	14.3	−792.6	−807.1	n/a
Balances at other financial institutions[2]	−2,706.0	−3,919.6	−1,213.6	44.8
Balances at banks abroad	8,166.7	9,306.6	1,139.9	14.0
Treasury bills	10,128.4	22,284.6	12,156.2	120.0
Treasury bonds	1,738.3	1,423.2	−315.1	−18.1
Certificates of deposit	4,729.2	159.0	−4,570.2	−96.6
Foreign exchange bearer Certificates	3.5	0	−3.5	−100.0
Total liquid assets	29,962.0	52,545.2	22,583.2	75.4
Net deposits liabilities	83,526.6	106,580.3	23,053.7	27.6
Average liquidity ratio (%)	36.0	49.0	13.0	
Statutory liquidity ratio (%)	20.0	25.0	5.0	
Average cash ratio	4.6	18.9	14.2	
Statutory cash ratio (%)	8.0	20.0	12.0	
Non bank Financial Institutions				
Vault and till cash[1]	64.0	93.6	29.6	46.3
Balances at banks in Kenya	2,326.2	3,369.7	1,043.5	44.9
Balances at other financial institutions[2]	399.5	−262.2	−662.2	−165.8
Balances at banks abroad	9.6	5.4	−4.2	−43.8
Treasury bills	5,868.8	22,428.0	16,559.2	282.2
Treasury bonds	782.3	82.7	−699.6	−89.4
Certificates of deposit	3,171.3	571.9	−2,599.4	−82.0
Foreign exchange bearer certificates	3.1	0	−3.1	−100.0
Total liquid assets	12,624.8	26,288.5	13,663.7	108.2
Total deposit liabilities	38,909.1	51,089.7	12,180.6	31.3
Average liquidity ratio (%)	32.0	51.0	19.0	
Statutory liquidity ratio (%)	24.0	30.0	6.0	
Average cash ratio	6.1	6.8	0.6	

[1]Since January 1991, cash has been redefined to include both domestic and foreign notes and coin.

[2]This has since January 1991 been redefined to include specified non bank financial institutions, mortgage companies and building societies.

*Provisional.

Source: Central Bank of Kenya.

The monthly average liquidity for NBFIs stood at 51 per cent in June 1994, or 21 percentage points above the minimum requirement. The increase in NBFIs liquidity in fy 1993/94 was largely in Treasury bill holdings and balances with banks in Kenya, which rose by 282.2 and 44.9 per cent, respectively. The NBFIs, like commercial banks, were required to maintain a higher liquidity ratio of 30 per cent with effect from March 20, 1994, compared with 24 per cent since January 1983.

7.4 *Interest Rates*

The trend of interest rates during fy 1993/94 was mixed. On average all commercial bank rates, except the interbank rate, rose. The average overdraft, term and savings deposits rates rose by 7.9, 0.4 and 2.7 percentage points to 33.1, 17.6 and 16.1 per cent in June 1994 (Table 14). The increase in term and savings deposits rates was influenced by the high rate of return on treasury bills during the year. Meanwhile, the weighted lending rates rose from 19.05 per cent in June 1993 to 28.2 per cent in June 1994 for 2 - 3 year maturities, and from 20.6 to 31.7 per cent for 0 - 1 year maturity during the same period. The average inter-bank rate, however

Table 14

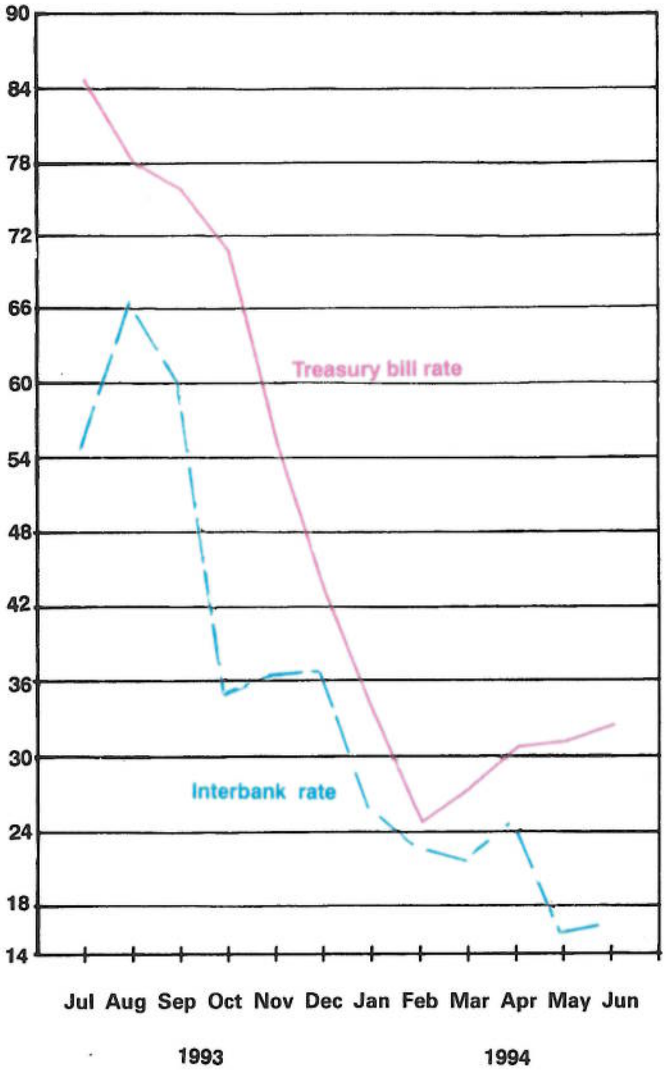
PRINCIPAL INTEREST RATES
(per cent)

