Central Bank of Kenya

"SAFEGUARDING THE VALUE OF YOUR MONEY"

2016 ANNUAL REPORT
AND FINANCIAL STATEMENTS

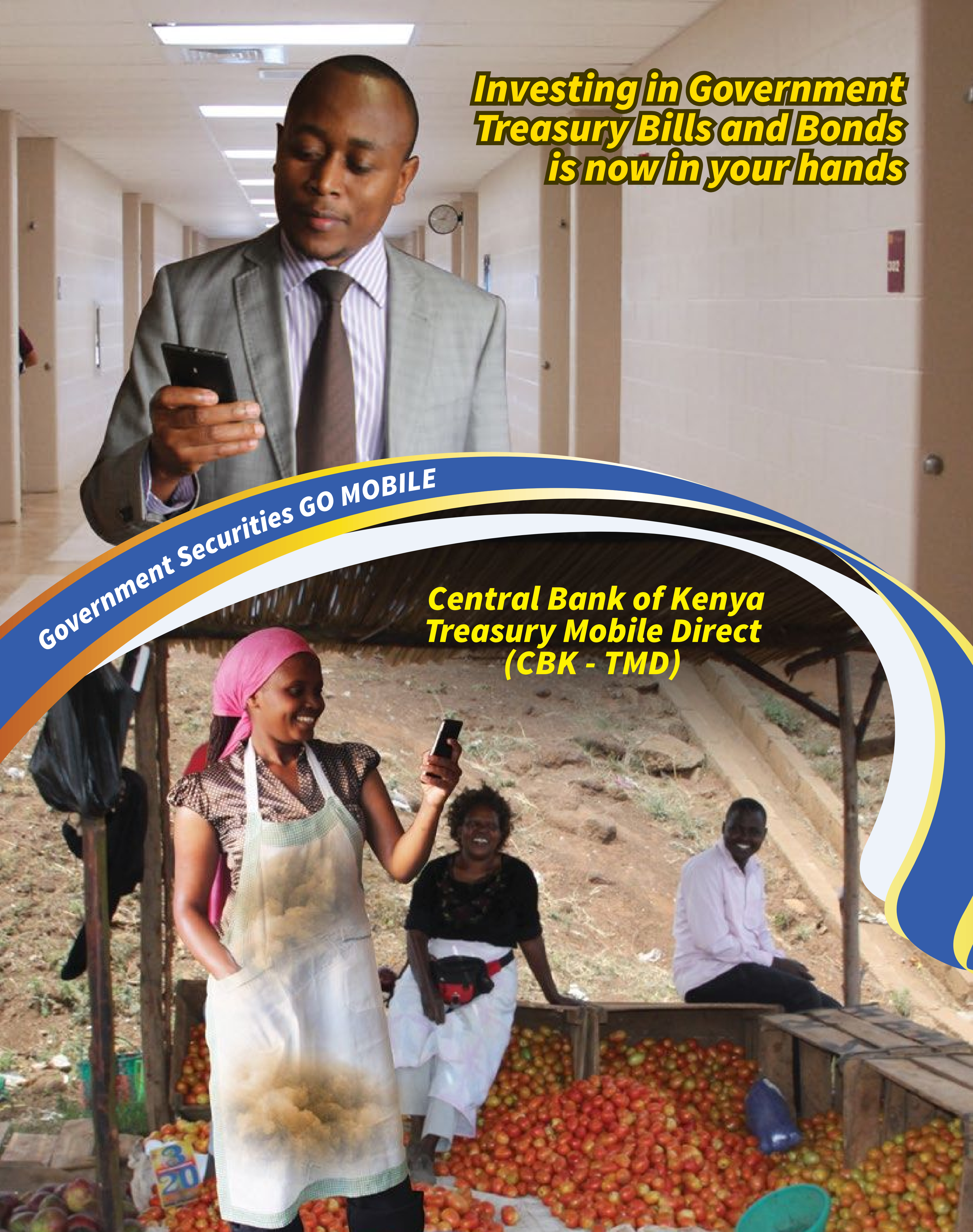

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TABLE OF CONTENT

OUR VISION

The Vision of the Bank is "To be a World Class Modern Central Bank."

OUR MISSION

To formulate and implement monetary policy for price stability, foster a stable market-based financial system and ensure a sound national payment system.

Commitment

The Board and staff are committed to implementing the Bank's mandate as stipulated in the Constitution of Kenya and the CBK Act.

Professionalism and Relevance

The Board and staff will always endeavour to offer quality services to its internal and external customers, diligently observing high professional standards at all times and respecting the rules and regulations set by the Bank. All initiatives and activities undertaken remain relevant to the Bank's strategic objectives in pursuit of its core mandate.

Efficiency & Effectiveness

The Bank will at all times undertake its operations in the most cost efficient and effective manner while maintaining high standards of performance in execution of its mandate.

Innovativeness

The Bank will encourage, nurture and support creativity and the development of new ideas and processes for the continued improvement of organisational performance.

Transparency, Accountability and Integrity:

The Board and staff will always act in a transparent and accountable manner when handling all the affairs of the Bank both internally and with external parties so as to uphold the Bank's image at all times. In addition, the Bank will uphold high standards of ethics, integrity and honesty as guided by the Constitution, act in an ethical manner as guided by the Leadership and Integrity Act and the Public Officers' Ethics Act, and observe high moral standards.

Diversity and Inclusiveness:

The Bank appreciates and embraces the differences in its employees' skills sets and abilities and encourages consultations and inclusiveness in pursuit of its mandate across departments. This is aimed at maximising productivity and enhancing the Bank's overall performance.

Mutual Respect and Teamwork:

Mutual respect shall at all times be observed internally amongst colleagues and when dealing with the Bank's external clients. In addition, the Board and staff will cooperate and collaborate to enhance performance and create a healthy work environment.

LETTER OF TRANSMITTAL

In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Cabinet Secretary of the National Treasury, the Annual Report of the Central Bank of Kenya for the Fiscal Year 2015/16. The Annual report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Fiscal Year ended June 30, 2016.

Dr. Patrick Njoroge

Governor

EXECUTIVE SUMMARY

In 2015, global economic activity remained subdued, growing at an estimated 3.2 percent compared to 3.4 percent in 2014. The slowdown was largely in emerging market and developing economies where growth declined to 4.0 percent from 4.6 percent in 2014, as growth in advanced economies picked up to 2.1 percent. In 2016 global economic activity continues to remain weak with increasing downside risks to the outlook. The IMF, World Economic Outlook (October 2016), projects global GDP growth at 3.1 per cent. The projected weak global growth mirrors subdued economic activity in advanced and emerging market economies. The causative factors range from subdued business investment, uncertainty attributed to British exit from EU membership and elevated policy uncertainty in advanced economies. The sluggish growth projection for emerging market and developing economies is attributed to rebalancing of economic activity in China from investment and manufacturing towards consumption and services growth, and diverse outlook for other emerging and developing economies due to challenging macroeconomic conditions including lower prices of energy and other commodities.

In Kenya, economic activity grew by 5.6 percent in 2015 - an improvement from 5.3 percent growth recorded in 2014. The resilience of the economy is attributed to improved weather conditions which supported agriculture production and electricity generation; high public investment that supported growth in the construction sector; recovery in the tourism sector; and low international oil prices that supported growth in the transport and storage sector. On the expenditure side, consumption increased significantly for government and moderately for the private sector. In the first half of 2016, the economy grew by 5.9 percent and 6.2 percent in the first and second quarters of 2016, respectively. The economy is projected to exhibit resilience in 2016 with growth projected at 6 percent on the back of improved weather, stable macroeconomic conditions and increased public investment.

Prudent monetary policy continued to support macroeconomic stability during FY 2015/16. The Central Bank of Kenya tightened monetary policy in July, raising the Central Bank Rate (CBR) to 11.5 percent from 10.0 percent set in May 2015, to anchor inflationary expectations associated with exchange rate volatility. As inflationary pressures eased and stability was restored in the foreign exchange market and the banking sector, the Central Bank of Kenya reduced the CBR by 100 basis points to 10.5 percent in May 2016. The stability in the foreign exchange market is partly attributed to narrowing of the current account deficit reflecting a lower import bill (owing to lower international oil prices), and improved export earnings from tea and horticultural products and resilient remittance inflows. The placing of 3 non systemic small banks under receivership (in August and October 2015 and April 2016) enhanced segmentation and accentuated trading within bank tier groups. To mitigate the potential threat to financial stability, the Central Bank of Kenya provided short term liquidity support to address skewed liquidity distribution attributed to segmentation of the interbank market along bank tier groups. The reopening of one of the small banks in April 27, 2016 boosted public confidence in the management of the banking sector.

Overall 12-Month inflation eased marginally from an average of 6.63 percent in financial year 2014/2015 to 6.47 percent in the financial year 2015/2016. Inflation in the financial year 2015/2016 was mainly a food phenomenon. Food prices remained high in the July - December 2015 period due to delayed rains but improved in the January - June 2016 period with improved weather conditions which boosted agricultural production. The push on domestic prices from the excise tax imposed on cigarettes and beer from December 1, 2015 was however, moderated by declining fuel inflation consistent with low international prices.

Performance in the foreign exchange rate market mainly reflected developments in the international and domestic market. During the fiscal year 2015/2016, the

EXECUTIVE SUMMARY

Kenya Shilling depreciated against the US Dollar, the Euro and the Japanese Yen and strengthened against the Sterling Pound. The weakening of the Shilling against major currencies occurred during the first quarter of 2015, following tightening of the global financial market conditions and the slowdown in China, while the strengthening of the Shilling against the Sterling Pound was triggered by the uncertainty surrounding the United Kingdom exit from the European Union (Brexit). The return to stability has been as a result of prudent monetary policy by the Central Bank of Kenya and its closer monitoring of the foreign exchange market, higher inflows from tea earnings and Diaspora inflows. Going forward, the Kenya Shilling is expected to remain relatively stable on the backdrop of a narrower current account balance driven mainly by lower import bill and higher foreign exchange receipts in key sectors of the economy.

Kenya's external current account balance improved to a deficit of USD 3,587 million (5.7 percent of GDP) during the fiscal year 2015/16 from USD 5,905 million (9.6 percent of GDP) during the fiscal year 2014/15. The performance in the current account balance reflected a narrowing in the import bill, following lower global oil prices and reduced importation of transport equipment. Developments in the financial account mainly reflected higher inflow of both government and private loans during the year to June 2016. The official international foreign exchange reserves position improved to USD 8,267 million, (5.5 months of import cover) in June 2016 from USD 7,212 million (4.5 months of import cover) in June 2015. The current account deficit is expected to narrow further as global oil prices still remain relatively low.

Government budgetary operations in Fiscal Year 2015/16 resulted in a deficit of KSh 521.7 billion (8.4 percent of GDP) on a commitment basis, which was within the projected KSh 626.4 billion deficit or 10.1 percent of GDP and higher than KSh 500.3 billion (9.3 percent of GDP) deficit recorded in the FY 2014/15. Budget implementation was impacted by slower absorption of development budget allocation, particularly in the first and second quarters of the Fiscal Year. While recurrent expenditure increased rapidly, revenue growth was somewhat constrained. The domestic financing component increased to 46.4 percent from 26.7 percent in the FY 2014/15 but remained below the 65.7 percent recorded in 2013/14.

Uptake of the National Payments System continued to increase as reflected in usage of the Real Time Gross Settlement System (RTGS), the Kenya Electronic Payments and Settlement System (KEPSS) and the East African Payment System (EAPS). The system which is owned, and operated by Central Bank of Kenya, was resilient and available to users (commercial banks) throughout the year under review. The system which is anchored on a secure SWIFT network to transmit payment instructions, has grown rapidly supported by developments in internet and mobile phones, e-commerce, technological developments and Near Field Communication (NFC) infrastructures. Activity through KEPSS and EAPS increased by 17.1 percent and 8.5 percent in volume and value, respectively in the year to June 30, 2016. The average amount moved per transaction declined by 7.3 percent, which indicates increased usage for lower value payments. The increase in uptake is attributed to continued expansion of trade within the East African Community buoyed by increased awareness by the public of the RTGS as a safe and efficient mode of payment for both high value and time critical payments for local and regional payments. Direct payments were largely processed through KEPSS at 98.8 percent, while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS accounted for the balance of 1.2 percent.

Convergence between mobile phone technology and commercial banks platforms has made banking services more accessible, especially for low-income customers, previously underserved by the formal banking system. Mobile money service usage maintained an upward

EXECUTIVE SUMMARY

trajectory among the Kenyan public with mobile money service providers recording increased volumes and values. This was sustained by continued collaborations and innovations in the industry such as Commercial Bank of Africa-Mshwari in 2012 and KCB-Mpesa launched in 2015; by widespread ownership of mobile phones; the need to access financial services by public; and the relatively low cost of mobile money transactions. In this regard, the number of mobile money service provider agents increased by 23.3 percent and the value transferred through mobile money services increased by 20.2 percent in the year to June 2016.

The Central Bank of Kenya remained on course in its strategy to create and enhance public awareness on security features of Banknotes as a way of minimizing counterfeiting. Collaboration with commercial banks and other educational institutions formed a key part of the anti-counterfeiting strategies through public education. The Bank continues to encourage the public to visit its website to learn more on the various security features on our currency.

The Central Bank of Kenya launched various programmes to anchor its 50th Anniversary Celebration. The climax of the celebrations was a high level Symposium entitled "50 years of Central Banking' held on September 13 and the launch of its Numismatic Museum on September 14, 2016.

MUHTASARI WA TAARIFA MAALUM

Shughuli za kiuchumi ulimwenguni zilisalia tulivu mnamo mwaka wa 2015,huku uchumi ukikua kwa takribani asilimia 3.2 ikilinganishwa na asilimia 3.4 katika mwaka wa 2014. Ukuaji huo mdogo ulitokea kwenye masoko yanayoibuka na kadhalika katika mataifa yanayostawi kiuchumi huku kiwango cha ukuaji kikipungua hadi asilimia 4.6 mwaka wa 2014, na kiwango cha ukuaji katika mataifa yaliyostawi kikikua kwa asilimia 2.1. Katika mwaka wa 2016, shughuli za kiuchumi ulimwenguni ziliendelea kusalia dhaifu kutokana na ongezeko la hatari kwa mtazamo uliopo. Ripoti ya kiuchumi ya kilimwengu (Oktoba 2016) ya IMFlinatabiri ukuaji wa jumla wa pato la kimataifa kufikia asilimia 3.1. Ukuaji thabiti wa uchumi kimataifa uliotabiriwa ulionyesha shughuli chache katika mataifa yanayoibuka kiuchumi. Baadhi ya masuala yanayosababisha hali hii ni pamoja na kudorora kwa shughuli za uwekezaji wa kibiashara, ukosefu wa uhakika kutokana na Uingereza kuijiondoa kutoka kwa Muungano wa Ulaya na kuongezeka kwa wasi wasi katika mataifa yaliyostawi kiuchumi. Matarajio ya ukuaji huu mdogo wa mataifa yanayoibuka na yanayostawi kiuchumi unatokana na usawazishaji wa shughuli za kiuchumi nchini China kutoka kwa kuwekezaji na viwanda vya uzalishaji bidhaa na huduma, na mtazamo tofauti wa mataifa mengine yanayostawi na yaliyostawi kiuchumi kutokana na changamoto zikiwa ni pamoja na bei ya chini ya nishati na bidhaa nyinginezo.

Nchini Kenya, uchumi ulikua kwa asilimia 5.6 katika mwaka wa 2015 – ongezeko kutoka asilimia 5.3 kama ilivyoshuhudiwa mnamo mwaka wa 2014. Uthabiti huu wa kiuchumi ulitokana na hali imara ya hewa ambayo ilihimii uzalishaji wa kilimo na uzalishaji wa umeme; kiwango kikubwa cha uwekezaji wa umma ambao ulistahamili ukuaji katika sekta ya ujenzi; kuimarika kwa sekta ya utalii; pamoja na bei ya chini ya bidhaa za mafuta kimataifa hali iliyosaidia pakubwa ukuaji katika sekta ya uchukuzi na uhifadhi. Katika upande wa gharama, matumizi yaliongezeka kwa kiwango kikubwa hususan katika upande wa serikali na kwa kiwango cha chini katika sekta binafsi. Katika kipindi cha nusu mwaka wa 2016, uchumi ulikuwa kwa asilimia 5.9 na asilimia 6.2 katika robo ya kwanza na ya pili, mtawalia. Uchumi unatabiriwa kuwa thabiti mwaka wa 2016, pakiwa na matarijio ya ukuaji wa asilimia 6 kwa kuzingatia uimarikaji wa hali ya hewa, hali thabiti ya kiuchumi pamoja na ongezeko la uwekezaji wa umma.

Sera thabiti za kifedha ziliendelea kuhimili uthabiti wa kiuchumi katika mwaka wa kifedha wa 2015/16. Kufikia mwezi Julai, Benki Kuu ya Kenya iliimarisha sera za kifedha na kuongeza viwango vya Malipo vya Benki Kuu ya Kenya (CBR) hadi kufikia asilimia 11.5 kutoka asilimia 10.0 mnamo mwezi Mei 2015. Hatua hii ilikuwa ni kwa lengo la kuthibiti mfumuko uliotarajiwa na uliohusishwa na mabadiliko ya viwango vya ubadilishanaji. Huku msukumo wa mfumuko ulivyoendelea kupungua, uthabiti ulirejeshwa katika soko la ubadilishanaji wa sarafu za kigeni na sekta ya benki, Benki Kuu ya Kenya ilipunguza viwango vya CBR kwa alama 100 na kufikia asilimia 10.5 mwezi Mei 2016. Uthabiti katika soko la ubadilishanaji pesa za kigeni hutokana na upungufu unaoshuhudiwa katika gharama ya chini ya uagizaji bidhaa kutoka ng'ambo (kutokana na bei ya chini ya mafuta kimataifa), na imariko la mapato yanayotokana na bidhaa za majani chai na maua na matunda pamoja na ongezeko la malipo ya kibinafsi yanayotumwa kutoka nchi za kigeni.

Hatua ya kuweka benki 3 ndogo chini ya urasimu (mwezi Agosti na Oktoba mwaka wa 2015 pamoja na Aprili 2016) iliimarisha migao ya vikundi vya benki na kuboresha biashara kati ya benki za vikundi hivyo. Ili kukabiliana na uwezekano wa hatari katika uthabiti wa kifedha, Benki Kuu ya Kenya ilitoa takrima ya mkopo ya muda ya ulipaji deni ili kuhimili tatizo lililokuwepo la mgao wa fedha lililosababishwa na kuwepo kwa vikundi fulani fulani kwenye soko la sekta ya kifedha kati ya benki mbali mbali nchini.. Ufunguzi upya wa mojawapo ya benki ndogo mwezi Apriil 27, 2016 ulimarisha imani ya umma katika usimamizi wa sekta ya benki.

MUHTASARI WA TAARIFA MAALUM

Mfumuko wa jumla katika kipindi cha miezi 12 ulipungua kutoka kwa wastani ya asilimia 6.63 katika mwaka wa kifedha wa 2014/2015 hadi asilimia 6.47 katika mwaka wa kifedha wa 2015/2016. Mfumuko katika mwaka wa kifedha wa 2015/2016 ulitokana hasa na masuala ya chakula. Bei ya vyakula ilisalia juu mnamo mwezi Julai hadi Desemba 2015 kutokana na kukawia kwa msimu wa mvua lakini hali ikaimarika kati ya kipindi cha Januari hadi Juni 2016 kutokana na hali ya hewa iliyoimarika na kuimarisha mazao ya bidhaa za kilimo. Hata hivyo msukumo wa bei kutoka kwa ushuru uliowekewa sigara na bia kutoka Desemba 1, 2015 ulisawazishwa kutokana nakupungua kwamfumuko wa bei ya mafuta kimataifa.