	Jun 1993	Jan 1994	Feb	Mar	Apr	May	Jun
Central Bank							
Treasury Bill average Yield	84.56	33.66	24.87	27.64	30.85	31.26	32.55
Commercial Banks							
Deposit Rates							
Time	17.28	23.27	20.84	19.98	18.61	17.76	17.42
Savings	13.43	16.18	18.40	17.46	18.00	17.44	16.11
Lending Rates							
Inter Bank Rate	61.15	25.90	22.72	21.69	24.79	15.71	16.48
Overdraft	25.28	32.90	33.24	32.62	33.78	32.30	33.17
0-1 year	25.10	32.08	31.89	31.74	32.50	31.62	32.60
1-2 years	24.32	32.49	32.39	30.26	32.41	30.94	31.58
2-3 years	23.15	30.40	30.43	28.24	30.44	29.24	28.81
Over 3 years	24.73	32.64	32.86	30.52	32.78	30.76	31.29

Source: Central Bank of Kenya.

Chart 6

TREASURY BILL AND INTER-BANK INTEREST RATES



Source: Central Bank of Kenya.

declined by 44.7 percentage points during fy 1993/94 to 16.5 per cent in June. This fall was consistent with the decline in the weighted average treasury bill yield rate from 84.6 per cent in June 1993 to 32.6 per cent in June 1994. Chart 6 shows the trend in Treasury bill yield and inter-bank rates.

Coupon rates for Treasury bonds remained unchanged at 15.0, 16.5 and 17.0 per cent for one, two and five year maturities respectively. Bearer bonds were also available at the same coupon rates as registered Treasury bonds upto December 1993 when they were discontinued.

7.5 *Monetary Policy Developments*

The Central Bank pursued tight monetary policy during fy 1993/94 to combat inflation, stabilise the value of shilling and ensure positive real rates of interest. These objectives were pursued through active application of Open Market Operations (OMO), frequent upward review in the cash ratio and restriction of commercial banks access to Central Bank credit. Quantitative credit guidelines were abolished on December 1, 1993.

The minimum cash ratio was raised from 8 per cent in April 8, 1993 to 10, 12, 14, 16 and 20 per cent in July, October and December 1993, and February and March 1994, respectively to complement OMO. To minimize loss to commercial banks, the Central Bank paid interest at 35 per cent per annum for any deposits above 10 per cent of the minimum requirement beginning October 21, 1993. This was lowered to 20 per cent per annum from February 7, 1994 and withdrawn in March 1994. To ensure institutions observed the cash ratio limits, stiff penalties were imposed on defaulters. In addition the Bank's Clearing House was reorganized to remove the element of automatic credit which was prevalent in the past.

The process of making overnight advances to banks was, effective August 9, 1993, streamlined by limiting eligible collateral to Treasury bills, registered and bearer Treasury bonds held for at least 10 days from the date of issue but with only a life of 90 days to maturity. The applicable rate was maintained at the highest accepted Treasury bill rate in the previous week's auction plus 2.5 percentage points for the first shs 50m. Additional increments of shs 50m continued to be charged a further 1 percentage. By April 18, 1994 the maximum duration for overnight loans was limited to 4 consecutive days and not more than 10 days per month. Defaulters risked being placed under Central Bank supervision and subjected to borrowing conditional on corrective action. The Central Bank, limited with effect from August 9, 1994, rediscounting to Treasury bills half way to maturity and to other government securities provided they are 45 days or less to maturity.

CHAPTER 8

Developments in the Financial System

8.1 Introduction

There was a marginal reduction in the number of operational banks and nonbank financial institutions (NBFIs) during fy 1993/94. However, money and capital markets were relatively buoyant.

8.2 Banking Industry

As at the end of June 1994, operational commercial banks stood at 33 compared with 34 in June 1993. The branch network and service outlets fell from 581 to 490 in the same period. Full fledged branches also fell from 257 to 237 and sub-branches from 77 to 76. Agencies and mobile units decreased from 247 to 177. The operational NBFIs at the end of June 1994 were 50 compared with 51 at the end of June 1993. Their branch network also fell to 90 from 92.

8.3 Deposit Protection Fund

The Deposit Protection Fund continued to play its role of protecting depositors in banks and non-bank financial institutions (NBFIs). During the year, the Fund was, in a accordance with Section 35 of the Banking Act (1989) directed by the Central Bank to liquidate 2 insolvent banks and 9 non-bank financial institutions. Significant progress in paying insured depositors in these institutions was made in the year. Meanwhile, the assessment rate was increased from 0.1 per cent to 0.15 per cent of an institution's average deposit liabilities and the minimum contribution from shs 100,000 to shs 300,000 in order to enable the Fund to mobilise sufficient resources to protect the interest of the depositors. This raised the assessed contributions from shs 100.9m in the year ended June 30, 1993 to shs 179.8m during the year under review.

The growth in net assets of the Fund since inception has been hampered by heavy deposit pay off, amounting to approximately shs 552m in the institutions that are currently under liquidation.

8.4 Money and Capital Markets

In the money market, outstanding Treasury bills rose by shs 19,691m during the year to shs 83,610m in June 1994. This reflected increased holdings of commercial banks and non-bank investors of shs 19,268m and shs 20,481m respectively, and a decline in Central Bank holdings of shs 22,730m. The increased investment in Treasury bills reflected mainly the higher return on them relative to the return on competing commercial bank interest-earning deposits. Meanwhile, total outstanding prommisory notes declined by shs 95m, reflecting redemptions by commercial banks and NBFIs of shs 75m and shs 20m respectively.

In the capital market, shs 22,400m Government's overdraft with the Central Bank was converted into government stocks. This brought the outstanding Government stocks to shs 28,052m in June 1994. Meanwhile, the holdings of bearer and non bearer Treasury bonds increased by shs 12,324m over the same period. This reflected an increase in holdings by the Central Bank of shs 22,935m and offsetting decreases in holdings by commercial banks and the non-bank sector of shs 7,261m and shs 3,350m respectively.

Although activity was high in the Nairobi Stock Exchange during fy 1993/94, there were no new issues of ordinary shares in contrast with five such issues in fy 1992/93. However, there was an increase in the total number of shares traded in the secondary market. The Nairobi Stock Exchange (NSE) price index also gained 1806.78 points to stand at 4,377.97 at the end of June 1994.

CHAPTER 9

Balance of Payments, Trade and Payment Arrangements

9.1 Introduction

The overall balance of payments improved substantially from a deficit of shs 8,661m in 1992 to a surplus of shs 25,682m in 1993 (Table 15). This reflected improvement in the current and capital accounts both of which were in surplus. Consequently, gross foreign reserves held by the banking system increased from shs 12,170m or 2.8 months of imports the previous year to shs 58,419m or 8.1 months of import cover at the end of December 1993.

9.2 Current Account

The current account, for the first time in many years, reverted from a deficit of shs 3,146m in 1992 to a surplus of shs 5,756m in 1993. This was due to strong performance in both the merchandise and services accounts. Exports increased by 113 per cent in the year while imports increased by only 68 per cent, thereby resulting in a merchandise account deficit of shs 17,817m, compared with a deficit of shs 19,024m in 1992. The services account had a surplus of shs 23,573m in 1993 compared with a surplus of shs 15,878m in 1992. The substantial increase in exports was mainly due to higher prices and to a lesser extent in volume growth. Export prices rose 90 per cent in shilling terms due to the large depreciation of the shilling and export volume grew by 16 per cent during this period.

Much of the increase in exports was in coffee which, owing to favourable international prices and partly owing to increased production occasioned by recent restructuring of the coffee export marketing and payments system, almost tripled (Charts 7 and 8). The volume of tea export

Table 15

SUMMARY OF BALANCE OF PAYMENTS, 1989-1993
(shillings million)

	1989	1990	1991	1992	1993
Current account	**-12,084**	**-11,104**	**-6,334**	**-3,146**	**5,756**
Trade balance	-21,339	-23,032	-18,123	-19,024	-17,817
Imports, fob	-40,392	-45,952	-47,107	-51,370	-86,583
Exports, fob	19,053	22,920	28,984	32,346	68,766
Net receipts on services & transfers	9,255	11,928	11,789	15,878	23,573
of which Government transfers	5,782	4,740	5,626	6,902	5,449
Capital Account (net)	**13,628**	**7,342**	**3,303**	**-5,361**	**19,748**
Long-term capital	12,545	4,081	3,785	-5,223	2,611
Government corps.	3,338	1,453	404	-2,643	-5,730
Central Government	7,791	2,103	2,310	-2,087	8,854
Private Sector	1,416	525	1,071	-493	-513
Short-term	1,083	3,261	-482	-138	17,137
Errors & omissions	**67**	**361**	**-34**	**-154**	**178**
Overall balance	**1,611**	**-3,401**	**-3,065**	**-8,661**	**25,682**
Financing	-1,611	3,401	3,065	8,661	-25,682
Change in gross reserves	-2,283	430	903	-4,803	-46,249
Use of Fund credit	-453	761	2,411	833	11,862
Changes in other liabilities	254	613	-2,524	8,322	-7,066
Valuation changes	871	1,597	2,275	4,309	15,771
Memorandum items:					
Gross reserves[2]	8,699 (2.6)	8,270 (2.2)	7,366 (1.9)	12,169 (2.8)	58,418 (8.1)
Of which official reserves[2]	7,298 (2.2)	6,617 (1.7)	5,391 (1.4)	6,407 (1.5)	34,636 (4.8)