Matokeo katika soko la ubadilishanaji wa sarafu za kigeni hasa liliangazia ustawi katika masoko hapa nchini na kimataifa. Katika mwaka wa kifedha wa 2015/2016, thamani ya Shilingi ya Kenya ilipungua dhidi ya Dola ya Amerika, Euro na Yen ya Japan na kuimarika dhidi ya Pauni ya Uingereza. Udhaifu wa shilingi dhidi ya sarafu kuu ulitokea katika robo ya kwanza ya mwaka wa 2015, kutokana na hali ngumu za kifedha katika masoko ya kimataifa na pia kudorora kwa hali ya kiuchumi nchini China, ilhali uthabiti wa shilingi dhidi ya Pauni ya Uingereza ulitokana na hali ya wasi wasi iliyotokana na hatua ya Uingereza kujiondoa kutoka kwa Muungano wa Ulaya (Brexit). Marejeo ya hali ya kawaida yametokana na sera ya kifedha ya Benki Kuu ya Kenya pamoja na ukaguzi wa karibu wa soko ya sarafu za kigeni, ongezeko la kifedha kutokana na mapato ya majani chai pamoja na mapato kutoka katika chumi nyinginezo. Ili kuelekea mbele, shilingi ya Kenya inatarajiwa kusalia thabiti licha ya masalio finyu kwenye akaunti ya benki yaliyotokana na gharama ya chini ya uagizaji bidhaa kutoka nje na hasa kutokana na gharama ya chini ya uagizaji bidhaa kutoka nje pamoja na viwango vya juu vya mapato kutoka nchi za kigeni katika sekta kuu za kiuchumi.

Udogo wa salio la akaunti ya mapato ya biashara kutoka nje uliimarika na kufikia USD 3,587 milioni (asilimia 5.7 ya GDP) katika mwaka wa kifedha wa 2015/16 kutoka USD 5,905 milioni (asilimia 9.6 ya GDP) katika mwaka wa kifedha wa 2014/15. Ufinyo wa matokeo katika salio la sasa la akaunti ulionyesha upungufu wa gharama ya uagizaji bidhaa kutoka nje kutokana na bei ya chini ya mafuta katika ngazi za kimataifa pamoja na uagizaji wa bidhaa za uchukuzi. Ustawi katika akaunti ya kifedha hasa uliashiria ongezeko la fedha kutoka kwa mikopo ya serikali na sekta ya binafsi katika mwaka hadi Juni 2016. Hali ya hazina rasmi ya fedha za kigeni iliimarika na kufikia USD 8,267 milioni, (miezi 5.5 ya uagizaji bidhaa kutoka nje) katika mwezi Juni 2016 kutoka USD 7,212 milioni (miezi 4.5 ya uagizaji bidhaa kutoka nje) katika mwezi Juni 2015. Udogo wa salio la sasa la akaunti unatarajiwa kuimarika zaidi huku bei za mafuta kimataifa zikiendelea kusalia chini.

Shughuli za bajeti za serikali katika mwaka wa kifedha wa 2015/16 ilizalisha mapungufu ya KSh 521.7 bilioni (asilimia 8.4 ya GDP), kiwango ambacho kiliambatana na utabiri wa mapungufu ya KSh. 626.4 bilioni au asilimia 10.1 ya GDP na zaidi ya mapungufu ya KSh 500.3 bilioni (asilimia 9.3 ya GDP) ulioandikishwa katika mwaka wa kifedha wa 2014/15. Utekelezaji wa bajeti ulithiriwa na shughuli za utumiwaji wa pole pole wa bajeti ya maendeleo, hususan katika robo ya kwanza na ya pili za mwaka wa kifedha. Huku matumizi ya kawaida yakiongezeka kwa kiwango cha juu, ukuaji wa mapato ulitatizika. Sehemu ya ufadhili wa kawaida iliongezeka hadi asilimia 46.4 kutoka asilimia 26.7 katika mwaka wa kifedha wa 2014/15 lakini ikasalia chini kwa asilimia 65.7 iliyorekodiwa mnamo mwaka wa 2013/14.

Shughli za utekelezaji Mfumo wa Kitaifa wa Malipo ziliendelea kukua kama ilivyoonyeshwa katika matumizi ya Mfumo wa Kufidia Mapato wa Nyakati Halisi (RTGS), Mfumo wa Malipo wa Kielektroniki (KEPSS) pamoja na Mfumo wa Malipo wa Afrika Mashariki (EAPS). Mifumo hii inamilikiwa na kuendeshwa na Benki Kuu ya Kenya ilikuwa thabiti na kufikiwa na watumiaji (benki) katika kipindi chote cha mwaka chini ya ukaguzi. Mfumo huu ambao umehimiliwa katika mfumo salama wa SWIFT ili kutoa maagizo ya malipo, umekua kwa kiwango kikubwa kutokana na ustawi wa muundomsingi wa mtandao

MUHTASARI WA TAARIFA MAALUM

na simu za rununu, biashara inayoendeshwa kwa njia ya kieletroniki (e-commerce), ustawi wa kiteknolojia na muundomsingi wa mawasiliano ya Near Field Communication (NFC). Shughuli hii kupitia KEPSS na EAPS iliimarika kwa asilimia 17.1 na asilimia 8.5 katika kiwango na thamani kufikia Juni 30, 2016. Kiwango wastani kilichohamishwa kwa kila hamisho la fedha kilipungua kwa asilimia 7.3, inayoashiria ongezeko la matumizi kwa malipo ya viwango vya chini. Ongezeko la utekelezaji huu unatokana na upanuzi wa biashara katika Jamii ya Afrika Mashariki uliotokana na ongezeko la uhamasishaji wa umma kuwa mfumo wa RTGS ni salama na thabiti wa kutoa malipo ya thamani ya juu na ya dharura katika malipo ya hapa nchini na sehemu nyinginezo katika eneo hili. Malipo ya moja kwa moja yaliendeshwa kupitia KEPSS kufikia 98.8 ambacho ni kiwango cha Clearing House Net Settlement Instructions (NSI) kilioendeshwa kupitia KEPSS ukichukua salio la asilimia 1.2.

Mtagusanokati ya teknolojia ya simu za rununu na majukwaa ya benki yamerahisisha ufikiaji wa huduma za benki hasa kwa wateja wenye mapato ya chini ambao awali walikuwa wanapokea huduma duni na mfumo rasmi wa benki. Huduma ya kutuma pesa kupitia simu za rununu iliongezeka. Wakenya wengi huku mashirika ya kutoa huduma za kutuma pesa kwa simu za rununu yakiandikisha kiwango cha juu cha matumizi yake na thamani. Hii ilithibitiwa kwa ushirikiano pamoja na ubunifu katika sekta hii kama vile M Shwari ya benki ya Commercial Bank of Africa- katika mwaka wa 2012 na KCB-Mpesa iliyozinduliwa mwaka 2015; umiliki mkubwa wa simu za rununu; nia ya wananchi kufikia huduma ya kifedha; na gharama ya chini ya kutuma pesa kwa kutumia simu za rununu. Kutokana na haya, idadi ya mawakala wa mashirika ya kutoa huduma ya kutuma pesa kwa njia ya simu ya rununu iliongezeka kwa asilimia 23.3 na thamani ya pesa zilizohamishwa kwa huduma ya kutuma pesa kwa njia ya simu ya rununu ikaongezeka kwa asilimia 20.2 katika mwaka huo kufikia Juni 2016.

Benki Kuu ya Kenya ilisalia katika mkondo unaofaa kimkakati ili kuhamasisha umma kuhusu mbinu salama za noti za benki kama mbinu ya kupunguza visa vya kughushi. Ushirikiano na benki na taasisi zingine za kielimu zimeunda sehemu muhimu ya mikakati ya kupitia elimu ya umma. Benki hii inazidi kuhimiza umma kutembelea wavuti wake na kujifunza mengi kuhusiana na sifa za usalama katika sarafu yetu.

Benki Kuu ya Kenya ilizindua mipango mbali mbali ili kuthibiti sherehe za maadhimisho yake ya miaka 50. Upeo wa sherehe hizo ulikuwa kongamano la kiwango cha juu kwa jina "50 years of Central Banking' lililofanyika Septemba 13 na uzinduzi wa Makavazi yake ya Sarafu mnamo Septemba 14, 2016.

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1.0 World Economy

WORLD ECONOMY

Global economic activity continues to remain weak with increasing downside risks to the outlook. According to the IMF, World Economic Outlook (WEO) October 2016, global GDP growth in 2016 is projected at 3.1 percent, slightly lower than growth in 2015 and unchanged from the July 2016 WEO. The developments are a reflection of economic activity in both the advanced and emerging market economies.

Growth in advanced economies is expected to slow down to 1.6 percent in 2016 from 2.1 percent in 2015, due to lower productivity growth and inflation that is persistently below the target. In the US, growth is projected to slow down to 1.6 percent in 2016 from 2.6 percent in 2015 as business investment continues to be soft amid weaker growth prospects and elevated policy uncertainty. In addition, the declining oil prices has occasioned reduced investments in energy related sectors, while the strong U.S. dollar and weakening global demand have contributed to declining exports.

In the EU, growth is constrained by uncertainty created by the outcome of British exit from the EU membership with the EU 2016 growth projected at 1.7 percent from 2 percent in 2015, while the UK growth is projected at 1.8 percent in 2016 from 2.2 percent in 2015. Growth in Japan is expected to remain weak driven by uncertainty surrounding an appreciating Japanese Yen as well as weak global growth. The European Central Bank (ECB), the Bank of England and Bank of Japan have continued to pursue accommodative monetary policy to boost aggregate demand and raise the inflation level that has been persistently below target.

In emerging markets and developing economies growth momentum remains modest and heterogeneous. Economic activity in China is expected to slow down in 2016 as the country transitions from investment and exports-led growth to consumption and services based growth. The outlook for other emerging market and developing economies remains diverse. Growth in India is expected to remain robust averaging 7.6 percent in 2016, while in Russia and Brazil, there are signs that their economies have gained traction into positive growth trajectory, with GDP projected at 1.1 percent and 0.5 percent, respectively, in 2017.

WORLD ECONOMY

Table 1.1: Actual and Projected Output Growth of Selected Countries/Regions (Percent Change)

	Actual		Projections		Difference from July 2016 WEO Update	
Country/Region	**2014**	**2015**	**2016**	**2017**	**2016**	**2017**
World Output	**3.4**	**3.2**	**3.1**	**3.4**	**0.0**	**0.0**
Advanced Economies	**1.9**	**2.1**	**1.6**	**1.8**	**-0.2**	**0.0**
United States	2.4	2.6	1.6	2.2	-0.6	-0.3
Euro area	1.1	2.0	1.7	1.5	0.1	0.1
Japan	0.0	0.5	0.5	0.6	0.2	0.5
United Kingdom	3.1	2.2	1.8	1.1	0.1	-0.2
Emerging Market and Developing economies	**4.6**	**4.0**	**4.2**	**4.6**	**0.1**	**0.0**
Emerging and Developing Asia	6.8	6.6	6.5	6.3	0.1	0.0
China	7.3	6.9	6.6	6.2	0.0	0.0
India	7.2	7.6	7.6	7.6	0.2	0.2
Latin America and the Caribbean	1.0	0.0	-0.6	1.6	-0.2	0.0
Brazil	0.1	-3.8	-3.3	0.5	0.0	0.0
Sub-Saharan Africa	5.1	3.4	1.4	2.9	-0.2	-0.4
South Africa	1.6	1.3	0.1	0.8	0.0	-0.2
Nigeria	6.3	2.7	-1.7	0.6	0.1	-0.5
Middle East and North Africa	2.6	2.1	3.2	3.2	-0.1	0.1

Source: IMF, World Economic Outlook, October 2016 update

WORLD ECONOMY

Global economic activity continues to remain weak with increasing downside risks to the outlook. According to the IMF, World Economic Outlook (WEO) October 2016, global GDP growth in 2016 is projected at 3.1 percent, slightly lower than growth in 2015 and unchanged from the July 2016 WEO. The developments are a reflection of economic activity in both the advanced and emerging market economies.

Growth in advanced economies is expected to slow down to 1.6 percent in 2016 from 2.1 percent in 2015, due to lower productivity growth and inflation that is persistently below the target. In the US, growth is projected to slow down to 1.6 percent in 2016 from 2.6 percent in 2015 as business investment continues to be soft amid weaker growth prospects and elevated policy uncertainty. In addition, the declining oil prices has occasioned reduced investments in energy related sectors, while the strong U.S. dollar and weakening global demand have contributed to declining exports.

In the EU, growth is constrained by uncertainty created by the outcome of British exit from the EU membership with the EU 2016 growth projected at 1.7 percent from 2 percent in 2015, while the UK growth is projected at 1.8 percent in 2016 from 2.2 percent in 2015. Growth in Japan is expected to remain weak driven by uncertainty surrounding an appreciating Japanese Yen as well as weak global growth. The European Central Bank (ECB), the Bank of England and Bank of Japan have continued to pursue accommodative monetary policy to boost aggregate demand and raise the inflation level that has been persistently below target.

In emerging markets and developing economies growth momentum remains modest and heterogeneous. Economic activity in China is expected to slow down in 2016 as the country transitions from investment and exports-led growth to consumption and services based growth. The outlook for other emerging market and developing economies remains diverse. Growth in India is expected to remain robust averaging 7.6 percent in 2016, while in Russia and Brazil, there are signs that their economies have gained traction into positive growth trajectory, with GDP projected at 1.1 percent and 0.5 percent, respectively, in 2017.

Growth projections for Sub-Saharan Africa (SSA) were revised down substantially, reflecting challenging macroeconomic conditions in some of the leading economies, which are adjusting to lower commodity revenues. In Nigeria, economic activity is projected to contract to 1.7 in 2016, as the economy adjusts to foreign currency shortages following lower oil receipts, low power generation, and weak investor confidence. Growth in South Africa is also expected to slow down to 0.1 percent in 2016 from 1.3 percent in 2015. By contrast, economic activity in most of the commodity importing countries has remained resilient, supported by lower oil prices in the international market.

Global growth in 2017 is expected to improve at a modest pace, improving to 3.4 percent, with persistent diversity across regions and countries. Market conditions are expected to improve the growth prospects in major emerging market economies. Improvement in output is also expected among advanced economies largely reflecting recovery in the US, Japan and Canada despite a projected slowdown in the Euro Area.

Risks to the outlook for global economic activity remain on the downside and relate primarily to volatility of the financial markets and heightened geopolitical risks that have exacerbated existing macroeconomic imbalances. Persistently low oil prices have also aggravated fiscal or financial imbalances in some oil-exporting countries. Policy uncertainty surrounding the economic transition in China may lead to an increase in global financial volatility while economic and political uncertainty surrounding the Brexit continues to weigh on the outlook. Other ongoing concerns on the outlook include spill overs to economic activity resulting from geopolitical tensions especially in the Middle East, terrorism as well as diseases such as the Zika virus affecting the Latin America and Caribbean region.

Financial Flows

Net inflows – comprising debt and equity – to low and middle income countries increased by 9 percent to US$ 1,132.3 billion in 2014 **(Table 1.2).** Net equity inflows accounted for 59 percent of total inflows while net debt flows accounted for 41 percent. In 2014, net equity inflows –comprising portfolio and foreign direct investment – increased by 6.6 percent to US$ 668.4 billion. Meanwhile, net debt inflows declined by 17.7 percent reflecting a 21.6 percent reduction in inflows from private creditors, fully offsetting a 58.7 percent increase in inflows from official creditors.

Remittances to Developing Countries

Flows to East Asia and Pacific region declined by 3.5 percent in 2014 but remained dominant accounting for 48.2 percent. Flows to Latin America and the Caribbean accounted for 26.4 percent of total net inflows in 2014 and increased by 4 percent while inflows to Europe and Central Asia accounted for 7.5 percent of total net inflows in 2014 and decreased by 37.6 percent. Inflows to South Asia, Sub-Saharan Africa and Middle East and North Africa accounted for 9.2 percent, 6.9 percent and 1.9 percent, respectively in 2014.

Remittances to developing countries in 2015 are estimated to have increased to US$ 431.6 billion from US$ 429.9 billion in 2014 reflecting an increase in flows to all regions **(Table 1.4).** East Asia and the Pacific accounted for the largest share of flows to developing countries in 2015 at 28.9 percent and increased to US$ 140.3 billion. Remittance flows to South Asia accounted for 28 percent of total flows and increased to US$ 135.8 billion in 2015. Flows to Latin America and the Caribbean accounted for 15.4 percent of total flows while those to the Middle East and North Africa accounted for 11.2 percent. Flows to Europe and Central Asia accounted for 8.3 percent while those to Sub-Saharan Africa accounted for 8.1 percent of total flows **(Table 1.4).**

Table 1.2: Net Financial Flows to Low and Middle Income Countries by Categories: 2009-2014 (USD Billion)

	2009	2010	2011	2012	2013	2014
Net inflows	674.6	1,105.2	1,020.6	1,054.8	1,190.4	1,132.3
Net debt inflows	213.9	508.7	447.5	447.9	563.5	463.9
Official creditors	79.4	76.4	32.6	27.7	27.6	43.8
Private creditors	134.5	432.3	414.9	420.1	535.8	420.1
Net equity inflows	460.7	596.4	573.1	607.0	626.9	668.4
Foreign Direct Investment	348.6	472.5	569.4	514.5	554.6	575.7
Portfolio equity	112.0	124.0	3.7	92.5	72.3	92.7

Source: World Bank Group: International Debt Statistics, 2016

Table 1.3: Net Financial Flows to Low and Middle Income Countries by Region: 2009-2014(USD Billion)

US$ billion	2009	2010	2011	2012	2013	2014
East Asia and Pacific	290.4	528.4	541.5	495.1	564.8	545.3
Europe and Central Asia	72.3	119.6	109.7	100.1	135.3	84.4
Latin America and the Caribbean	151.9	279.2	213.6	265.1	287.7	299.1
Middle East and North Africa	25.5	27.1	13.9	21.1	29.7	21.5
South Asia	89.3	106.2	81.3	103.2	102.3	104.4
Sub-Saharan Africa	45.2	44.7	60.6	70.2	70.6	77.7

Source: World Bank Group: International Debt Statistics, 2016

Table 1.4: Remittance Flows to Developing Countries: 2013-2018 (USD Billion)

			Estimate	Forecast		
	2013	**2014**	**2015**	**2016**	**2017**	**2018**
Developing Countries	416.6	429.9	431.6	447.9	465.7	484.7
East Asia and Pacific	113.4	121.8	127.0	131.0	135.5	140.3
Europe and Central Asia	47.7	43.4	34.6	36.3	38.3	40.3
Latin America and Caribbean	61.1	63.6	66.7	69.3	71.9	74.6
Middle-East and North Africa	48.8	50.8	50.3	51.6	53.0	54.5
South Asia	110.8	115.5	117.9	123.3	129.3	135.8
Sub-Saharan Africa	34.7	34.8	35.2	36.4	37.7	39.1

Source: World Bank Group: Migration and Development Brief April 2016

DOMESTIC ECONOMY - OVERVIEW

The Kenyan economy remains resilient, having registered strong performance in 2015 despite headwinds from a weaker global economic environment. Real GDP grew by 5.6 percent in 2015 - an improvement from 5.3 percent growth recorded in 2014. In the first half of 2016 the economy grew by 6.1 percent, compared to 5.5 percent recorded in the first half of 2015. The improved performance is attributed to favourable weather conditions which supported agriculture production and electricity generation; high public investment that supported growth in the construction sector; recovery in the tourism sector; and low international oil prices that supported growth in the transport and storage sector. On the expenditure side, real GDP growth was mainly supported by a significant increase in government consumption, coupled with moderate growth in private consumption.

Conduct of prudent monetary and fiscal policies continued to support macroeconomic stability during the year to June 2016. In this regard, the Central Bank of Kenya tightened monetary policy in July 2015, raising the Central Bank Rate (CBR) to 11.5 percent from 10.0 percent set in May 2015, to anchor inflationary expectations associated with exchange rate volatility, more specifically in the April June 2015 period. The bank also implemented measures during the July - December period of 2015 to address further exchange rate volatility, and to safeguard financial stability concerns following the placement of two non-systemic small banks into receivership. Consequently inflation eased gradually during the year under review following restoration of stability in the foreign exchange market. Furthermore, targeted liquidity support through reverse repos to the small tier banks eased challenges of liquidity distribution in the interbank market following enhanced segmentation and trading within banks tier groups. The reopening of third of the small banks placed into receiver ship in April 27, 2016 boosted public confidence in the management of the banking sector.

Overall 12-Month inflation eased marginally from an average of 6.63 percent in financial year 2014/2015 to 6.47 percent in the financial year 2015/2016. Inflation in the financial year 2015/2016 was mainly a food phenomenon. Food prices remained high in the July - December 2015 period due to delayed rains but improved in the January - June 2016 period with improved weather conditions which boosted agricultural production. The push on domestic prices from the excise tax imposed on cigarettes and beer from December 1, 2015 was however, moderated by declining fuel inflation consistent with international prices.