[1]Provisional.

[2]Figures in parentheses represents months of import cover.

Source: Economic Survey, 1993; and the Central Bank of Kenya.

increased by 13 per cent and continued to remain the second leading source of export earnings after tourism. Non-traditional exports improved further to shs 21,371m reflecting a volume increase of 38 per cent. Table 16 shows trends in volume of Kenya's principal exports.

Imports increased in value terms by 67 per cent, entirely reflecting the effect of depreciation of the shilling. In volume terms, imports fell by about 4 per cent in the year. Imports of machinery and transport equipment, basic raw materials and animal and vegetable oils experienced the largest drop. Food and mineral fuels and chemical imports increased significantly.

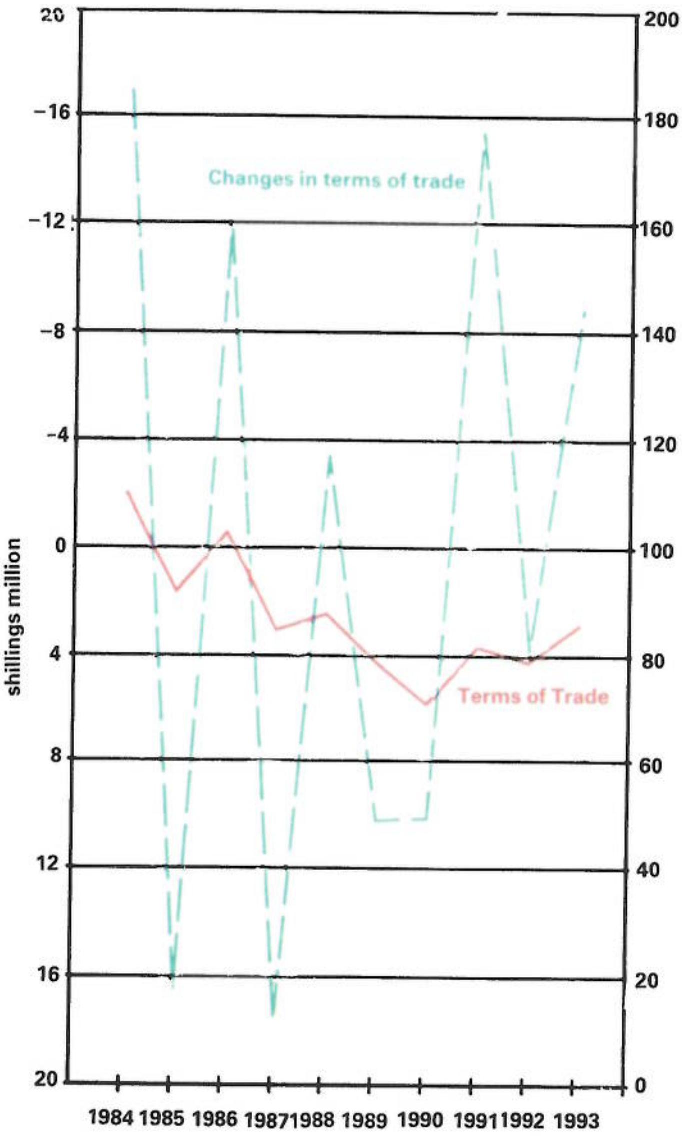
Net earnings from invisibles increased by 48 per cent to shs 23,573m in 1993. This was mainly due to the increase in tourism earnings associated with higher number of visitors. Net private transfers also increased, rising from shs 2,200m in 1992 to shs 8,533m in 1993. A net outflow of shs 22,533m was recorded on investment account.

9.3 Capital Account

The capital account had a large surplus of shs 19,748m against a deficit of shs 5,361m in 1992. This reflected substantial inflow of short-term and long term capital. Short term net capital inflows improved from a net outflow of shs 138m in 1992 to a net inflow of shs 17,137m, largely due to higher domestic interest rates relative to foreign rates. Government long-term net capital inflows had recorded a turnaround from a deficit of shs 5,361m in 1992 to shs 19,137m as donors resumed their disbursement following the November Paris Club meeting. During the year, the Government received SDR 115m and SDR 51m in respect of Export Development Programme and Education Sector Adjustment Credit respectively.