The foreign exchange market remained relatively stable despite heightened global uncertainties, reflecting a narrower current account deficit due to a lower import bill, improved earnings from exports and resilient inflows from diaspora remittances. The stability of the Kenya Shilling was supported by the Central Bank of Kenya's closer monitoring of the market including in the period after the June 23, 2016 Brexit Vote. The resilience of the Kenya Shilling can also be explained in part, by the fact that, the capital slowdown experienced in many emerging markets was driven mostly by weaker economic prospects on exports dominated by oil and metals.

Kenya's external position remained resilient despite heightened global uncertainties occasioned by weaker prospects for global growth and subdued commodity prices. The current account deficit improved reflecting decline in the value of oil imports due to lower oil prices in the international markets, improved export earnings and resilience of remittance inflows. Kenya's official international reserves position, at US$ 8,267 million by end-June 2016, was equivalent to 5.5 months of imports. The Precautionary Arrangements with the IMF, amounting to US$ 1,500 million approved in March 2016, also provided additional buffer against short term external and domestic shocks.

The fiscal out-turn was more favourable with Government budgetary operations in Fiscal Year 2015/16 recording a smaller budget deficit of 8.4 percent of GDP on a commitment basis compared to the projected 10.1 percent of GDP and lower than the previous year's at 9.3

DOMESTIC ECONOMY - OVERVIEW

percent of GDP. Budget implementation was impacted by slower absorption of development budget allocation, particularly in the first and second quarters of the fiscal year. While recurrent expenditure increased rapidly, revenue growth was somewhat constrained. The domestic financing component increased to 46.4 percent from 26.7 percent in the FY 2014/15 but remained below the 65.7 percent recorded in 2013/14.

Uptake of the National Payments System continued to increase as reflected in usage of the Real Time Gross Settlement System (RTGS), the Kenya Electronic Payments and Settlement System (KEPSS) and the East African Payment System (EAPS). The system which is owned, and operated by Central Bank of Kenya, was resilient and available to users (commercial banks) throughout the year under review. The system, anchored on a secure SWIFT network to transmit payment instructions, has grown rapidly supported by developments in internet and mobile phones, e-commerce, technological developments and Near Field Communication (NFC) infrastructures. The increase in uptake is attributed to continued expansion of trade within the East African Community buoyed by increased awareness by the public of the RTGS as a safe and efficient mode of payment for both high value and time critical payments for local and regional payments. Direct payments were largely processed through KEPSS at 98.8 percent.

Convergence between mobile phone technology and commercial banks platforms has made banking services more accessible, especially for low-income customers, previously under-served by the formal banking system. Mobile money service usage maintained an upward trajectory among the Kenyan public with mobile money service providers recording increased volumes and values. This was sustained by continued collaborations and innovations in the industry; by widespread ownership of mobile phones; the need to access financial services by the public; and the relatively low cost of mobile money transactions.

2.0 Real Sector

REAL SECTOR

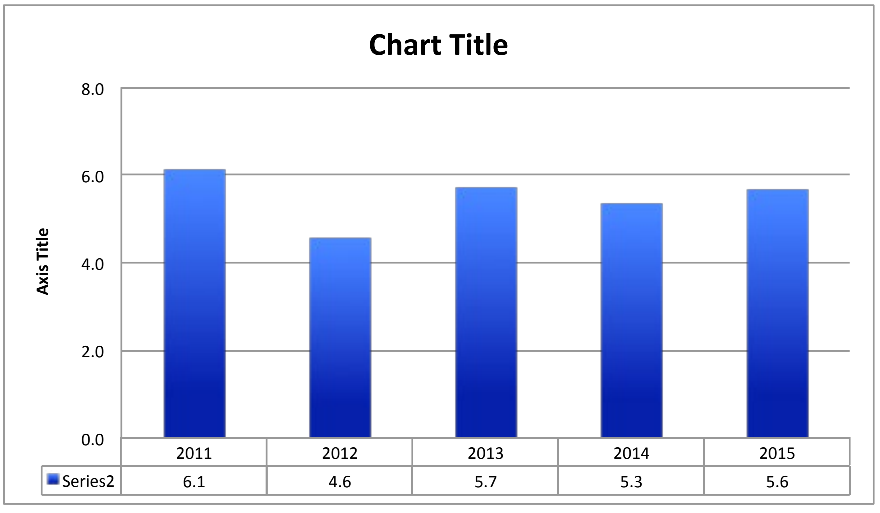
Real GDP grew by 5.6 percent in 2015, an improvement from 5.3 percent growth recorded in 2014 (Chart 2A and Table 2.2). The improved performance was attributed to favourable weather conditions which supported agriculture production and electricity generation; high public investment that supported growth in the construction sector; recovery in the tourism sector; and low international oil prices that supported growth in the transport and storage sector.

The share of the agriculture sector to real GDP remained stable at 22.1 percent, while the share of manufacturing to GDP declined marginally from 10.9 percent in 2014 to 10.6 percent in 2015. The accommodation and restaurants sector improved significantly, recording a lower contraction in 2015 compared to 2014, which confirms recovery of the tourism sector **(Table 2.2).**

On the expenditure side, growth was mainly supported by final consumption, largely due to the notable growth in government final consumption coupled with a moderate growth in private consumption. Investment growth decelerated in 2015, following a decrease in gross fixed capital formation. Foreign trade balance (net exports) contracted in 2015, which was reflected in decline for both exports and imports of goods and services (Table 2.1A).

The economy maintained the higher growth trajectory in the first half of 2016, recording real GDP of growth of 5.9 percent and 6.2 percent in the first and second quarters, respectively, compared to 5.0 percent and 5.9 percent recorded in similar quarters of 2015. The recovery was due to improved performance of the following sector: agriculture; transport and storage; electricity and water supply; wholesale and retail trade; and accommodation and restaurants.

Chart 2A: Real GDP Growth Rates, 2011 - 2015 (in %)



	2011	2012	2013	2014	2015
Series2	6.1	4.6	5.7	5.3	5.6

Sources: Revised National accounts, Kenya National Bureau of Statistics

REAL SECTOR

2.1 GDP from the expenditure side

Real GDP growth in 2015 was largely boosted by government (public) final consumption expenditure which grew by 15.4 percent, coupled with a moderate increase of 5.3 percent in private consumption **(Table 2.1A).** The growth in public consumption expenditure is partly attributable to higher domestic interest payments during the year. Total investment growth declined substantially from 11.5 percent in 2014 to 2.8 percent in 2015, following a significant decrease in gross fixed capital formation. Foreign trade balance contracted by -1.6 percent in 2015, which was reflected in the contraction of both exports and imports of goods and services.

The contribution of final consumption expenditure to real GDP growth increased from 4.9 percentage points in 2014 to 5.3 percentage points in 2015. It accounted for the largest share to real GDP at 93.8 percent. Contributions of total investment, exports and imports of goods and services to GDP growth remained stable at 1.1 percentage points, 1.0 percentage points and -1.7 percentage points, respectively in 2014 and 2015 **(Table 2.1A).**

Total resources available to the economy, measured as gross national disposable income was 105.3 percent of GDP in 2014 compared with 105.5 in 2015. Gross national income grew by 15.3 percent in 2015 from 13.6 percent in 2014. The gross national disposable income increased by 15.1 percent in 2015 from 14.1 percent **(Table 2.1B).** Most of the resources were spent on consumption, which comprised 93.8 percent of GDP.

2.2 GDP from the Production Side

On the production side, growth in 2015 was largely supported by improved performance in agriculture production (5.6 percent) and electricity generation (7.1 percent); growth in transport and storage sector (7.1 percent); and recovery in tourism as reflected by the notable decline in contraction of the accommodation and restaurant sector **(Table 2.2).**

Agriculture

Growth in agricultural output increased to 5.6 percent in 2015 from 3.5 percent in 2014. The sector's share to GDP remained stable at 22.1 percent, while its contribution to overall GDP growth was 1.2 percentage points. The improved performance was attributed to favourable weather conditions, with most parts of the country experiencing heavy and well-distributed rains. This boosted production of crops such as tea, coffee and fresh vegetables for export.

Available agricultural indicators show an improvement in production in the first half of 2016 compared to a similar period in 2015 **(Table 2.3).** Production of tea increased by 48.8 percent cumulatively in the period January to May 2016, compared with 36.5 percent decline recorded over the same period in 2015. Coffee sales and horticultural exports increased significantly in the first half of 2016, recording growth rates of 33.0 percent and 40.7 percent, respectively. Milk intake in the formal sector and sugarcane deliveries also increased to record growth rates of 30.0 percent and 5.9 percent, respectively over the period January to May 2016, compared with declines of 28.5 percent and 17.8 percent recorded in a similar period in 2015. Consequently, the agriculture sector recorded an improved sectoral GDP growth of 5.3 percent in the first half of 2016, compared to an average of 3.5 percent recorded in the first half of 2015.

REAL SECTOR

Table 2.1A: Gross Domestic Product by Expenditure

KENYA: REAL GDP AND GROWTH 2010-2015					
	2011	**2012**	**2013+**	**2014+**	**2015***
Gross Domestic Product by expenditure, at constant 2009 prices - KSh Million					
Final consumption	2,964,674	3,141,275	3,392,077	3,554,949	3,799,332
Private	2,463,475	2,604,583	2,826,285	2,956,968	3,113,461
NPISH (Non-profit Institutions Serving Households)	31,011	32,025	33,150	33,502	34,328
Public	470,188	504,667	532,642	564,479	651,542
Total Investment	657,074	720,970	711,893	793,997	816,435
Gross fixed capital formation	632,010	712,002	720,850	827,332	870,046
Change in stocks/inventories	25,063	8,968	-8,957	-33,335	-53,612
Foreign trade balance	-399,609	-459,071	-446,918	-530,365	-521,976
Exports of goods and services	681,289	679,828	682,966	718,989	712,783
Imports of goods and services	1,080,897	1,138,899	1,129,884	1,249,353	1,234,759
Statistical discrepancy	71,886	40,893	-16,896	15,662	-42,942
GDP	**3,294,026**	**3,444,067**	**3,640,156**	**3,834,244**	**4,050,848**
Growth rates (in percent)					
Final consumption	5.9	6.0	8.0	4.8	6.9
Private	6.3	5.7	8.5	4.6	5.3
NPISH (Non-profit Institutions Serving Households)	1.3	3.3	3.5	1.1	2.5
Public	4.2	7.3	5.5	6.0	15.4
Total Investment	7.0	9.7	-1.3	11.5	2.8
Gross fixed capital formation	4.8	12.7	1.2	14.8	5.2
Change in stocks/Inventories	134.3	-64.2	-199.9	272.2	60.8
Foreign trade balance	20.8	14.9	-2.6	18.7	-1.6
Exports of goods and services	9.2	-0.2	0.5	5.3	-0.9
Imports of goods and services	13.2	5.4	-0.8	10.6	-1.2
GDP	**6.5**	**4.6**	**5.7**	**5.3**	**5.6**
Sectoral Contribution to Overall GDP (in percent)					
Final consumption	90.0	91.2	93.2	92.7	93.8
Total Investment	19.9	20.9	19.6	20.7	20.2
Exports of goods and services	20.7	19.7	18.8	18.8	17.6
Imports of goods and services	-32.8	-33.1	-31.0	-32.6	-30.5
Statistical discrepancy	2.2	1.2	-0.5	0.4	-1.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Contribution to GDP growth (in percent)					
Final consumption	5.8	4.2	5.3	4.9	5.3
Total Investment	1.3	1.0	1.1	1.1	1.1
Exports of goods and services	1.3	0.9	1.1	1.0	1.0
Imports of goods and services	-2.1	-1.5	-1.8	-1.7	-1.7

* Provisional + Revised

Source: Kenya National Bureau of Statistics

REAL SECTOR

Table 2.1B: Gross National Income, National Disposable Income and Saving, 2011-2015

Current Prices - KSh Million					
	2011	**2012**	**2013+**	**2014+**	**2015***
Gross domestic product at market prices	**3,725,918**	**4,261,151**	**4,745,439**	**5,398,020**	**6,224,369**
Gross national income at market prices	**3,726,538**	**4,248,694**	**4,718,884**	**5,362,337**	**6,180,677**
Receivable from the rest of the world	279,617	240,850	274,152	349,953	368,422
Payable to rest of the world	-4,121	-3,352	-4,020	-17,853	6,248
Gross national disposable income	**4,002,034**	**4,486,192**	**4,989,016**	**5,694,437**	**6,555,347**
Consumption of fixed capital	422,395	475,642	567,840	731,738	814,704
Net national disposable income	**3,579,639**	**4,010,550**	**4,421,176**	**4,962,699**	**5,740,643**
Final consumption expenditure	3,458,413	3,940,473	4,512,799	5,093,998	5,839,445
Private	2,903,300	3,306,912	3,788,956	4,284,523	4,889,745
NPISH	33,051	37,496	43,585	43,445	47,686
Public	522,062	596,065	680,258	766,030	902,014
Saving, net	**121,226**	**70,077**	**-91,623**	**-131,299**	**-98,802**
Financing of capital formation					
Saving, net	121,226	70,077	-91,623	-131,299	-98,802
Capital transfers from abroad, net	20,861	19,890	13,644	24,204	25,219
Total	**142,087**	**89,967**	**-77,979**	**-107,095**	**-73,583**
Gross fixed capital formation	759,746	903,740	977,516	1,237,600	1,339,389
Consumption of fixed capital	-422,395	-475,642	-567,840	-731,738	-814,704
Changes in inventories	48,881	14,166	-20,581	-23,348	-19,473
Net lending (+) Net borrowing (-)	**153,910**	**189,752**	**148,751**	**286,300**	**398,904**
Growth rates (in percent)					
Gross national income at market prices		**14.0**	**11.1**	**13.6**	**15.3**
Receivable from the rest of the world		-13.9	13.8	27.6	5.3
Payable to rest of the world		-18.7	19.9	344.1	-135.0
Gross national disposable income		**12.1**	**11.2**	**14.1**	**15.1**
Saving, net		**-42.2**	**-230.7**	**43.3**	**-24.8**
Shares to Overall GDP (in percent)					
Gross national income at market prices	**100.0**	**99.7**	**99.4**	**99.3**	**99.3**
Gross national disposable income	**107.4**	**105.3**	**105.1**	**105.5**	**105.3**
Saving, net	**3.3**	**1.6**	**-1.9**	**-2.4**	**-1.6**

+ Revised * Provisional

Source: Kenya National Bureau of Statistics

REAL SECTOR

TABLE 2.2: Real Gross Domestic Product by Activity (KSh million)

MAIN SECTORS	Share in 2014 Real GDP (%)	Share in 2015 Real GDP (%)	2011	2012	2013	2014*	2015**
Agriculture	22.1	22.1	753,596	775,798	818,044	846,568	894,188
Mining & Quarrying	1.0	1.0	28,429	33,838	32,385	37,097	41,161
Manufacturing	10.9	10.6	383,890	381,750	403,131	416,029	430,421
Electricity & water supply	2.4	2.4	74,438	81,545	86,959	92,334	98,859
Construction	4.8	5.2	139,050	154,816	164,092	185,514	210,767
Wholesale & Retail Trade	7.7	7.7	237,502	254,222	274,040	294,690	312,291
Accommodation & restaurant	1.1	1.1	53,333	54,972	52,441	43,657	43,086
Transport & Storage	6.6	6.7	231,333	237,495	240,939	252,118	270,055
Information & Communication	3.6	3.7	105,606	108,186	121,848	139,603	149,793
Financial & Insurance	6.0	6.2	185,163	196,220	212,241	229,819	249,884
Public administration	3.9	3.9	132,612	137,872	141,719	149,269	157,342
Professional, Administration & Support Services	2.3	2.3	81,064	84,274	87,321	89,918	92,254
Real estate	8.1	8.2	272,055	283,061	294,747	311,148	330,494
Education	6.9	6.8	210,928	234,345	249,371	265,072	277,414
Health	1.8	1.8	60,723	59,023	63,581	68,711	73,228
Other services	1.3	1.3	44,786	45,800	47,891	49,911	51,811
FISIM	(2.5)	(2.7)	(75,076)	(82,648)	(86,932)	(96,763)	(111,242)
All Industries at basic prices	88.0	88.2	2,919,431	3,040,567	3,203,818	3,374,695	3,571,804
Taxes on products	12.0	11.8	374,594	403,499	436,339	459,549	479,044
GDP at market prices	100.0	100.0	3,294,026	3,444,066	3,640,157	3,834,244	4,050,848
Growth Rates (Percent)							
	Share in 2014 Real GDP (%)	Share in 2015 Real GDP (%)	2011	2012	2013	2014	2015
Agriculture	22.1	22.1	2.4	2.9	5.4	3.5	5.6
Mining & Quarrying	1.0	1.0	19.0	19.0	-4.3	14.5	11.0
Manufacturing	10.9	10.6	7.2	-0.6	5.6	3.2	3.5
Electricity & water supply	2.4	2.4	9.4	9.5	6.6	6.2	7.1
Construction	4.8	5.2	4.0	11.3	6.0	13.1	13.6
Wholesale & Retail Trade	7.7	7.7	8.3	7.0	7.8	7.5	6.0
Accommodation & restaurant	1.1	1.1	4.1	3.1	-4.6	-16.8	-1.3
Transport & Storage	6.6	6.7	7.1	2.7	1.5	4.6	7.1
Information & Communication	3.6	3.7	22.1	2.4	12.6	14.6	7.3
Financial & Insurance	6.0	6.2	4.6	6.0	8.2	8.3	8.7
Public administration	3.9	3.9	2.4	4.0	2.8	5.3	5.4
Professional, Administration & Support Services	2.3	2.3	2.0	4.0	3.6	3.0	2.6
Real estate	8.1	8.2	5.1	4.0	4.1	5.6	6.2
Education	6.9	6.8	7.5	11.1	6.4	6.3	4.7
Health	1.8	1.8	-2.6	-2.8	7.7	8.1	6.6
Other services	1.3	1.3	1.5	2.3	4.6	4.2	3.8
FISIM	-2.5	-2.7	9.1	10.1	5.2	11.3	15.0
All Industries at basic prices	88.0	88.2	5.3	4.1	5.4	5.3	5.8
Taxes on products	12.0	11.8	12.6	7.7	8.1	5.3	4.2
GDP at market prices	100.0	100.0	6.1	4.6	5.7	5.3	5.6

* Revised **Provisional

Source: Kenya National Bureau of Statistics

REAL SECTOR

Table 2.3: Output Growth of Key Crops and Milk

	2010	2011	2012	2012	2014	2015	2016+
Tea**							
Production (Tonnes)	399,006	377,913	369,562	432,453	445,106	399,211	212,751
Annual Growth, %	31.2	-5.3	-2.2	17.0	2.9	-10.3	48.8
Coffee*							
Sales (Tonnes)	38,938	29,984	46,051	37,943	42,450	32,219	26,448
Annual Growth, %	-21.3	-23.0	53.6	-17.6	11.9	-24.1	33.0
Horticulture*							
Exports (Tonnes)	268,533	238,562	250,814	309,029	303,254	310,458	202,379
Annual Growth, %	8.2	-11.2	5.1	23.2	-1.9	2.4	40.7
Sugar Cane**							
Deliveries (Tonnes)	5,709,620	5,338,571	5,716,379	6,671,800	6,477,650	6,849,224	3,099,720
Annual Growth, %	1.8	-6.5	7.1	16.7	-2.9	5.7	5.9
Milk**							
Intake (Million Litres)	511	549	495	523	544	584	263
Annual Growth, %	25.7	7.5	-9.8	5.6	4.0	7.4	30.0

+ Partial data for 2016

*2016 reflects cumulative data from January-June 2016,

**2016 reflects cumulative data from January-May 2016

Source: Kenya National Bureau of Statistics

Manufacturing

The growth of manufacturing sector improved marginally to 3.5 percent in 2015 compared to 3.2 percent in 2014, with the sector benefiting from lower production costs due to reduced fuel and electricity costs. The improved performance in 2015 was reflected in increased production of pharmaceutical products; beverages; meat and meat products; non-metallic minerals; plastic products; and processed sugar. It was, however, tempered by declined production of soft drinks and galvanized sheets **(Table 2.4).** The share of manufacturing to GDP declined slightly from 10.9 percent in 2014 to 10.6 percent in 2015.