Chart 7

TERMS OF TRADE 1982=100



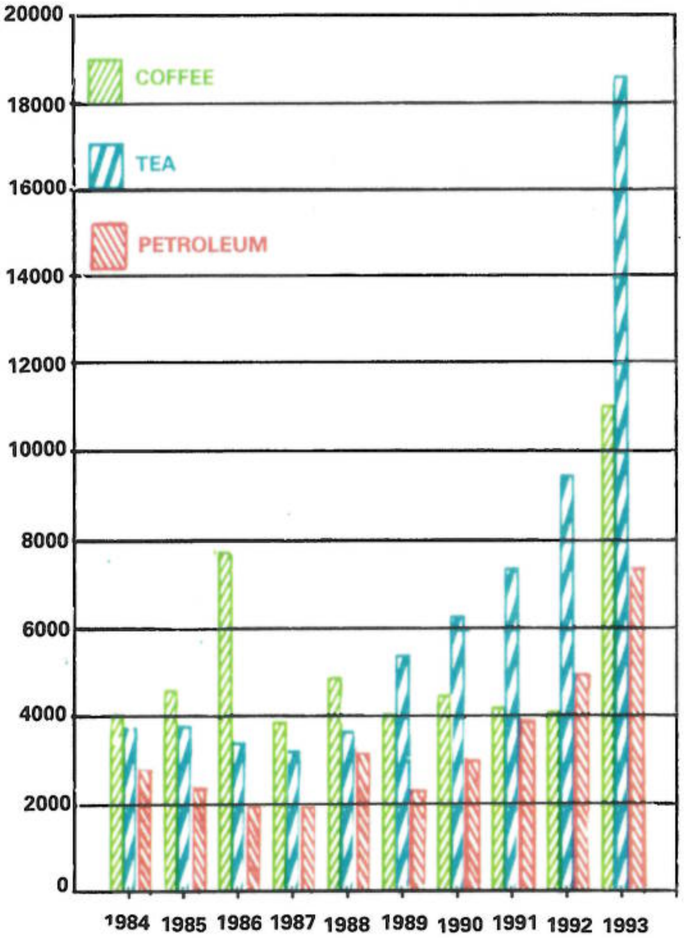
Source: Central Bureau of Statistics, Economic Survey (various issues).

9.4 External Debt

External public debt increased substantially from shs 122,260m in 1992 to shs 271,568m in 1993. As a result and in addition to shortage of forex the country was experiencing, debt arrears which began accumulating in 1992 continued to rise. However, during 1993, the Government entered into a refinancing arrangement with the donors for debt arrears amounting to US$ 700m. According to this Agreement, the Government will clear the outstanding arrears over a period of seven years beginning 1995. Meanwhile, the Government continued to maintain a prudent debt strategy, borrowing mainly from concessional sources.

CHART 8

EXPORT VALUES: COFFEE, TEA & PETROLEUM
(shillings million)



Source: Customs & Excise Department.

Table 16

VOLUME OF KENYA'S MAJOR EXPORTS
(tonnes)

	1989	1990	1991	1992	1993[1]
Coffee	98,041	114,384	84,191	78,147	88,356
Tea	163,279	166,405	175,557	166,518	188,435
Petroleum (million litres)	646	638	767	769	723
Sisal	32,856	30,179	27,743	32,026	27,000
Soda Ash	206,812	185,179	197,427	163,521	215,024
Pyrethrum Products	540	453	442	241	749
Horticulture	134,178	188,825	169,292	154,112	265,305

[1]Provisional.

Source: Economic Survey, 1994.

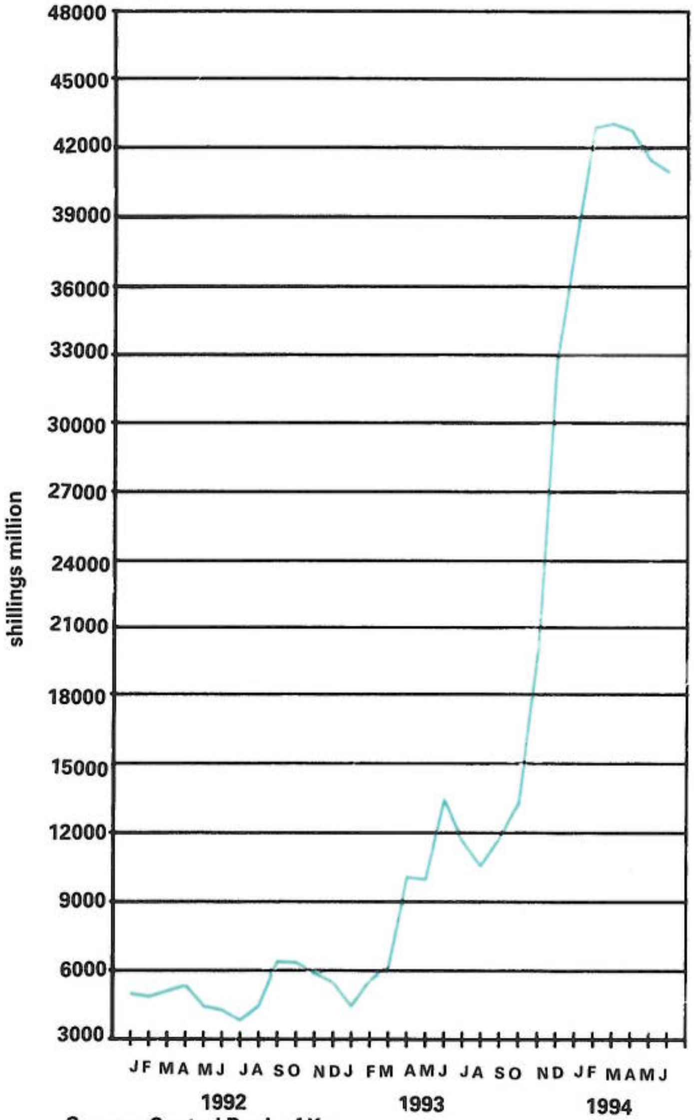
9.5 Foreign Exchange Reserves

The country's foreign exchange reserves increased significantly from shs 12,169m (SDR 244m) in 1992 to shs 58,418m (SDR 621m) in 1994, sufficient to finance 8.1 months of imports (Chart 9). The build up in reserves reflected substantial net inflow of programme finance and short-term private capital. Of the total, the Central Bank's reserves stood at shs 33,035m (SDR 351m) against shs 5,571m (SDR 112m,) at the end of 1992. The increase in private capital inflow was partly due to the liberalization of the payments and exchange system and partly due to the introduction of retention and foreign currency accounts.

Total foreign liabilities of the banking system stood at shs 32,906m, compared with shs 17,916m in 1992. The net international reserves of the banking system was therefore shs 25,513m in December 1993, compared with shs −5,747m at the end of 1992, registering a positive position for the first time since 1984.

Chart 9

FOREIGN RESERVES OF THE CENTRAL BANK OF KENYA



Source: Central Bank of Kenya.

9.6 The Shilling Exchange Rate

Further reforms were made in the exchange and payments system during the year. The shilling was partially floated during the early part of the year, giving rise to the development of an interbank foreign exchange market in which commercial banks buy and sell foreign exchange among themselves to service the requirements of the non government sector. On October 18, 1993, the official and interbank foreign exchange rates were unified.

Meanwhile, the shilling depreciated by 88.2 per cent, 84.5 per cent, 75.6 per cent, 109.5 per cent and

62.6 per cent against the US dollar, the sterling pound, the deutschemark, the Yen and the Italian Lira, respectively. Reflecting these movements, the nominal effective exchange rate (NEER), that is, the trade weighted exchange rate with respect to major trading partners, depreciated by 51.8 per cent in 1993. The real effective exchange rate (REER), which is the nominal exchange rate adjusted for inflation differentials between Kenya and her trading partners, depreciated by 23.6 per cent. This made Kenyan exports more competitive.

9.7 Trade and Payments Arrangements

9.7.1 Export Policy

The country's trade policy continued to focus on strengthening the export drive through provision of incentives to promote production for export. The export compensation scheme was phased out and replaced with import duty/VAT remission scheme in which exporters are exempt from paying duty on imported inputs. The duty/VAT remission scheme was extended to cover both direct and indirect exporters.

Export Processing Zones and the Manufacturing Under Bond continue to be major vehicles in the promotion of exports. There are now 15 firms operating in the Export Processing Zones and a number of applications are in the pipeline. To hasten development of EPZ, goods produced in these Zones are now allowed to be sold in the local market on condition that value added tax, import duty and a surcharge of 2.5 per cent is levied. Some progress has also been made in the Manufacturing Under Bond (MUB) Scheme and 25 manufacturing enterprises are operating under this scheme compared with 21 in 1992. Institutional changes to support export promotion were undertaken in the year. The operations of the Export Promotion Programme Office and Export Promotion Council were substantially strengthened through increased private sector participation.

9.7.2 Import Policy

The Government has over the past three years introduced a wide range of measures aimed at liberalising the importation process. Import licensing was abolished in May 1993. Import tariffs were further rationalized in the year in order to create a more uniform pattern of protection and thereby enhance efficiency of the domestic industry. The number of tariff categories were reduced from eight to seven in the year while the top import duty was lowed to 45 per cent. Only a short list of items which, for security, health or environmental reasons, still require government approval. Importers, however, have to complete import declaration forms for statistical purposes. For imports of more than US$ 500, payments cannot be made unless import documents include a clean report of findings issued by international inspection agencies verifying the price, quality and quantity. All private sector imports continue to be transacted at the interbank market rate while all Government imports are financed by the Central Bank also at market exchange rates.