Available indicators point to mixed performance in the first half of 2016. Production of processed sugar increased by 3.4 percent, while that of cement increased by 3.8 percent. However, production of soft drinks, galvanized sheets and assembled vehicles declined in the first quarter of 2016 **(Table 2.4).** Overall, the manufacturing sector recorded subdued growth of 3.2 percent in the first half of 2016 which was lower than 4.9 percent recorded in a similar period of previous year.

REAL SECTOR

Table 2.4: Production Of Selected Manufactured Goods

	2010	2011	2012	2013	2014	2015	2016+
Processed Sugar*							
Production (Tonnes)	523,470	475,061	494,030	600,210	616,852	631,957	284,193
Annual Growth, %	-4.5	-9.2	4.0	21.5	2.8	2.4	3.4
Soft Drinks***							
Production ('000 Litres)	361,333	371,353	359,518	403,981	459,464	454,799	119,895
Annual Growth, %	0.0	2.8	-3.2	12.4	13.7	-1.0	-11.6
Galvanised Sheets***							
Production (Tonnes)	201,410	268,095	235,812	306,100	284,509	256,936	61,552
Annual Growth, %	10.6	33.1	-12.0	29.8	-7.1	-9.7	-4.1
Cement*							
Production (Tonnes)	3,709,806	3,969,003	4,639,693	5,059,129	5,856,828	6,338,185	2,678,515
Annual Growth, %	11.7	7.0	16.9	9.0	15.8	8.2	3.8
Assembled Vehicles**							
Production (Units)	5,721	6,049	6,218	6,948	9,246	10,181	2,258
Annual Growth, %	13.1	5.7	2.8	11.7	33.1	10.1	-31.3

+ Partial data for 2016

*2016 reflects cumulative data from January-May 2016,

**2016 reflects cumulative data from January-April 2016

***2016 reflects cumulative data from January-March 2016

Source: Kenya National Bureau of Statistics

Energy Sector Developments

The electricity and water supply sector recorded growth of 7.1 percent in 2015, an improvement from 6.2 percent in 2014 **(Table 2.2)**. The expansion reflected increased generation of hydro-electricity and geothermal electricity following improved long rains, and increased government investment towards expanding geothermal production capacity. Increased production of hydroelectricity and geothermal electricity was accompanied by a corresponding decrease of the more expensive thermal electricity **(Table 2.5** and **Chart 2B)**.

Consumption of electricity declined significantly in the second quarter of 2016, as construction of the Standard Gauge Railway (SGR) nears completion **(Chart 2B)**. However, the electricity and water supply sector recorded increased growth of 10.8 percent, up from 8.5 percent recorded in the first quarter of 2016 and 9.2 percent in second quarter of 2015.

International crude oil prices continued to decline for the better part of 2015, recording a low of USD 29.95 per barrel in January 2015, but reversed the trend and rose to USD 49.05 per barrel in June 2016 **(Chart 2C)**.

REAL SECTOR

Table 2.5: Energy Sector

	2010	2011	2012	2013	2014	2015	2016+
Electricity Generation*							
Output (Million KWH)	6,407	7,161	7,517	8,217	8,889	9,315	4,854
Annual Growth, %	20.2	11.8	5.0	9.3	8.2	4.8	7.1
Of which:							
Hydro-power Generation (Million KWH)	3,195	3,183	4,032	4,387	3,411	3,463	1,940
Annual Growth, %	51.7	-0.4	26.6	8.8	-22.2	1.5	20.0
Geo-Thermal Generation (Million KWH)	1,442	1,444	1,522	1,781	2,917	4,521	2,307
Annual Growth, %	-2.4	0.1	5.4	17.0	63.8	55.0	4.0
Thermal (Million KWH)	1,769	2,533	1,963	2,049	2,561	1,332	608
Annual Growth, %	1.3	43.2	-22.5	4.4	24.9	-48.0	-12.8
Consumption of Electricity (Million KWH)*	5,870	6,152	6,298	6,564	7,406	8,256	4,272
Annual Growth, %	10.8	4.8	2.4	4.2	12.8	11.5	2.5
Consumption of Fuels ('000 tonnes)**	3,177	3,545	3,764	3,649	3,873	4,439	2,076
Annual Growth, %	-0.4	11.6	6.2	-3.1	6.2	14.6	13.5

+ Partial data for 2016

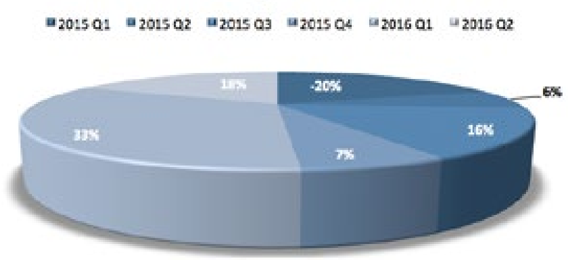
*2016 reflects cumulative data from January-June 2016

**2016 reflects cumulative data from January-May 2016

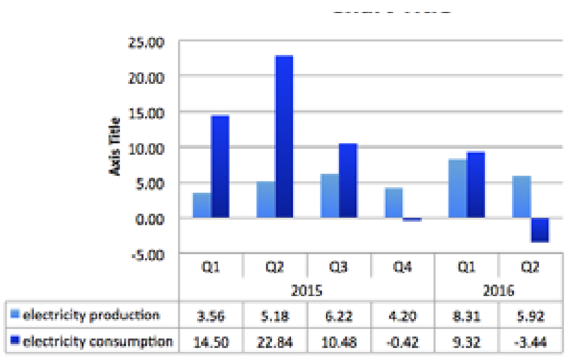
Source: Kenya National Bureau of Statistics

Chart 2B: Production of Electricity by Source and Consumption of Electricity

Electricity Production



Electricity Production and Consumption



Source: Kenya National Bureau of Statistics

Building and Construction

Growth in the construction sector improved to 13.6 percent in 2015 from 13.1 percent in 2014, supported by increased government spending on major infrastructure projects such as the SGR, as well as expansion of road networks in various parts of the country. Consumption of cement increased by 9.6 percent to 5.7 million tonnes in 2015 from 5.2 million tonnes consumed in 2014, in tandem with increased activity in the sector. The value of building plans approved by the Nairobi City County rose by 6.2 percent, supported by increased demand for both residential and commercial space in Nairobi and its environs.

Growth in the construction industry slowed to 8.2 percent in the second quarter of 2016, compared to 11.2 percent in the second quarter of 2015. This was reflected in reduced production and consumption of cement during the quarter under review, mainly attributed to reduced activity related to the SGR.

Transport and Storage

Performance in the transport and storage sector improved significantly, with growth at 7.1 percent in 2015 compared to 4.6 percent in 2014. Growth in the sector was boosted by reduced cost of transportation due to low oil prices. Available data showed an increase of 2.6 percent in passenger flows through the Jomo Kenyatta International Airport, Nairobi in 2015. This was an improvement compared to a decline of 1.3 percent in 2014. Data on the volume of fuel throughput by the Kenya Pipeline indicates an increase of 1.3 percent in the first half of 2016 **(Table 2.6)**. Transport and storage sector registered improved performance in the first half of 2016, growing by 8.8 percent and 8.4 percent in the first and second quarters of 2016, respectively.

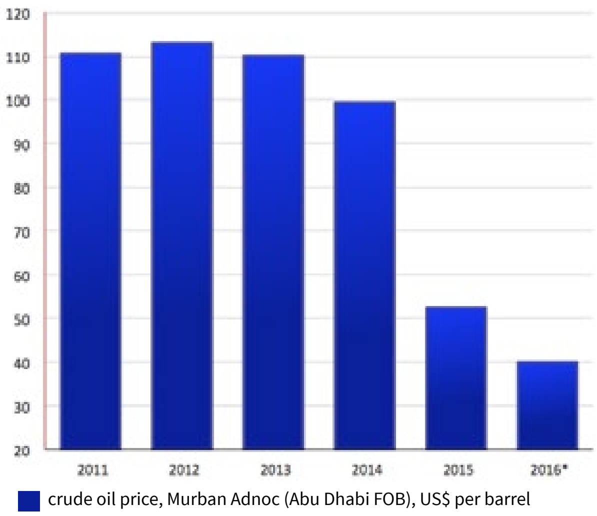
Tourism

The tourism sector reverted firmly to a path of recovery in 2015 after a dismal performance in 2014, as reflected in the performance of accommodation and restaurant sector in 2015 **(Table 2.2)**. Though the sector declined by 1.3 percent, this was a significant improvement from the 16.8 percent decline in 2014. Overall tourist arrivals also declined by a lower margin of 13.1 percent in 2015 compared to a decline of 20.4 percent recorded in the previous year.

Growth in the accommodation and restaurant sector remained on an upward trend, registering 15.3 percent growth in the second quarter of 2016, up from 12.1 percent recorded in the first quarter of 2016. The sector received a considerable boost from increased conference tourism as the country continues to host high profile international conferences as well as various incentives offered by government to the sector. Available data for the first half of 2016 indicates a positive outlook for the tourism sector. Overall tourist arrivals increased by 14.3 percent from January to May 2016 cumulatively **(Table 2.7** and **Chart 2D)**.

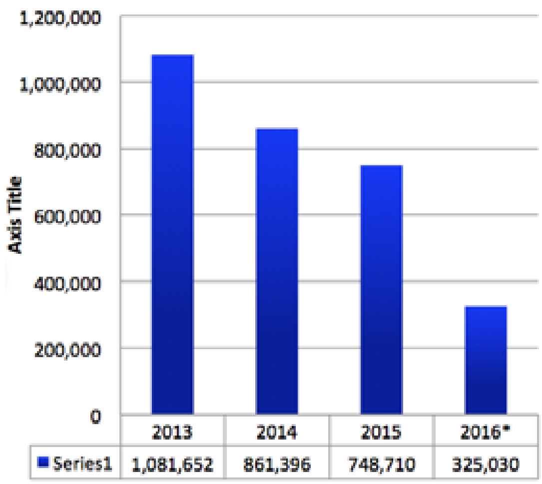
REAL SECTOR

Chart 2C: Murban Crude Oil



Source: Kenya National Bureau of Statistics

Chart 2D: Tourist Arrivals



Source: Kenya Tourist Board (KTB)

Table 2.6: Performance of Transport Sub-Sector

Activity	2010	2011	2012	2013	2014	2015	2016+
Passengers through JKIA**							
Total passenger flows	3,029,419	4,135,126	4,302,244	4,290,349	4,232,523	4,340,724	1,082,784
Annual Growth, %	15.4	36.5	4.0	-0.3	-1.3	2.6	-0.9
Of which:							
Number of incoming passengers	1,508,841	2,088,798	2,148,105	2,144,002	2,102,886	2,166,669	541,061
Growth %	13.1	38.4	2.8	-0.2	-1.9	3.0	-0.5
Number of outgoing passengers	1,520,578	2,046,328	2,154,139	2,146,347	2,129,637	2,174,055	541,723
Growth %	17.8	34.6	5.3	-0.4	-0.8	2.1	-1.3
Throughput by Kenya Pipeline*							
Output ('000 litres Equivalent)	4,195,669	4,257,425	4,855,571	5,181,600	5,623,628	5,737,943	2,902,322
Output Growth %	-13.8	1.5	14.0	6.7	8.5	2.0	1.3

+ Partial data for 2016

*2016 reflects cumulative data from January-June 2016

**2016 reflects cumulative data from January-March 2016

Source: Kenya National Bureau of Statistics and Kenya Pipeline Company

Table 2.7: Tourist Arivals by Point of Entry

	2010	2011	2012	2013	2014	2015	2016+
JKIA*	862,586	1,036,486	1,053,361	912,998	743,600	672,789	289,642
Growth %	12.9	20.2	1.6	-13.3	-18.6	-9.5	14.6
MIAM*	232,698	227,794	187,151	168,654	117,796	75,921	35,388
Growth %	24.5	-2.1	-17.8	-9.9	-30.2	-35.5	12.4
Total*	1,095,284	1,264,280	1,240,512	1,081,652	861,396	748,710	325,030
Growth %	15.2	15.4	-1.9	-12.8	-20.4	-13.1	14.3

+ Partial data for 2016

*2016 reflects cumulative data from January-May 2016

Source: Kenya Tourism Board

3.0 MONETARY POLICY MANAGEMENT

Overview

Overall 12-Month inflation declined marginally from an average of 6.63 percent in financial year 2014/2015 to 6.47 percent in the financial year 2015/2016. Inflation in the financial year 2015/2016 was mainly a food phenomenon as food prices remained elevated on account of unfavourable weather conditions in the first half of the financial year 2015/16. Similarly, developments in inflation in the financial year 2015/16 reflected the gradual decline in international oil prices and impact of implementation of the new excise tax imposed on selected items in the 'Alcoholic Beverages, Tobacco & Narcotics' category in December 2015.

Inflation

Overall 12-Month inflation declined marginally from an average of 6.63 percent in financial year 2014/2015 to 6.47 percent in the financial year 2015/2016 (**Chart 3A**). In the first half of the financial year overall 12-month inflation increased largely on account of rising food prices. It, however, declined from January through June 2016 as food inflation eased following favourable weather conditions (**Chart 3B**).

Non-Food-Non-Fuel (NFNF) inflation remained stable between July and November 2016 contributing 1.3 percentage points to overall inflation over the same period. However, its contribution increased in December 2015 and remained elevated for the remainder of the financial year on account of the excise tax imposed on items in the 'Alcoholic Beverages, Tobacco and Narcotics' category such as beer and cigarettes.

Inflationary pressure was however moderated by declining fuel inflation whose contribution to overall inflation declined in line with international oil prices. Its contribution remained below one percentage points in the year under review (**Chart 3C**).

Chart 3A: 12-Month Inflation and Annual Average Inflation In Percent

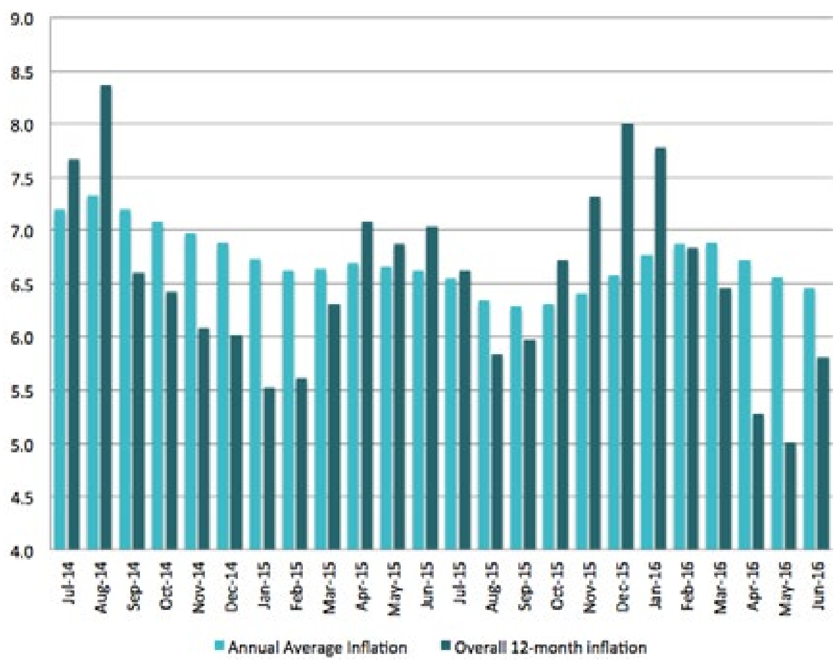


Chart 3B:Contribution of Baskets to Food Inflation in Percent

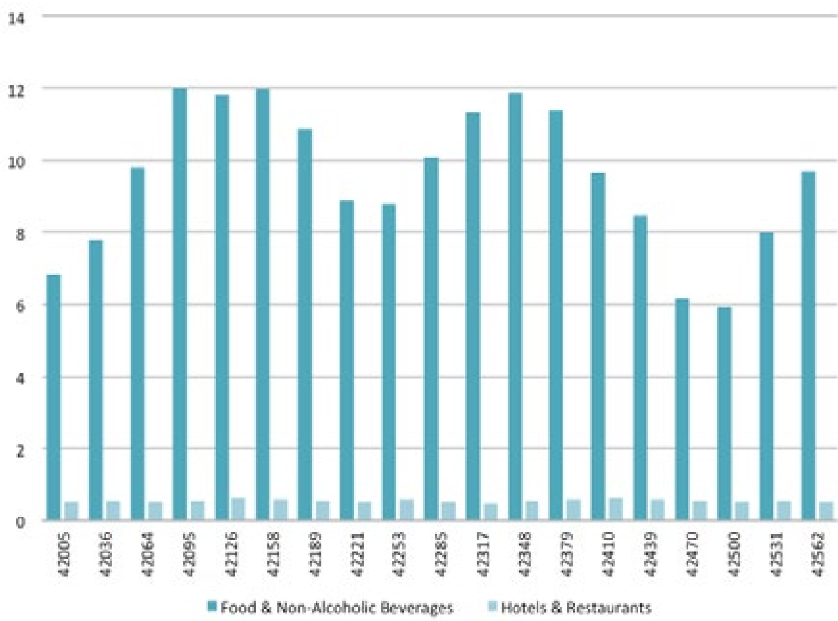
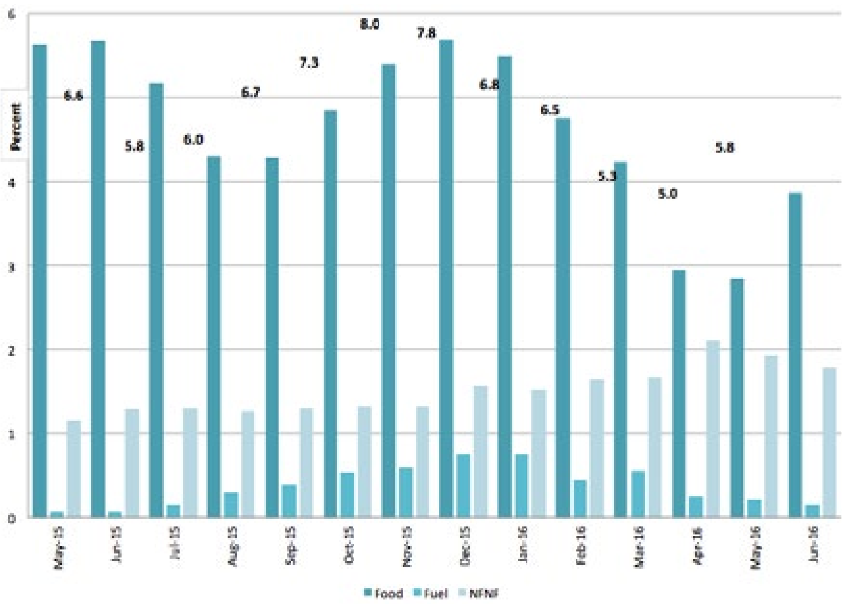


Chart 3C: Coontributions of Food,Fuel, and Non-Food Non-Fuel inflation to overall inflation



Food Inflation

Food inflation, largely driven by prices of items in the 'Food and Non-Alcoholic Beverages' category, declined by 280 basis points to 8.6 percent in June 2016 from 11.4 percent in July 2015. This is reflected by the decline in the contribution of the 'Food and Non-Alcoholic Beverages' category to food inflation from 10.9 percentage points in July 2015 to 8.0 percentage points in June 2016, (**Chart 3B**). The high food inflation in the first half of the financial year was on account of delayed long rains in 2015 while the improvements recorded in the second half were on account of favourable weather conditions which boosted agricultural production beginning January 2016, leading to a decline in prices of food items in the subsequent months. Moreover, the volatility in food prices during the year under review was accounted by a few key and seasonal agricultural produce. The 'Restaurants and hotels' category, recorded a marginal decline contributing 0.5 percentage points in June 2016 compared to 0.6 percentage points in July 2015.

The contribution of food inflation to overall inflation peaked at 5.7 percentage points in December 2015 compared to 5.2 percentage points in July 2015 **(Chart 3C)**. However, the pressure begun to dissipate in 2016 on account of favourable weather conditions. The contribution of food inflation therefore declined to 3.9 percentage points in June 2016 compared to 5.5 percentage points in January 2016.

Fuel Inflation

Fuel inflation increased by 120 basis points to 1.4 percent in June 2016 from 0.2 per cent in June 2015. This was reflected in the increase in inflation in the 'Transport' category which more than offset the decline in inflation in the 'Housing, Water, Electricity, Gas and other Fuels' category. The 'Transport' index recorded an increase of 365 basis points to 0.63 percent in June 2016 from a deflation of 3.02 percent in June 2015. The 'Housing, Water, Electricity, Gas and other Fuels' index, declined by 17 basis points to 1.84 percent in the period under review from 2.01 percent in the previous period.