CHAPTER 10

Balance Sheet and Income Statement, 1993/94

Balance Sheet

The Balance Sheet as at 30th June, 1994 and the Profit and Loss Account for the year ended June 30, 1994 appear in the appendix on pages 25 and 26.

10.1 Assets and Liabilities

The Bank's total assets rose by shs 40,004m in the year to shs 128,265m at the end of June 1994. The foreign exchange holdings of the Bank rose by shs 27,263m, direct advances to the Government remained unchanged at shs 200m while advances and discounts to commercial banks fell by shs 6,968m. The Bank's holdings of non-bearer Treasury Bonds rose by shs 25,115m in fy 1993/94 while bearer Treasury Bonds fell by shs 2,180m. The Bank's holdings of Government Stocks rose by shs 19,400m while that of Treasury Bills fell by shs 23,085m. Uncleared effects fell by shs 2,609m while Fixed Assets, Other Assets and Revaluation Accounts rose by shs 277m, shs 596m and shs 2,208m respectively.

Currency in circulation rose by shs 3,136m. Deposits of Kenya banks rose by shs 10,880m and those of external banks fell by shs 108m during the financial year. Deposits of the International Monetary Fund (IMF) decreased by shs 2,946m while other deposit liabilities fell by shs 1,911m.

The Government deposits with the Bank rose from shs 23,776m as at 30th June 1993 to shs 52,012m. The Bank's capital remained unchanged at shs 500m during fy 1993/94. Net surplus amounted to shs 937m. In accordance with Section 9 (1) of the Central Bank of Kenya Act, shs 93m is transferrable from the net annual profits of the Bank in fy 1993/94 to the General Reserve Fund. As a result, the Capital and Reserves of the Bank would rise to shs 593m at the end of June 1994.

10.2 Income, Expenditure and Profits Appropriation

Total gross receipts in fy 1993/94 amounted to shs 15,354m, an increase of shs 5,542m over the previous year. Earnings from foreign investments rose by shs 749m to shs 1,009m in the year and receipts from domestic investments increased by shs 4,197m to shs 12,580m. Total recurrent expenditure and provisions fell by shs 81m in the year to shs 14,417m. Banking expenses accounted for about 35 per cent of the recurrent expenses with an expenditure amounting to shs 5,067m. Interest paid on deposits of the Government, commercial banks and other public entities holding accounts with the Bank amounted to shs 4,876m for the financial year 1993/94. Provisions amounting to shs 3,634m were set aside for doubtful debts of some commercial banks while shs 2,989m was paid as premium on the redemption of Forex-Cs that were outstanding with the public after liberalisation of exchange controls. Interest and charges paid to the IMF accounted for shs 130m. Administrative expenses accounted for shs 1,178m of the total recurrent expenditure. Supervision of foreign trade and currency expenses took shs 677m and shs 872m, respectively. Net annual profits for the year, as specified under Section 9(2) of the Central Bank of Kenya Act, amounted to shs 937m for fy 1993/94 compared with a net loss of shs 4,524m in fy 1992/93.

10.3 Revaluation Account

The account reflects a debit balance of shs 20,237m as at 30th June, 1994 compared with a debit balance of shs 18,029m as at 30th June, 1993. A net revaluation gain of shs 3,063m arose from the revaluation of IMF, EEC and Special Drawing Rights (SDR) Deposits while a loss of shs 5,010m was made from the revaluation of Foreign Securities and Deposits. Revaluation losses of shs 149m and shs 112m were made on the revaluation of SDR deposits and Gold. The net revaluation loss, therefore amounted to shs 2,208m during the year.

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES

(a) Accounting Convention

The accounts have been prepared under the historical cost covention.

(b) Exchange Rates

Foreign exchange balances have been converted at the rates ruling at 30th June, 1994.

(c) Exchange Differences

Differences on exchange have been dealt with as follows:

(i) Profit and Loss Account

Differences arising from dealings in foreign exchange have been transferred to Profit and Loss Account.

(ii) Revaluation Account

Differences arising from revaluation of Gold in accordance with Note 1(d) below and from changes in exchange rates during the year, with the exception of those referred to in Note 1(c) (i) above, and the amount which at 30th June, 1994 was required to maintain the value of local currency held by the International Monetary Fund in terms of Special Drawing Rights, have been transferred to the Revaluation Account set up under Section 51 of the Central Bank of Kenya Act.

(d) Valuation of Gold

Gold reserves were revalued at 50 per cent of market price at 30th June, 1994. The revaluation loss arising, amounting to shs 113m, has been transferred to the Revaluation Account.