The reversal of the downward trend in international oil prices in April 2016 is reflected by the diminished support of fuels (petrol, diesel, kerosene and Liquefied Petroleum Gas, LPG) on fuel inflation. The contribution of key fuel items to fuel inflation increased to 0.1 percentage points in June 2016 from negative 0.1 percentage points in July 2015 while that of fares increased to 0.3 percentage points in June 2016 from negative 0.6 percentage points in July 2015 **(Chart 3D)**.

The increase in domestic fuel inflation reflects the low but rising international oil prices. The international price of murban crude oil depicted mixed trends during the financial year 2015/16; declining gradually from US$63.70 per barrel in June 2015 to US$.29.95 per barrel by January 2016, and rising thereafter to US$ 49.05 per barrel in June 2016 (**Chart 3E**). Consequently, the average domestic retail price of motor gasoline premium declined to KSh. 87.07 per litre in June 2016 from KSh. 98.14 per litre in June 2015, while the average domestic retail price of light diesel declined to KSh. 74.69 per litre in June 2016 from KSh 84.26 per litre in June 2015.

Chart 3D:Contribution of Baskets to Fuel inflation in percent

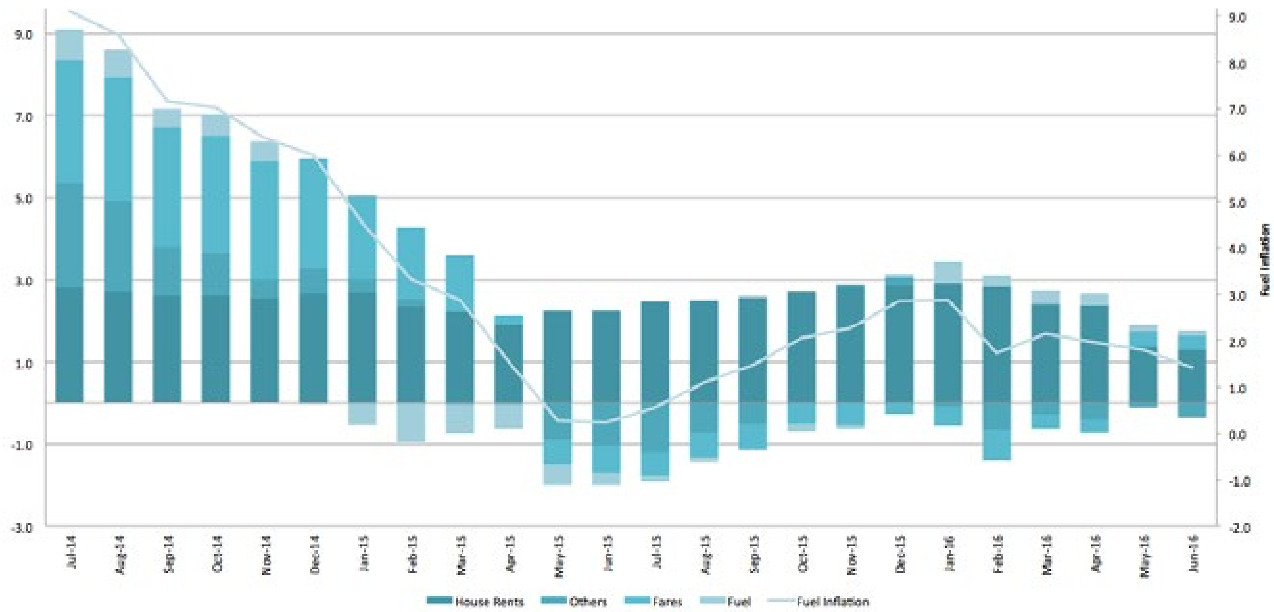
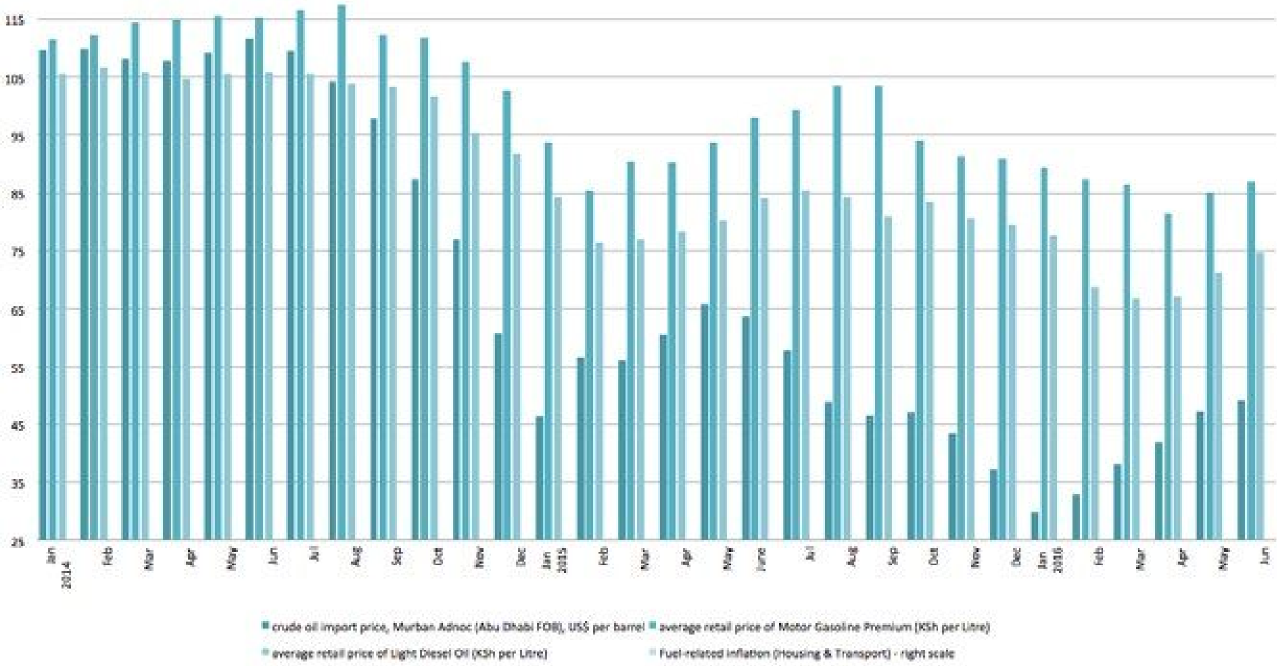


Chart 3E: Trends in Fuel Prices and Fuel-Related Inflation



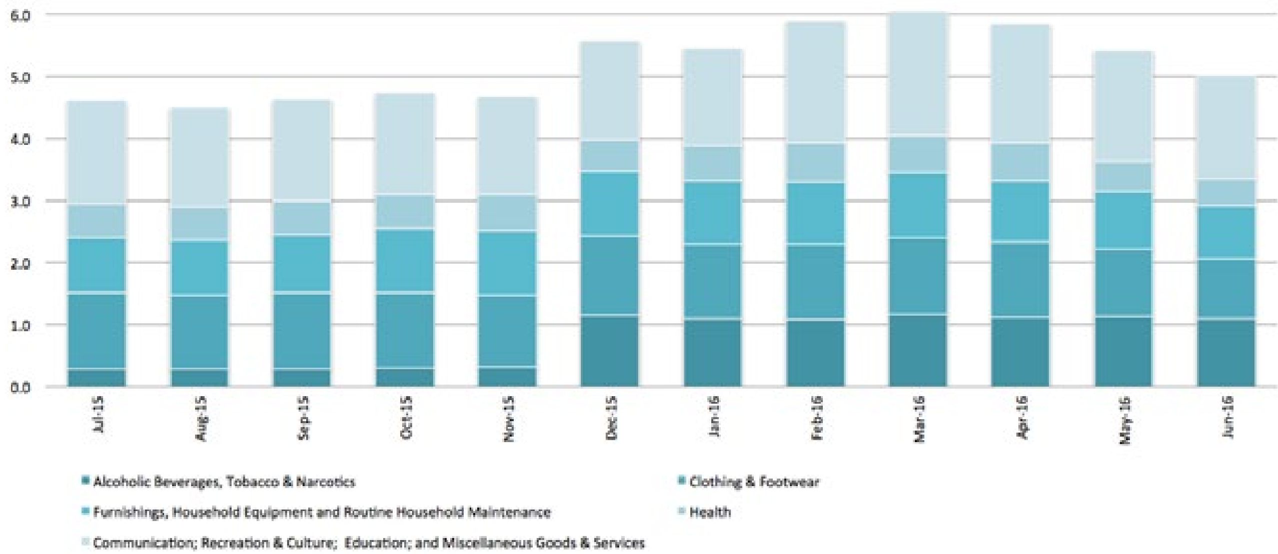
Non-Food-Non-Fuel Inflation

Non-Food-Non-Fuel (NFNF) inflation increased to 5.01 per cent in June 2016 from 4.67 per cent in July 2015 (**Chart 3F**), largely driven by increased prices in the 'Alcoholic Beverages, Tobacco and Narcotics' category of goods, following the upward revision of the excise tax on commodities in this category in December 2015. This is reflected by the increase in the contribution of the 'Alcoholic Beverages, Tobacco and Narcotics' in December 2015 which persisted for the remainder of the year. However, the contribution of 'Health', 'Clothing and Footwear' and 'Furnishings, Household Equipment and Routine Household Maintenance' baskets remained stable in the year under review. Moreover, except for the beginning of 2016, the contribution of the 'Recreation and culture', 'Communication', 'Education', 'Miscellaneous Goods and Services' to NFNF inflation remained muted.

Overall Inflation across Income Groups

Inflation eased in Nairobi by 16 basis points from 6.44 percent in July 2015 to 6.28 percent in June 2016 reflecting declines in inflation in the lower and middle income groups over the same period. Inflation in the lower income group remained high in the year accounting for nearly 50 percent of inflation in Nairobi reflecting high prices of basic commodities such as food. Inflation peaked at 8.21 percent in Nairobi in December 2015 and remained above 5 percent during the period on account of high food prices, (**Chart 3G**).

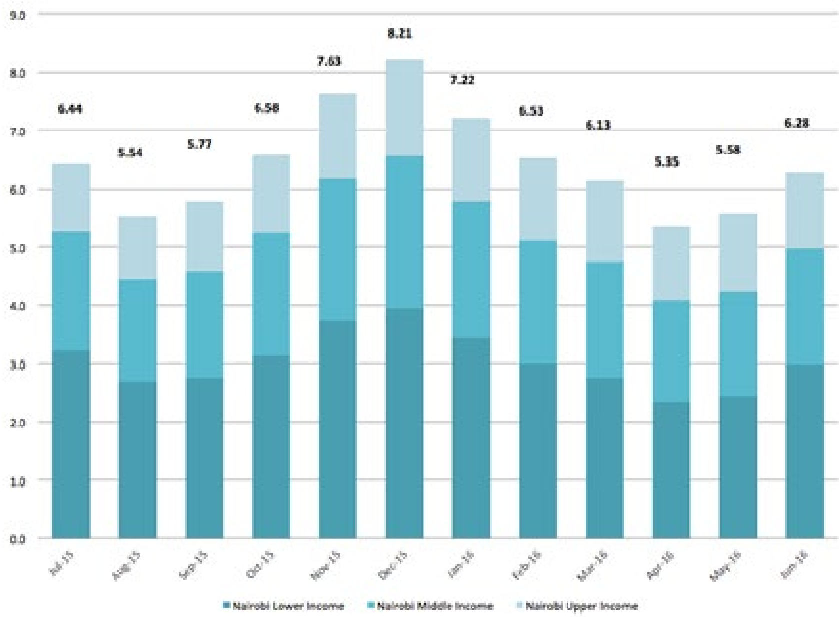
Chart 3F:Contribution of Baskets to Non-food Non-Fuel inflation



Overall Inflation across Regions

The share of inflation in Nairobi and the Rest of Kenya was fairly balanced reflecting the evolution of food and fuel prices. The contribution of inflation in Nairobi to overall inflation declined to 2.87 percentage points in June 2016 from 3.29 percentage points in July 2015 largely reflected in the prices of food and non-alcoholic beverages, transport as well as communication **(Chart 3H)**. Similarly, the contribution of the rest of Kenya to overall inflation declined to 2.93 percentage points in June 2016 from 3.33 percentage points in July 2015.

Chart 3G:Contribution of Income Groups to Inflation in Nairobi



The Share of Baskets in Overall Inflation

The average share of inflation in the 'Food and Non-Alcoholic Beverages' category to overall inflation increased from 59.6 percent in the fiscal year 2014/15 to 66.9 percent in fiscal year 2015/16 owing to rising prices of food items (**Table 3.1**). Moreover, the 'Transport' category recorded a negative share of 0.8 percent in the year under review, compared to a 7.5 percent average share in the previous period, on account of declining international oil prices. However, the share of items not related to food and fuel inflation showed mixed performance in the period under review, owing to the performance of the monetary policy measures implemented during the fiscal year 2015/2016.

Chart 3H: Contribuiton of Regions to Overall Inflation in Percent

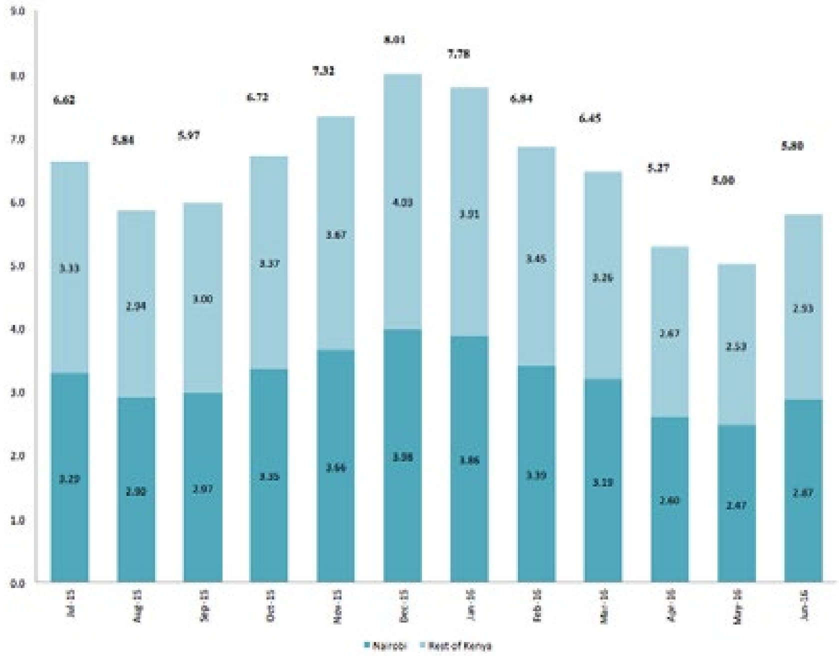


Table 3.1: Average Contributions to Overall 12-month Inflation, percent

	FY 2013/14	FY 2014/15	FY 2015/16
Food & Non-Alcoholic Beverages	53.6	59.6	66.9
Housing, Water, Electricity, Gas & other Fuels	12.6	11.0	8.8
Transport	9.2	7.5	-0.8
Clothing & Footwear	4.8	4.6	5.0
Restaurants & Hotels	4.8	4.2	4.2
Furnishings, Household Equipment & Routine Household Maintenance	4.0	3.9	4.1
Recreation & Culture	3.1	1.7	1.2
Miscellaneous Goods & Services	2.7	2.7	3.0
Health	2.3	2.1	2.2
Alcoholic Beverages, Tobacco & Narcotics	2.1	0.8	3.2
Education	1.9	1.8	1.7
Communication	-1.0	0.1	0.6

Source: Kenya National Bureau of Statistics

4.0 MONEY AND CREDIT DEVELOPMENTS

MONEY AND CREDIT DEVELOPMENT

Monetary Policy

The Central Bank of Kenya (CBK) conducted monetary policy focused on achieving and maintaining stability in the general level of prices in the economy. In this regard, the monetary policy aimed to achieve the inflation target of 5 percent set by the Cabinet Secretary of the The National Treasury during fiscal year 2015/16.

In the first half of fiscal year 2015/16 the Monetary Policy Committee (MPC) held four meetings in July, August, September and November 2015. In the July meeting, the MPC raised the CBR to 11.5 percent from 10.0 percent set in May 2015 to mitigate incipient inflationary pressures in the economy. The month on month inflation had increased to 7.0 percent in June 2015 from 6.9 percent in May 2015 mainly on account of fuel price increases emanating from the depreciation of the Kenya Shilling. The tight policy stance adopted succeeded in stemming exchange rate volatility and anchored inflation expectations. In the subsequent meetings of August, September and November 2015, the Monetary Policy Committee retained the CBR at 11.5 percent. Consequently, overall inflation eased to 6.0 percent in September 2015 but ticked up in November to 6.7 percent largely on account of rising prices of a few seasonal and fast growing foods. In December 2015, overall inflation at 8.0 percent exceeded the 7.5 percent upper bound of the Government's target range. The acceleration reflected revision to the excise tax law on December 1, 2016 which affected the prices of beer and cigarettes, and partly rising prices of food.

In the second half of fiscal year 2015/16 the MPC meetings of January and March 2016, retained the CBR at 11.50 percent, in order to anchor inflation expectations. The decision was supported by evidence of declining overall month on month inflation within the target range, while the foreign exchange market stabilized despite the volatility in the global markets arising from turbulence in China and uncertainties in the advanced economies. In May 2016, the MPC reduced the CBR by 100 basis points to 10.5 percent following the success of monetary policy measures put in place to anchor inflationary expectations. The month on month inflation had declined to 5.3 percent in April from 6.5 percent in March 2016 reflecting a drop in food and fuel prices. In addition, stability was slowly restored in the banking sector following the reopening of Chase Bank which had been put under receivership in April 2016. The foreign exchange market remained stable due to narrowing of the current account deficit reflecting a lower import bill (owing to lower international oil prices) and improved export earnings from tea and horticultural products.

To mitigate the impact of possible shocks on the Kenyan economy, the IMF Executive Board approved, on February 2, 2015, a financing package for Kenya of about $700 million supported under IMF Standby Arrangement/Standby Credit Facility (SBA/SCF). The arrangement is a precautionary facility for mitigating adverse impact of a shock to the economy. It is monitored through observance of the monetary policy consultation clause (MPCC) defined as an inflation band of +/-2.5 percent from the 5 percent medium term inflation target and profile of Net International Reserves performance Criteria (PCS), and structural benchmarks.

Table 4.1: Performance Under SBA/SCF Arrangement for 2015

	Performance criteria (PC) Mar-15	Indicative Target (IT) Jun-15	Performance criteria (PC) Sep-15	Indicative Target (IC) Dec-15
1. Net International Reserves (NIR)				
Actual average	6,498	5,918	5,545	6,352.30
Target	5,956	6,115	5,308	5,987.00
Deviation	542	-197	237	362.1
Comments	PC met	IT not met	PC met	IT met
2. Net Domestic Assets (NDA)				
Actual average	-224	-158	-121	-171.4
Target	-206	-186	-111	-124
Deviation	-18	28	-10	-47.4
Comments	IT met	IT not met	IT met	IT met
3. Monetary policy consultative clause				
Actual*	5.82	6.99	6.14	7.35
Target	5±2.5 percent	5±2.5 percent	5±2.5 percent	5±2.5 percent
Comments	PC met	IT met	PC met	IT met

Table 4.2: Performance Under SBA/SCF Arrangement for 2016-2017

	March indicative criteria (IT)	June Performance criteria (PC)
1. Net International Reserves(NIR)		
Actual	6534.50	6821.30
Target	5784.00	5900.00
Deviation	750.50	921.30
Comments	IT MET	PC MET
2. Net Domestic Assets		
Actual	-268.5	-299.9
Target	-169	-151
Deviation	-99.5	-148.9
Comments	IT MET	IT MET
3. Monetary consultative clause		
Actual	7.02	5.36
Target	8.5	5±2.5
Comments	IT MET	PC MET

Source :Central Bank of Kenya

The Central Bank of Kenya met the performance criteria on inflation and the Net international reserves (NIR) for March and September 2015 **(Table 4.1)**. Inflation averaged 5.82 percent and 6.14 percent in the quarter to March and September 2015, respectively, and was within the inflation target of 5±2.5 percent. Net domestic assets (NDA) of the CBK was also within the ceiling set for March and September 2015.