(e) Revaluation of Investments

Foreign and local securities are valued at the lower of cost or market value. To determine the lower of cost or market value, investments are grouped into their respective currencies and only if the group total market value is lower than cost is a provision made against that group. At 30th June, 1994, the applicable market values of investments under the following Balance Sheet headings were:

Gold and Foreign
Exchange: Foreign Securities Nil (1993 shs 47m)
Gold shs 1,727m (1993 shs 1,952m)

Investment in Government Securities:
Kenya Stock shs 22,446m (1993 shs 3,099m).

2. FORWARD EXCHANGE

There were no commitments for forward operations as at 30th June 1994 (1993 shs 5,864m for forward sales and nil for forward purchases).

3. GOLD AND FOREIGN EXCHANGE

Gold and foreign exchange comprises:

	(shs m) 1994	1993
Balances with Banks & Cash	39,743	9,557
Treasury Bills	61	2,933
Other Investments	987	1,021
Holdings of SDRs	18	35
	40,809	13,546

Included under Balances with Banks and Cash are amounts totalling shs 3,696m (1993 shs 4,848m) which represent external funds held by the Central Bank on behalf of the Government and Other Public Entities. The corresponding liabilities are held under Other Deposits.

4. REDEMPTION OF FOREIGN EXCHANGE BEARER CERTIFICATES (FOREX-Cs)

Included in the Profit and Loss Account is an amount of shs 2,989m incurred by the Bank on the redemption of Forex-Cs at a premium.

5. ADVANCES AND DISCOUNTS TO BANKS

Included in Advances and Discounts to Banks are principal funds amounting to shs 9,842m representing overdrawn account balances of four commercial banks which are currently in liquidation. A provision of shs 3,634m has been made in the current year in respect of the above principal amounts bringing the total provision as at 30th June 1994 to shs 7,466m. The balance is secured against the property of Uhuru Highway Development Limited (Grand Regency Hotel).

6. GENERAL RESERVE FUND

	1994 shs m.	1993 shs m.
Blance brought forward	—	1,558
Transfer from/(to) Profit/(Loss) Accounts	93	(1,558)
Balance carried forward	93	Nil

7. CAPITAL COMMITMENTS

As at 30th June 1994 the Bank had entered into the following capital commitments for construction work which was in progress:

	shs m.
CBK Towers – Nairobi	1,000
School of Monetary Studies – Nairobi	180
	1,180

CENTRAL BANK OF KENYA
BANKI KUU YA KENYA

Balance Sheet as at 30th June 1994
(Amounts in shs million)

	NOTE	1994	1993
ASSETS			
Gold and Foreign Exchange	1(d) (e) & 3	40,809	13,546
Investment in Government Securities	1(e)	50,191	30,954
Direct Advances to Kenya Government		200	200
Advances and Discounts to Banks	5	12,274	19,242
Uncleared Effects		721	3,330
Fixed Assets		1,045	768
Other Assets		2,788	2,192
Revaluation Account	1c (ii)	20,237	18,029
Total Assets		128,265	88,261
LIABILITIES, CAPITAL AND RESERVES			
Currency in Circulation		23,311	20,175
Deposits			
Government of Kenya		52,012	23,776
Banks - Kenya		17,474	6,594
- External		97	205
IMF		22,797	25,743
Others		4,371	6,282
Other Liabilities and Provisions		7,610	4,986
Capital		500	500
General Reserve Fund	6	93	—
Total Liabilities, Capital and Reserves		128,265	88,261

These accounts were approved by the Board of Directors on September 22, 1994.

....
MICAH CHESEREM
Governor

The notes on pages 23 and 24 form part of these accounts.

CENTRAL BANK OF KENYA
BANKI KUU YA KENYA

Profit and Loss Account for the year ended 30th June 1994

(Amounts in shs million)

	NOTE	1994	1993
NET PROFIT/(LOSS) (After charging current expenditure, writing down fixed assets and providing for contigencies and movements in reserves)		937	(4,524)
Appropriated as follows: Transferred to/(Recovered from) General Reserve Fund	6	93	(1,558)
Government of Kenya		844	(2,966)
		937	(4,524)

The notes on pages 23 and 24 form part of these accounts.

Report of the Auditors Pursuant to Section 54 of the Central Bank of Kenya Act

We have audited the accounts set out on pages 25 and 26 and have obtained all the information and explanations which we considered necessary. Proper books have been kept and the accounts, which are in agreement therewith, comply with the requirements of the Central Bank of Kenya Act.

The Profit for the year ended on 30th June 1994 has been ascertained in accordance with Section 9 of the Central Bank of Kenya Act. In our opinion the accounts, which have been prepared on the basis of the accounting policies set out on page 23, give a true and fair view of the state of affairs of the Bank at 30th June 1994 and the results of its operations for the year to that date.

KPMG PEAT MARWICK

BELLHOUSE MWANGI ERNST & YOUNG

Joint Auditors

Nairobi

September 22, 1994