Following successful implementation of the 2015 SBA/SCF, on 14th March 2016, the IMF Executive Board approved a new 24 month SBA/SCF arrangement of about US$ 1.5 billion. Central

Table 4.3: Monetary Aggregates (Ksh Billion)

	End June Level			Annual Growth Rates			Absolute Change (Ksh Bn)		
	Jun-14	Jun-15	Jun-16	Jun-14	Jun-15	Jun-16	Jun-14	Jun-15	Jun-16
1. Money supply, M1 (1.1+1.2+1.3)	**913.0**	**1001.0**	**1131.3**	**21.3**	**9.6**	**13.0**	**160.2**	**88.0**	**130.4**
1.1 Currency outside banks	158.2	175.3	187.9	6.9	10.8	7.2	10.19	17.08	12.64
1.2 Demand deposits	685.5	775.3	878.9	17.2	13.1	13.4	100.73	89.76	103.59
1.3 Other deposits at CBK 1/	69.2	50.2	64.3	247.1	-27.4	28.1	49.24	-18.96	14.09
2. Money supply, M2 (1+2.1)	**1838.1**	**2139.5**	**2330.7**	**18.8**	**16.4**	**8.9**	**290.25**	**301.40**	**191.21**
2.1 Time and saving deposits	925.1	1138.6	1199.4	16.4	23.1	5.3	130.06	213.45	60.83
3. Money supply, M3 (2+3.1)	2152.1	2553.0	2753.6	18.2	18.6	7.9	331.25	400.86	200.56
3.1 Foreign Currency Deposits	314.0	413.5	422.8	15.0	31.7	2.3	41.00	99.47	9.35
Sources of M3									
1. Net foreign assets 2/	**529.4**	**435.5**	**558.4**	**46.6**	**-17.7**	**28.2**	**168.20**	**-93.90**	**122.83**
Central Bank	615.4	565.2	690.4	53.0	-8.2	22.2	213.28	-50.27	125.23
Banking Institutions	-86.0	-129.6	-132.0	110.2	50.7	1.9	-45.08	-43.63	-2.40
2. Net domestic assets (2.1+2.2)	**1622.7**	**2117.5**	**2195.2**	**11.2**	**30.5**	**3.7**	**163.05**	**494.76**	**77.73**
2.1 Domestic credit	2042.9	2638.9	2856.5	14.6	29.2	8.2	259.92	596.06	217.56
2.1.1 Government (net)	283.1	522.0	560.8	-25.4	84.4	7.4	-96.45	238.98	38.72
2.1.2 Private sector	1719.8	2068.4	2245.3	25.8	20.3	8.6	352.57	348.54	176.93
2.1.3 Other public sector	40.0	48.5	50.5	10.5	21.4	4.0	3.80	8.55	1.92
2.2 Other assets net	-420.2	-521.5	-661.3	30.0	24.1	26.8	-96.87	-101.29	-139.83
Memorandum items									
4. Overall liquidity, L (3+4.1)	**2718.3**	**3196.9**	**3589.7**	**-0.5**	**17.6**	**12.3**	**-14.68**	**478.53**	**392.82**
4.1 Non-bank holdings of government securities	566.2	643.9	836.1	-37.9	13.7	29.9	-345.94	77.67	192.26

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

1/ Includes county deposits and special projects deposit

2/ Net Foreign Assets at current exchange rate to the US dollar.

Source :Central Bank of Kenya

Bank met both March 2016 indicative targets and June 2016 performance criteria **(Table 4.2)**. Average inflation in the quarters to March and June 2016 were within the target. In addition, the Central Bank met the NIR targets in March and June 2016 adequate buffers. The foreign exchange reserves were boosted by interbank purchases as well as a project loan from China in June 2016.

Money Supply

Annual growth in broad money supply (M3) decelerated to 7.9 percent in June 2016 from 18.6 percent in June 2015. This is reflected in the slowdown in the time and savings deposits and foreign currency deposits **(Table 4.3 & Chart 4A)**. Chart 4A underscore a portfolio shift by nonbank holders from deposits to investment in government securities due to concerns for return and risk, especially from September 2015.

Net Foreign Assets

Growth of Net Foreign Assets (NFA) of the banking system recovered to 28.2 percent in fiscal year 2015/16 from 17.7 percent decline in fiscal year 2014/155. The accumulation reflected both in the holding of the Central Bank of Kenya and commercial banks. The NFA of the Central Bank of Kenya was boosted by receipts from a syndicated loan contracted by Government in October 2015 and a commercial loan from China by end June 2016. The CBK also purchased foreign exchange from the interbank market. The NFA of commercial banks improved on account of increases in commercial banks' deposits abroad.

Net Domestic Assets

Growth of the Net Domestic Assets (NDA) of the banking system decelerated to 3.7 percent in fiscal year 2015/16 compared to 30.5 percent in fiscal year 2014/15. The slower growth was in credit extended to all sectors of the economy **(Table 4.3)**.

Domestic Credit

Net domestic credit increased by KSh 217.6bn in fiscal year 2015/16 compared to KSh 596.1billion in fiscal year 2014/15. The slowdown was across all sectors of the economy. Annual growth of net credit to government decelerated from 84.4 percent in June 2015 to 7.4 percent in June 2016 reflecting build-up of government deposits at CBK on account receipts from the syndicated loans contracted from commercial banks during the fourth quarter of 2015, Government Budget Support (Projects) from China in June 2016 and quarterly tax returns in June 2016. Credit extended to the private sector also reduced significantly to KSh 185.1 billion compared to KSh 348.5 billion recorded in June 2015. Generally all the activities recorded reduced credit uptake **(Chart 4B)** due to:

- the high lending rates following the tightening of monetary policy stance in June and July 2015,
- enforcement of strict credit standards by banks to reduce non-performing loans,
- slower credit demand by the business sector exhibited in reduced utilization of the overdraft facilities;
- reduced loan approvals by banks;
- write-offs of some outstanding facilities as required by prudential guidelines - or increased provisioning of non- performing loans - and net loan repayments.

MONEY AND CREDIT DEVELOPMENT

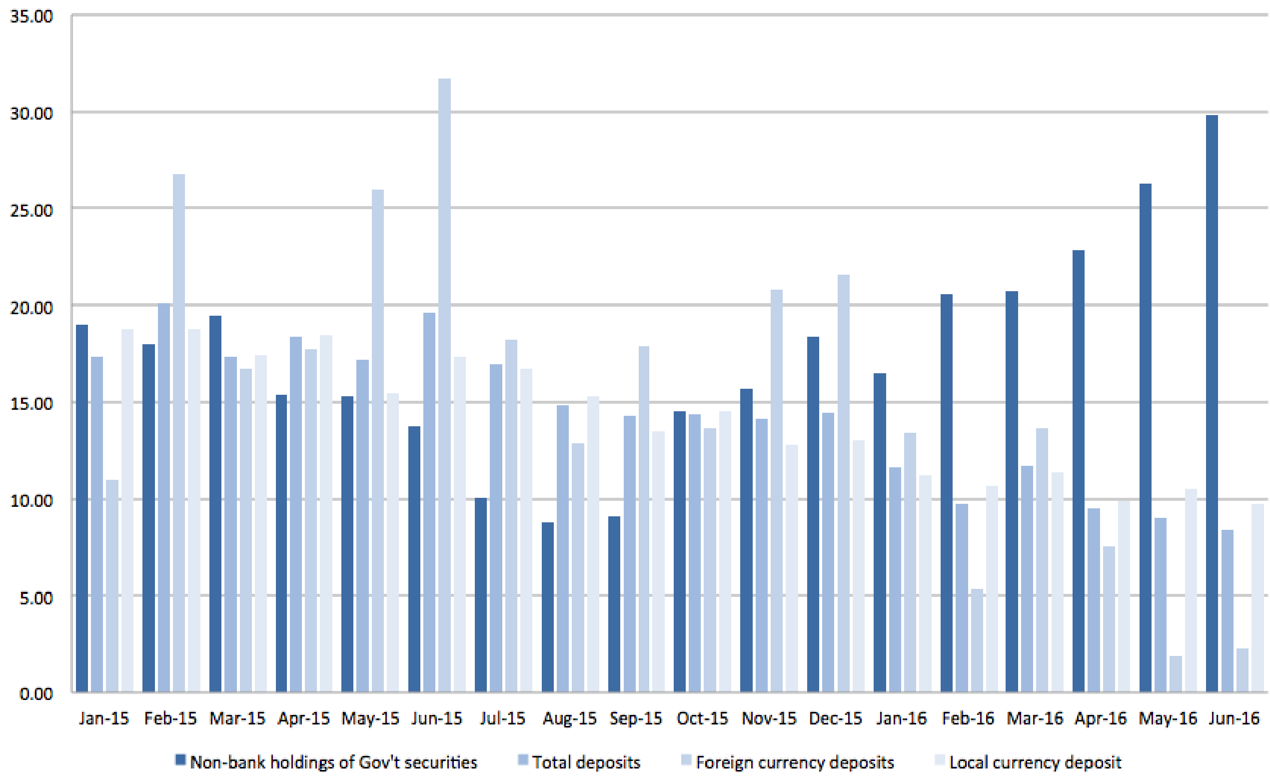
Annual credit growth decelerated fastest for the private household activity compared to the productive and services activities **(Chart 4B).** The monthly flows declined gradually in the first half of the year with the lowest uptake recorded in October 2015 when commercial banks tightened their credit lines after placement of two banks into receivership. In the second half, there was a net repayment in February 2016 **(Chart 4C)**.

Reserve Money

Reserve money grew by KSh 18.1 billion in the FY 2015/16 compared to an increase of KSh 48.3 billion in June 2015. The slowdown reflected a decline in bank reserves and cash outside banks. Bank reserves grew by KSh 5.5bn during the fiscal year reflecting largely a decline in deposits growth **(Table 4.4)** . In the period under review, reserve money declined in August 2015 on account of liquidity mop-up by Central Bank of Kenya to dampen volatility in the forex market **(Chart 4D)**.

The slowdown in reserve money growth was attributed to Net Domestic Assets which decelerated by KSh 107.1bn. This was reflected in the net government borrowing due to the build-up of deposits at CBK. The Net Foreign Assets (NFA) remained the main source of reserve money growth expanding by KSh 125 billion (22 percent) in FY 2015/16. The NFA was boosted by purchases of forex from the interbank market and proceeds of project loan from China to support the government budget.

Chart 4A: Annual Percentage Growth in Deposits and Non-Bank Holdings of Government Securities



MONEY AND CREDIT DEVELOPMENT

Chart 4B: Contributions to Overall Credit Growth by Activity Group in Percent

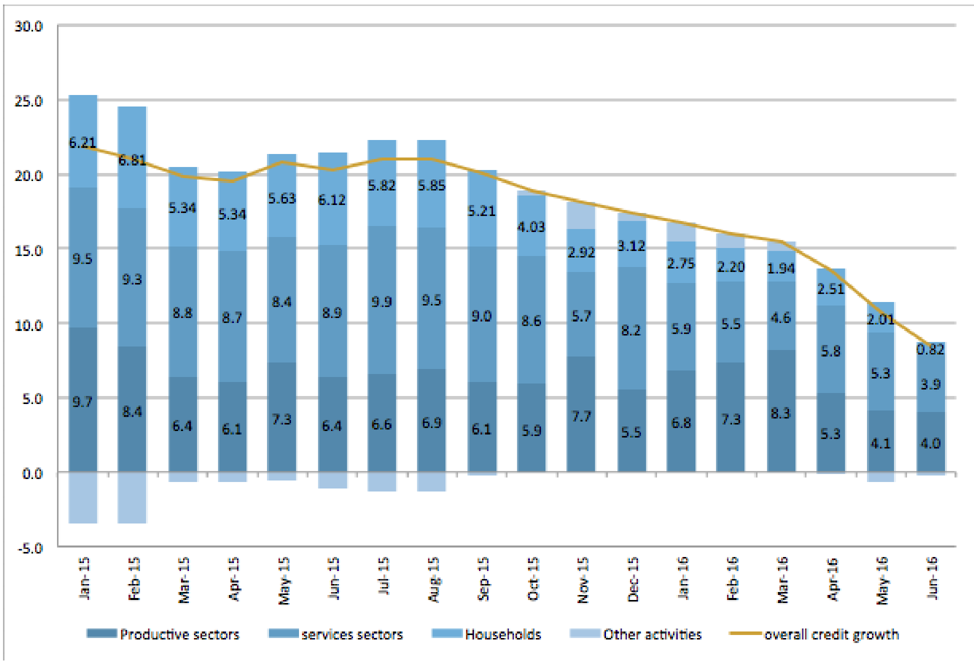
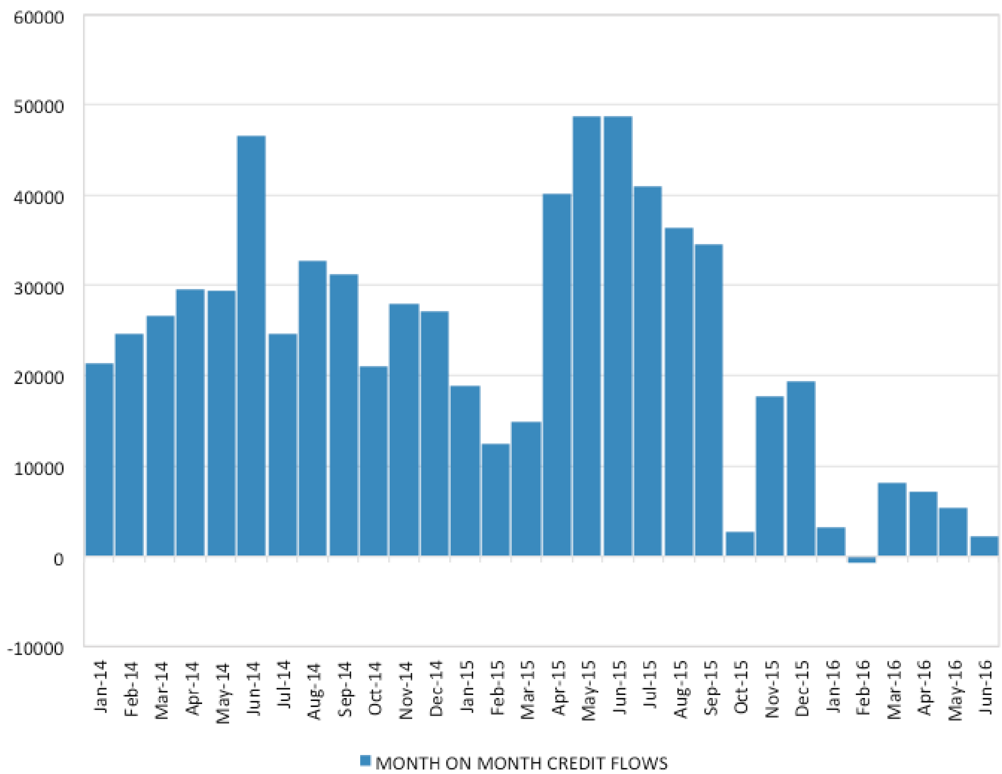
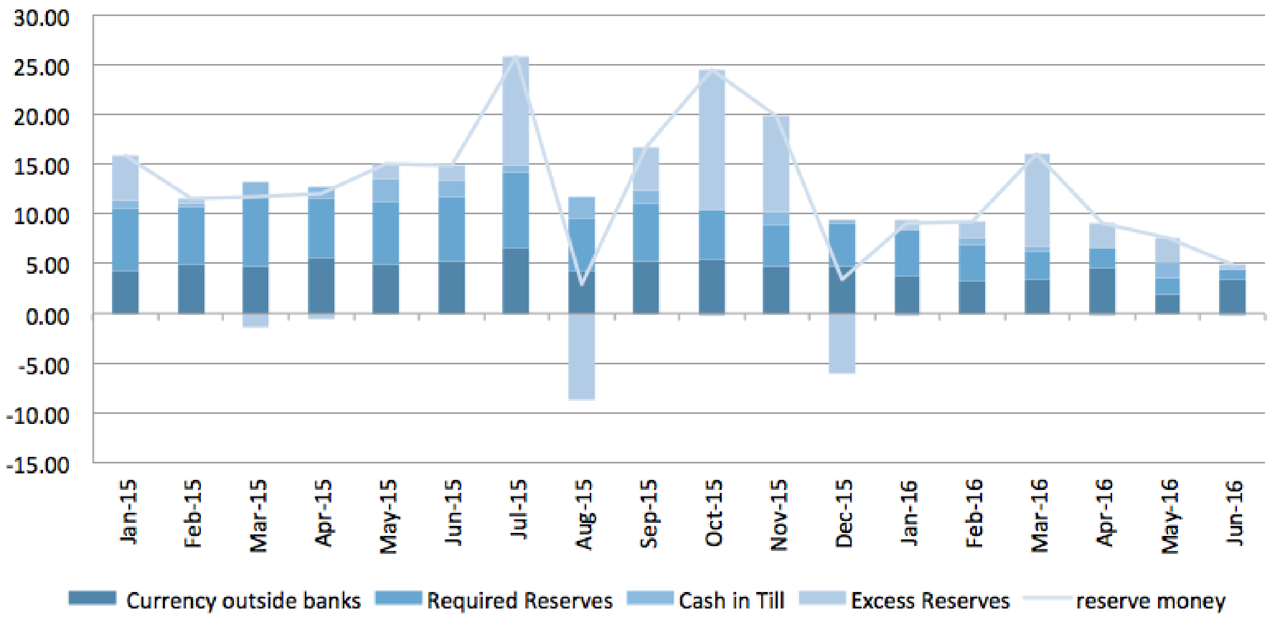


Chart 4C Monthly Uptake Of Credit by the Private Sector



MONEY AND CREDIT DEVELOPMENT

Chart 4D: Contributions to Reserve Money Growth



Source :Central Bank of Kenya

Table 4.4: Reserve Money & its Components (Ksh Billion)

	Jun-14	Jun-15	Jun-16	2013/14	2014/15	2015/16
1. Net Foreign Assets	615.4	565.2	690.4	213.3	-50.3	125.2
2. Net Domestic Assets	-291.7	-193.2	-300.3	-177.0	98.5	-107.1
2.1 Government Borrowing (net)	-176.1	-23.1	-154.7	-155.2	153.0	-131.6
2.2 Commercial banks (net)	0.0	-29.7	3.0	41.7	-29.7	32.7
2.3 Other Domestic Assets (net)	-119.3	-143.9	-152.0	-63.3	-24.6	-8.1
3. Reserve Money	323.7	372.0	390.1	36.3	48.3	18.1
3.1 Currency outside banks	158.2	175.3	187.9	10.2	17.1	12.6
3.2 Bank reserves	165.6	196.7	202.2	26.1	31.2	5.5
3.2.1 Required Reserves	107.4	128.1	131.8	13.7	20.8	3.7
3.2.2 Cash in Till	41.8	46.9	46.9	6.7	5.1	-0.1
3.2.3 Excess Reserves	16.4	21.7	23.6	5.7	5.3	1.9

Source :Central Bank of Kenya

5.0 INTEREST RATES

INTEREST RATES

Central Bank Rate

The Monetary Policy Committee raised the Central Bank Rate (CBR) to 11.50 percent in July 2015 to mitigate exchange rate volatility and anchor inflationary expectations. It maintained the policy rate at that level until May 2016, when it effected a further 100 basis points reduction to 10.5 percent, after it became evident that there were no undue inflationary pressures in the economy.

Kenya Bankers Reference Rate (KBRR)

During the MPC meeting held in July 7, 2016 the committee revised the Kenya Bankers Reference rate to 9.87 percent from 8.54 percent which had been maintained since January 2015 consistent with monetary policy stance.

Short Term Rates

Short term interest rates increased from June through October 2015 which was consistent with a tight monetary policy stance. The weighted average interbank rate soared to highs of 19.9 percent in September 2015 and remained elevated through October 2015, due to the turbulence in the financial markets following the placement of two non- systemic banks into receivership. The deepening of market segmentation and concentration of liquidity in a few large banks that followed caused the weighted interbank rate to drop to 4.0 percent by March 2016.

The 91-day Treasury bill rate increased from 8.3 percent in June 2015 to 21.7 percent in October 2015 while the 182-day Treasury bill rate increased from 10.6 percent to 21.5 percent. The hike in the rates observed in October was on account of escalated costs of funds in the interbank market due to segmentation. The 91-day and 182-day Treasury bill rate declined to 7.25 percent and 9.56 percent, respectively in June 2016 **(Table 5.1)** from above 21 percent in October 2015.

Lending Rates

The average commercial banks' lending rate increased to 18.2 percent in June 2016 from 16.1 percent in June 2015 reflecting the effect of the tight monetary conditions during the year. The overdraft rate increased by 239 basis points while the '1-5 years' and 'over 5 years' category rates increased by 191 basis points and 253 basis points, respectively from June 2015 to June 2016.

INTEREST RATES

Deposit Rates

The average deposit rate increased marginally to 6.78 percent in June 2016 from 6.64 percent in June 2015. The increase was reflected in the '0-3 months' and 'over 3 months' deposit categories. The 0-3 months deposit rate increased by 47 basis points while the over 3 months deposit rate increased by 21 basis points. However, the savings rate declined by 25 basis points **(Table 5.1)**.

Table 5.1: Interest Rates (%)

								2016					
	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
91-day Treasury bill rate	8.26	10.57	11.54	14.61	21.65	12.34	9.81	11.36	10.63	8.72	8.92	8.15	7.25
182-day Treasury bill rate	10.55	11.99	12.06	13.40	21.52	14.02	11.43	13.46	13.19	10.83	10.87	10.25	9.56
Interbank rate	11.77	13.48	18.80	19.85	14.82	8.77	7.27	6.12	4.54	4.10	4.01	3.82	4.56
Repo rate	9.70	10.61	11.50	11.50	11.50		9.23	8.85	9.68	4.31	5.23	6.00	10.04
Reverse Repo rate	-	-	-		18.12	14.21	11.92	11.44	11.58	11.63	12.49	11.55	10.59
Central Bank Rate (CBR)	10.00	11.50	11.50	11.50	11.50	11.50	11.50	11.50	11.50	11.50	11.50	10.50	10.50
Average lending rate (1)	16.06	15.75	15.68	16.82	16.58	17.16	18.30	17.96	17.86	17.79	17.94	18.08	18.15
Overdraft rate	15.65	16.05	15.98	16.65	16.81	17.44	18.48	18.25	18.25	18.06	18.36	18.25	18.04
1-5years	16.72	16.77	16.64	17.41	16.90	17.72	18.40	18.27	18.01	18.00	18.25	18.46	18.63
Over 5years	15.11	14.44	14.43	15.93	15.87	16.26	18.03	17.33	17.41	17.31	17.20	17.53	17.64
Average deposit rate (2)	6.64	6.31	6.91	7.28	7.54	7.39	8.02	7.54	7.51	7.17	6.70	6.38	6.78
0-3months	8.33	7.89	9.22	10.05	10.55	10.50	11.14	10.32	10.00	9.78	8.68	8.54	8.80
Over 3 months deposit	9.73	9.67	10.03	10.06	10.38	10.35	11.35	10.75	11.15	10.41	10.05	8.93	9.94
Savings deposits	1.85	1.37	1.50	1.71	1.68	1.32	1.56	1.56	1.37	1.32	1.38	1.69	1.60
Spread (1-2)	9.42	9.44	8.77	9.54	9.04	9.77	10.28	10.41	10.35	10.62	11.23	11.70	11.37

Source :Central Bank of Kenya

6.0 EXCHANGE RATES

EXCHANGE RATES

The foreign exchange market remained relatively stable despite heightened global uncertainties, reflecting a narrower current account deficit due to a lower import bill, improved earnings from exports and resilient inflows from diaspora remittances. The stability of the Kenya Shilling was supported by the Central Bank of Kenya's closer monitoring of the market following the June 23, 2016 Vote in the United Kingdom in favour of leaving the European Union (Brexit). The resilience of the Kenya Shilling can also be explained in part, by the fact that, the capital slowdown experienced in many emerging markets is being driven mostly by weaker economic prospects affecting countries in Latin America and, those in the Middle-East and Sub-Saharan Africa that are to a large extent dependent on exports of oil and metals.

In the financial year ending 2015/16, the Kenya Shilling ended slightly weaker by 3.5 percent and 3.6 percent against the US dollar and the Euro, respectively but strengthened against the Pound Sterling by 5.2 percent. Most of the weakening occurred in the first quarter of the financial year 2015/16, especially August and September 2015 following the stock market sell-off that began in China, and continued strengthening of the U.S. Dollar against most currencies. In addition, Kenya's current account deficit also remained high up to the third quarter of 2015, reflecting the peak of aircraft imports in 2014 and weak exports.

Pressures on the foreign exchange market subsided in the second half of the financial year 2015/16 reflecting improved inflows from tea and horticulture and a slowdown in outflows due to lower oil prices. Hence, despite the volatility in global financial markets due to risks posed by, among other factors, slower growth in China, the timing of the U.S. Fed's next increase in interest rates, and, at that time, the outcome of the referendum on Brexit, the Shilling remained resilient. As a result, the Kenya Shilling partially offset a 4.6 percent loss in the first half of the financial year 2015/16 – strengthening against the US Dollar consecutively between February and May 2016 – and thereby appreciated by 1 percent in the second half of the financial year. Against the Pound Sterling, the Kenya Shilling gained by 5.8 percent in the second half of the financial year 2015/16. This reflects weakening of the Pound Sterling in the international markets, due to substantial uncertainty surrounding the United Kingdom's future trading arrangements and the impact this would have on its competitiveness. Against regional currencies, the Kenya Shilling displayed mixed performance during the review period. It strengthened against the South African Rand, Uganda Shilling and Rwanda Francs by 15.3 percent, 3.0 percent and 1.8 percent, respectively but weakened against the Tanzania Shilling by 3.6 percent **(Table 6.1)**.

EXCHANGE RATES

International Trade Competitiveness

The Nominal Effective Exchange Rate (NEER) depreciated by 5.4 percent to an average index level of 124.63 in the Fiscal Year 2015/16 compared to an average index level of 118.29 in the Fiscal Year 2014/15. The Real Effective Exchange Rate (REER), which measures Kenya's competitiveness to its main trading partners, appreciated by 0.9 percent from an average index level of 60.30 during the Fiscal Year 2014/15 to an average index level of 59.73 during the Fiscal Year 2015/16 with the appreciation reflecting a higher domestic rate of inflation relative to foreign inflation.

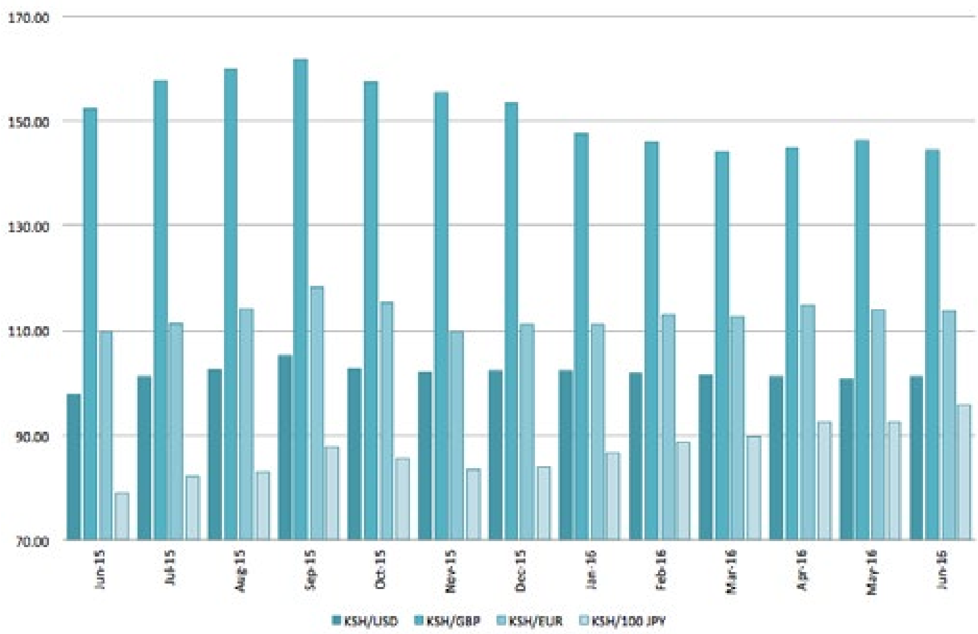
Table 6.1: Kenya Shilling Exchange Rates

	Period average				% change
	June 2013	June 2014	June 2015	June 2016	June 2016-June 2015
US Dollar	85.49	87.61	97.70	101.14	3.5
Pound Sterling	132.42	148.15	152.16	144.32	-5.2
Euro	112.81	119.16	109.72	113.69	3.6
100 Japanese Yen	87.77	85.88	79.00	95.85	21.3
South Africa Rand	8.51	8.20	7.95	6.73	-15.3
Uganda Shilling*	30.34	29.44	32.67	33.27	1.8
Tanzania Shilling*	19.13	19.18	22.49	21.67	-3.6
Rwanda Franc*	7.56	7.74	7.37	7.59	3.0
Burundi Franc*	18.22	17.68	16.06	16.02	-0.2

**** Units of currency per Kenya Shilling***

Source :Central Bank of Kenya

Chart 6B: Kenya Shilling Reer and Neer



Outlook for the Kenya Shilling

International oil prices are expected to remain low, as weak economic prospects and abundant supply put downward pressure on commodity prices, resulting in a relatively lower import bill. Foreign exchange earnings from key commodities such as tea and horticulture are expected to remain stable reflecting increased export volumes, while inflows from diaspora remittances remain resilient. These developments are expected to put less pressure on the current account deficit. Receipts from tourism are on a recovery path reflecting on-going campaigns by government to target new markets as well as new segments. Two high level conferences have since been held; the fourteenth session of the United Nations Conference on Trade and Development (UNCTAD XIV), held in July 2016 in Nairobi and the Sixth Tokyo International Conference of African Development (TICAD) held in Nairobi in August 2016. International reserves remain adequate at US$8.1 billion at end-July 2016, equivalent to 5.4 months of imports. Approval on March 14, 2016 of the new IMF Precautionary Arrangements amounting to US$1.5 billion also reflects confidence in the country’s macroeconomic policies and provides buffers against short term shocks.

The main risks to the outlook are the uncertainty surrounding the United Kingdom’s vote to leave the European Union (Brexit), as well as uncertainty over the signing and subsequent ratification of the EU-EAC economic partnership agreement, both of which have implications on Kenya’s trade. In addition the projected decline in output within the Euro Area – a key market for Kenya’s exports – from 1.6 percent in 2016 to 1.4 percent in 2017, may have an impact.

7.0 FISCAL POLICY MANAGEMENT

Highlights

Government budgetary operations in the Fiscal Year 2015/16 resulted in a deficit of KSh 521.7 billion (8.4 percent of GDP) on a commitment basis, compared to KSh 500.3 billion (9.3 percent of GDP) incurred in the FY 2014/15. The deficit was within the projection of KSh 626.4 billion or 10.1 percent of GDP **(Table 7.1 and Chart 7A)**. Budget implementation was impacted by slower absorption of development budget allocation particularly in the first and second quarters of the Fiscal year and revenue growth was somewhat constrained. The domestic financing component improved to 46.4 percent, from 26.7 percent in the FY 2014/15 but remained below the 65.7 percent recorded in 2013/14.

Government Revenue

Government revenue (inclusive of grants) increased by 12.6 percent to KSh 1,250.0 billion during the fiscal year 2015/16 from KSh 1,110.5 billion in fiscal year 2014/15 **(Chart 7B)**. As a proportion of GDP, total cumulative revenue and grants declined marginally from 20.6 percent during the FY 2014/15 to 20.1 percent during the FY 2015/16. Tax revenue in fiscal year 2015/16 increased by 12.8 percent and remained the dominant component of total revenue and grants, accounting for 89.0 percent during the fiscal year under review. Revenue collection was weaker than projected, reflecting mainly lower-than-expected income tax from individuals (PAYE), VAT collection on imported goods and Import duty. The delay in approving new Excise tax measures also contributed to weaker revenue performance. External grants and appropriations-in-aid increased by 2.3 percent and 25.8 percent respectively in the fiscal year under review, but remained below target. The A-I-A underperformance reflects under reporting by the ministry's expenditure return for the period under review.

The Government made progress towards broadening the tax base and improving revenue administration. It simplified and modernized the VAT legislation and consolidated all the appeals in the tax legislation into one legislation. Similarly, a modern and simplified Excise Duty and Tax Procedure legislation was enacted during the fiscal year and a review of the Income Tax Act commenced.

Additionally the Kenya Revenue Authority instituted measures to seal revenue leakages in customs administration and border areas for all imports. The effects of these reforms once fully operationalized are expected to increase revenue collection in the FY 2016/17.

Expenditure and Net Lending

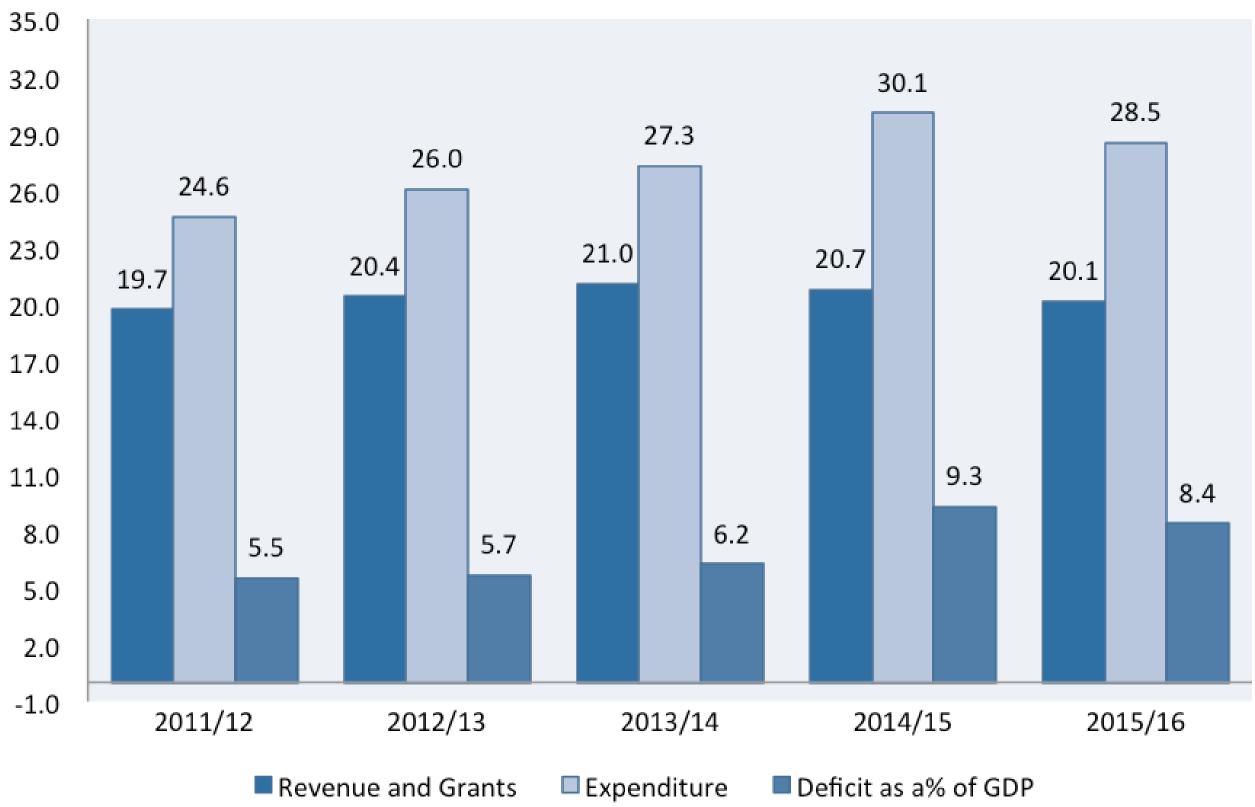
Government expenditure and net lending increased by 10 percent, from KSh 1,610.8 billion in the FY 2014/15 to KSh 1,771.8 billion in the FY 2015/16 (Chart 7C). Recurrent expenditure increased most rapidly, by 18.5 percent, and accounted for 99.3 percent of the total Government expenditure and net lending. Expenditures on salaries and wages declined in the fourth quarter of the FY 2015/16. This slowdown is against a backdrop of higher salaries paid out in the third quarter, following delayed teachers' salaries due to the industrial dispute between their union and Teachers Service Commission in the first quarter of the FY 2015/16. Additionally the discrepancy between actual and target expenditures partly reflect the non-capture of the district expenditures and hence under reporting by ministries. Recurrent expenditure however, remained within target.

Development expenditures declined by 5.6 percent, thereby trailing the respective target due to slower absorption of development funds. Majority of development expenditure went into infrastructure and energy and petroleum ministries. Development expenditures in large ministries were below arget because of non-inclusion of expenditures from the districts and some donor funded projects. The largest share of development outlay was absorbed by the Standard Gauge Railway Project, consistent with the Government's fiscal policy objective of prioritizing infrastructural developments.

County transfers increased by 15.1 percent to KSh 264 billion and was largely in line with the target **(Table 7.1)**.

The Government is committed to increasing the effectiveness and efficiency of public spending through savings on recurrent expenditures and prioritization of investment projects.

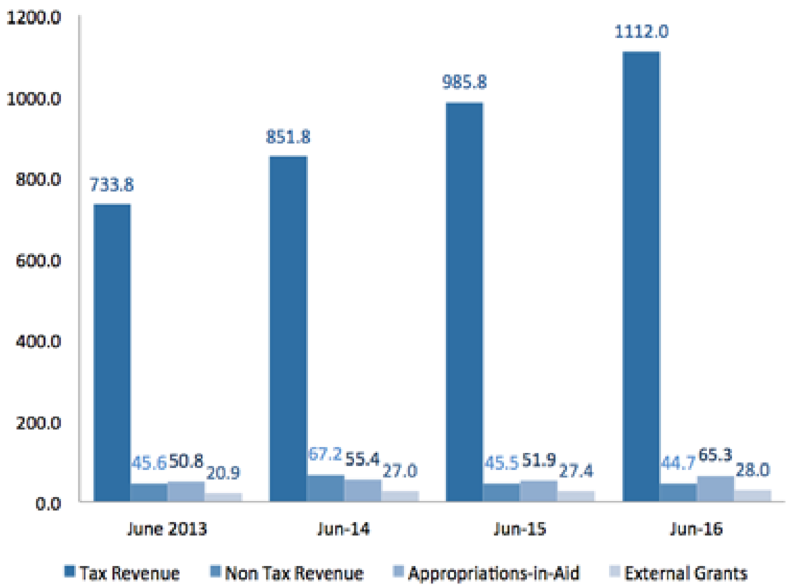
Chart 7A: Government Budget Performance



Financing

The budgetary operations of the Government resulted in a financing requirement of KSh 621.9 billion during the period under review **(Table 7.2)**. The Government sourced the funds through domestic borrowing of KSh 367.7 billion (or 59.1 percent) and net external borrowing of KSh 251.9 billion (or 39.9 percent). Access to domestic financing was constrained during the first quarter of the year, as a result of tight liquidity conditions in the market, which led to accumulation of pending bills. Subsequently, money market liquidity conditions stabilized and the performance of the Government's domestic borrowing programme improved. The Treasury also frontloaded some of the planned foreign financing, by drawing in early November on a two-year syndicated loan of US$750 million (about 1.2 percent of GDP) at about 8 percent effective cost. The government also borrowed a commercial loan from China Development Bank in June 2016. The funds were used to bridge the Government budgetary deficit of KSh 474.3 billion.

Chart 7A: Government Budget Performance



Outlook for FY 2016/17

In the budget estimates for the FY 2016/17, Revenue is estimated at KSh 1,500.6 billion (20.3 percent of GDP) and external grants at KSh 72.7 billion (1.0 percent of GDP). Government expenditure is estimated at KSh 2,265 billion (30.6 percent of GDP), and comprise of KSh 1,164.9 billion in recurrent expenses, KSh 280.3 billion in transfer to the county governments and, and KSh 817.0 billion development expenditure.

The overall budget deficit including grants on commitment basis is therefore estimated at KSh 691.5 billion (9.4 percent of GDP) in 2016/17. The deficit will be financed through net external borrowing of KSh 462.3 billion and net domestic borrowing of KSh 229.2 billion.

FISCAL POLICY MANAGEMENT

Table 7.2: Government Gross Borrowing Requirement & Sources (Ksh Billion)

I. FINANCING REQUIREMENTS	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
1. Budget deficit	83.5	163.7	117.8	172.6	230.2	309.1	488.8	474.3
2. External debt reduction	-	-	-	-	-	-	-	-
3. Domestic debt reduction	6.3	-	10.8	-	11.0	-	2.4	
3.1 Central Bank (incl. items in transit)	6.3	-	10.8	-	11.0	-	2.4	-
3.2 Commercial banks (net of deposits)	-	-	-	-	-	-	-	-
3.3 Non-bank sources	-	-	-	-	-	-	-	-
4. Increase in GoK deposits at CBK*	-	-	5.2	0.4	14.3	46.2	-	147.6
5. Adjustment to cash basis			3.0	-	-	15.5	-	-
TOTAL	**89.8**	**163.7**	**135.9**	**173.0**	**255.5**	**339.0**	**491.2**	**621.9**
II. FINANCING SOURCES	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14		
1. Budget surplus	-	-	-	-	-	-	-	-
2. External debt increase	11.6	11.9	29.1	99.4	60.5	106.1	217.5	251.9
3. Increase in domestic debt	72.4	131.1	107.7	73.6	195.1	233.8	132.1	367.7
3.1 Central Bank	-	9.8	-	7.7		29.3	-	36.5
3.2 Commercial banks	43.6	91.6	24.4	25.4	112.4	90.1	108.0	187.2
3.3 Non-bank sources	28.8	29.7	83.3	40.6	82.7	114.3	24.1	144.0
4. Reduction in GoK deposits at CBK	3.3	20.7	-	-	-	-	138.7	-
5. Privatisation proceeds (Net of Restructuring Costs)	2.5	-	-0.9		-	-	-	-
6. Domeastic loan repayment							3.0	2.4
TOTAL	**89.8**	**163.7**	**135.9**	**173.0**	**255.5**	**339.9**	**491.2**	**621.9**

* Increase in GoK deposits at the CBK is less the Ksh 36.3 billion deposits by the county government

Source: Treasury and Central Bank of Kenya

8.0 PUBLIC DEBT

PUBLIC DEPT

Kenya's public and publicly guaranteed debt increased by 28.7 percent during the FY 2015/16. The increase comprised KSh 394.7 billion (48.6 percent share) in domestic debt and KSh 416.8 billion (51.4 percent share) in external debt. In terms of the public debt stock as at 30 June 2016, domestic debt accounted for 50.1 percent and external debt 49.9 percent. The share of external debt has been on the rise since 2014, underpinned by the Government's medium term debt management strategy which aims at safeguarding borrowing space for the private sector, diversifying financing sources by continuing access to commercial sources of financing, as well as, ensuring public debt sustainability by recourse to external debt on concessional terms. The ratio of public debt to GDP rose to 55.2 percent in nominal terms, and 49.5 percent in present value terms which was within the EAC convergence criterion.

The increase in the total public debt stock reflected execution of expenditure guided by the Medium Term Plan II of the Vision 2030 and the Jubilee Administration Strategic Priorities. Financing was sourced from the domestic market as well as disbursements from the Chinese government, Exim Bank China, International Development Association, African Development Bank and, the 2-year syndicated loan.

Public Domestic Debt

Total domestic debt increased by 27.8 percent during the FY 2015/16, largely reflecting increased uptake of securitized debt. While the performance of the government borrowing programme improved in FY 2015/16, it had a slow start in the first quarter mainly due to tight liquidity in the money markets. Liquidity conditions stabilized in the third and the fourth quarters, after the Central Bank of Kenya restored stability in the domestic and foreign exchange market and the government drawing under the syndicated loan, leading to improved performance of the borrowing programme. Meanwhile, the average length of maturity of existing domestic debt declined from 5 years and two months in June 2015 to 4 years and 3 months in June 2016, reflecting preference for the short dated securities.

As shown in **(Chart 8A)**, the percentage of Treasury bonds in total domestic debt decreased from 72.9 percent in June 2015 to 63.5 percent in June 2016, while that of Treasury bills increased from 24.3 percent of total domestic debt to 33.8 percent during the review period. The significant increase in Treasury Bills relative to Treasury Bonds reflects investors' preference for shorter dated securities during periods of rising interest rates. This was reflected in the inverted yield curve observed around October 2015.

The Government made significant progress in issuing and re-opening long-dated instruments during the FY 2015/16 **(Chart 8B)**. The 9 year Treasury bond accounted for the largest increase of outstanding Government securities during the period, increasing by KSh 61.4 billion (406.3 percent) by June 2016. The 9 year Treasury bond is an infrastructure bond, which has attractive tax incentives.

PUBLIC DEPT

The trends in the holdings of Treasury bills show the banking sector as the dominant institutional holder of short dated debt securities. However, the holdings of commercial banks declined by 7.6 percent while those of pension funds increased by 7.4 percent. Holdings of Treasury bonds across institutional holders were stable and the moderate changes recorded were mainly on account of maturities.

Table 8.1 : Public Debt

	June 2012		June 2013		June 2014		June 2015		June 2016	
	KSH BN	%	KSH BN	%	KSH BN	%	KSH BN	%	KSH BN	%
DOMESTIC DEBT										
Securitised debt	848.8	98.8	1040.8	99.1	1242.4	96.7	1381.2	97.2	1765.1	97.2
Treasury Bills	161.8	18.8	296.6	28.2	327.7	25.5	345.5	24.3	613.0	33.8
Of which Repo Treasury bills	29.8	3.5	28.9	2.8	28.3	2.2	26.6	1.9	25.0	1.4
Treasury Bonds	687.0	80.0	744.2	70.8	914.8	71.2	1035.7	72.9	1152.0	63.5
Non Securitised debt	10.0	1.2	9.8	0.9	41.9	3.3	39.2	2.8	50.1	2.8
Overdraft at CBK	7.3	1.1	7.0	0.7	37.2	2.9	36.5	2.6	44.2	2.4
others	2.8	0.1	2.8	0.3	4.6	0.4	2.7	0.2	5.9	0.3
TOTAL DOMESTIC DEBT	**858.8**	**100.0**	**1050.6**	**100.0**	**1284.3**	**100.0**	**1420.4**	**100.0**	**1815.1**	
(as a % of GDP)*	20.2		22.1		24.0		26.5		27.7	
(as a % of Total Debt)	52.9		55.5		54.2		50.2		50.2	
EXTERNAL DEBT**										
Bilateral	246.2	31.8	257.6	30.5	289.9	26.7	430.4	30.6	539.1	29.9
Multilateral	452.9	59.8	511.8	60.7	597.3	55.0	684.6	48.6	812.3	45.0
Comm. Banks	50.5	6.5	58.9	7.0	182.2	16.8	276.9	19.7	442.6	24.5
Export Credit	14.8	1.9	15.2	1.8	16.5	1.5	16.6	1.2	9.2	0.5
TOTAL EXTERNAL DEBT	**764.5**	**100.0**	**843.6**	**100.0**	**1085.9**	**100.0**	**1408.6**	**100.0**	**1803.2**	**100.0**
(as a % of GDP)*	18.0		17.7		20.3		26.3		27.5	
(as a % of Total Debt)	47.1		44.5		45.8		49.8		49.8	
TOTAL PUBLIC DEBT	**1,623.4**		**1894.1**		**2,370.3**		**2,829.1**		**3618.3**	
(as a % of GDP)*	38.2		39.8		44.2		45.5		55.2	
* Estimates										
** Provisional										
Source: Treasury and Central Bank of Kenya										

PUBLIC DEPT

Table 8.2: Outstanding stock of Treasury Bills by holder (Ksh Billion)

Holders	Jun-12		Jun-13		Jun-14		Jun-15		Jun-16	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	111.9	69.1	201.8	68.0	204.7	62.5	244.4	70.7	386.8	63.1
Central Bank*	36.4	22.5	18.4	6.2	28.3	8.6	26.7	7.7	45.5	7.4
Comm. Banks	75.5	46.7	183.5	61.9	176.4	53.8	217.7	63.0	341.3	55.7
Insurance Companies	7.2	4.5	14.9	5.0	19.9	6.1	20.8	6.0	18.4	3.0
Parastatals	1.2	0.7	5.6	1.9	4.2	1.3	15.0	4.3	53.8	8.8
Pension Funds	28.7	17.7	42.9	14.5	67.8	20.7	40.9	11.8	117.9	19.2
Others	12.9	8.0	31.3	10.6	31.1	9.5	24.4	7.1	36.1	5.9
Total	**161.8**	**100.0**	**296.6**	**100.0**	**327.7**	**100.0**	**345.5**	**100.0**	**613.0**	**100.0**

* Includes Repo Treasury bills

Source: Central Bank of Kenya

Table 8.3: Outstanding stock of Treasury bonds by holder (Ksh Billion)

Holders	Jun-12		Jun-13		Jun-14		Jun-15		Jun-16	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	337.4	49.1	341.2	45.9	436.4	47.7	510.3	49.3	569.8	49.5
Central Bank	3.3	0.5	0.3	0.0	0.0	0.0	0.0	0.0	9.4	0.8
Comm. Banks	334.1	48.6	341.0	45.8	436.3	47.7	510.2	49.3	560.4	48.6
Insurance Companies	74.7	10.9	93.7	12.6	101.2	11.1	107.0	10.3	107.0	9.3
Parastatals	21.6	3.1	42.7	5.7	34.4	3.8	33.6	3.2	33.6	2.9
Pension Funds	164.5	24.0	213.5	28.7	272.9	29.8	311.8	30.1	351.0	30.5
Others	88.7	12.9	53.1	7.1	69.9	7.6	73.0	7.0	90.6	7.9
Total	**687.0**	**100.0**	**744.2**	**100.0**	**914.8**	**100.0**	**1035.7**	**100.0**	**1152.0**	**100.0**

Source: Central Bank of Kenya

Interest Payments on Public Debt

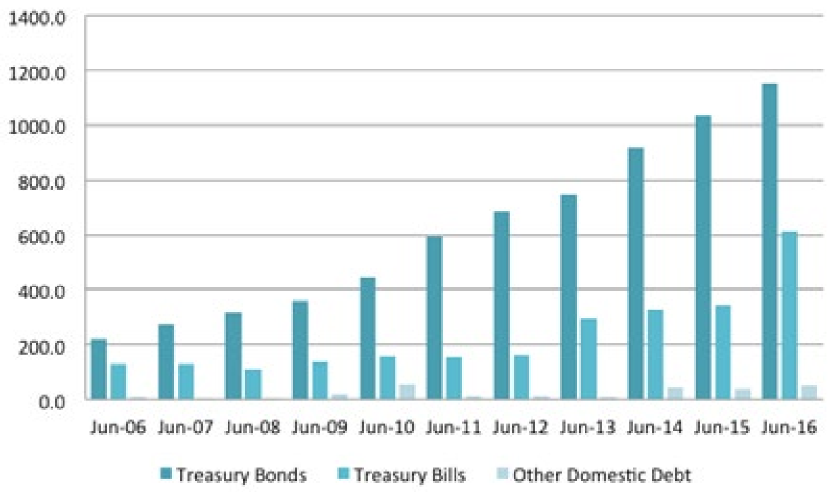
External and domestic interest payments increased during the FY 2015/16 mainly reflecting increased domestic financing during the financial year in line with the Budget Framework for FY 2015/16. Cumulative interest and other charges on domestic debt amounted to KSh 172.9 billion (or 2.8 percent GDP and 13.8 percent of revenues) compared with KSh 139.7 billion (or 2.6 percent GDP and 12.6 percent of revenues) during the FY 2014/15. The largest component of domestic interest payments was on Treasury bonds (56.2 percent). Interest payments on external debt increased to KSh 42.6 billion from KSh 29.3 billion recorded in the FY 2014/15.

Public and Publicly Guaranteed External Debt

Kenya's external debt increased by 29.6 percent from KSh 1,408.6 billion in June 2015 to KSh 1,825.4 billion in June 2016 **(Table 8.4)**. The growth in external debt during this period was attributed to disbursements from the Chinese government, Exim Bank China, African Development Bank, and the International Development Association.

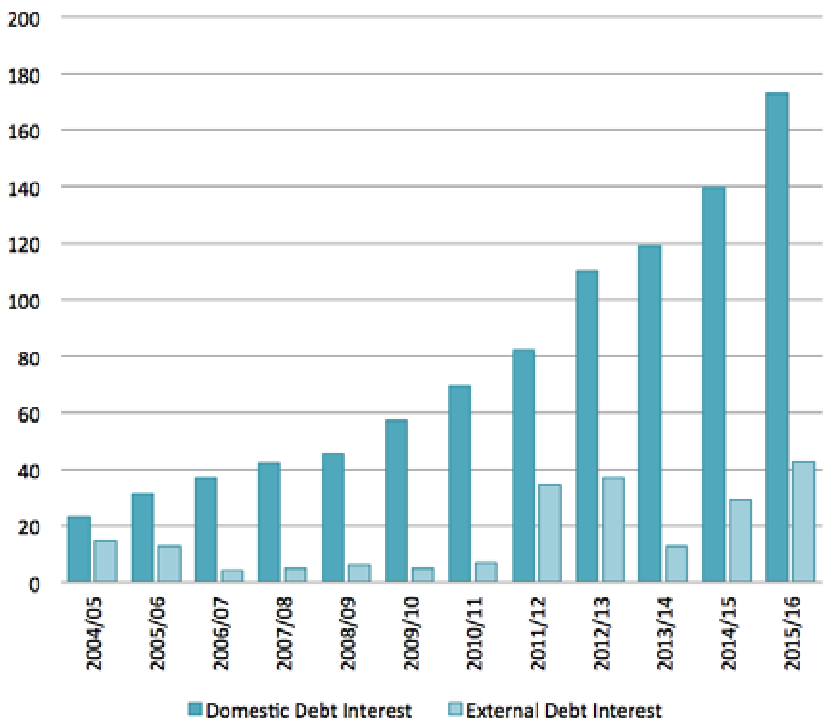
The proportion of debt owed to multilateral lenders declined by 4.1 percent while that owed to commercial banks increased by 4.5 percent. The increase in commercial debt reflected drawing of the 2-year syndicated loan in October 2015 and disbursements from Exim Bank China. Conversely, the decline in debt owed to multilateral lenders reflected KSh 12.1 billion amortization of principal owed to the International Development Association. The KSh 75.2 billion disbursed by the Chinese government was offset by repayments to Japan, France and Belgium governments.

Chart 8A: Composition of Government Domestic Debt



Sources: Central Bank of Kenya and National Treasury

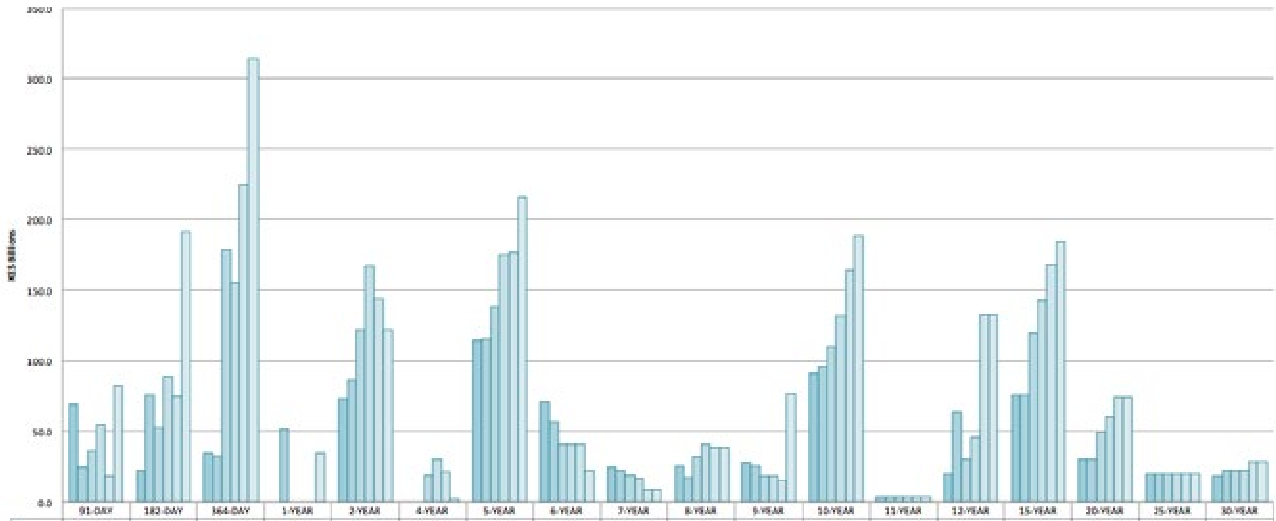
Chart 8C: Domestic and External Debt Interest Payments[1]



Sources: Central Bank of Kenya

PUBLIC DEPT

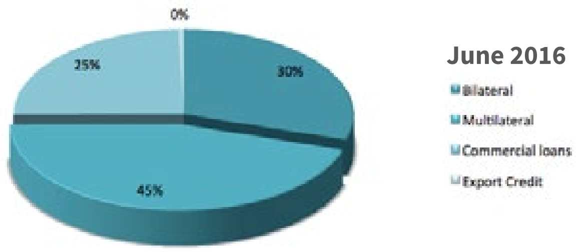
Chart 8B: Outstanding Treasury Bills & Bonds by Tenor

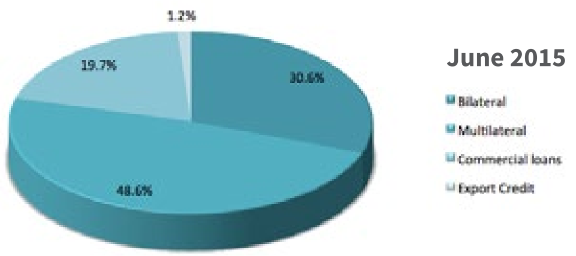


	91-DAY	182-DAY	364-DAY	1-YEAR	2-YEAR	4-YEAR	5-YEAR	6-YEAR	7-YEAR	8-YEAR	9-YEAR	10-YEAR	11-YEAR	12-YEAR	15-YEAR	20-YEAR	25-YEAR	30-YEAR
June-11	69.1	22.5	34.9	0.0	73.0	0.0	114.6	70.8	24.3	25.7	27.7	91.4	4.0	20.1	75.4	29.7	20.2	18.8
June-12	24.3	75.7	32.1	51.5	86.5	0.0	115.3	57.4	22.5	17.6	25.4	95.7	4.0	63.5	75.4	29.7	20.2	22.1
June-13	36.2	52.2	178.8	0.0	122.0	19.1	138.4	40.7	19.3	31.8	18.2	109.4	4.0	30.2	119.8	49.0	20.2	22.1
June-14	54.7	88.9	155.8	0.0	166.7	29.9	175.3	40.7	17.0	40.9	18.2	131.1	4.0	45.4	142.9	60.5	20.2	22.1
June-15	18.6	75.3	225.1	0.0	143.4	21.4	177.4	40.7	8.7	38.2	15.3	163.9	4.0	132.1	168.2	74.3	20.2	28.1
June-16	81.8	191.8	314.5	34.5	122.1	2.3	215.9	22.7	8.7	38.2	76.5	188.5	4.0	132.1	183.8	74.3	20.2	28.1

Sources: Central Bank of Kenya and National Treasury

Chart 8D: Composition of External Public Debt June 2015





Sources: Central Bank of Kenya and National Treasury

External Debt Service

Total external debt service decreased from KSh 111.2 billion in June 2015 to KSh 78.6 billion in June 2016 reflecting concessional terms of debt. External debt service during the period comprised KSh 36 billion in principal repayments and KSh 42.6 billion in interest payments. Liquidity indicators of indebtedness, that is debt service to revenues and exports improved from 10.0 percent and 9.4 percent to 6.3 percent, respectively. This is an indicator of improving debt dynamics and a reduction of external vulnerability during the FY 2015/16 relative to the previous financial year. Similarly, these ratios were below the thresholds on debt sustainability liquidity indicators of - 25 percent of exports and 22 percent of revenues- a sign of low exposure to external debt service default.

Debt Sustainability Analysis

The March 2016 Debt sustainability update showed that Kenya faces a low risk of external debt distress. All the liquidity and solvency debt burden indicators were below the CPIA based thresholds both in the baseline and stress scenario. Public DSA sensitivity analysis showed that if primary deficit were to remain at the current levels, public debt would take an upward trajectory and way above the EAC convergence criterion. This thereby stresses on the need for the fiscal authority to undertake the intended medium term fiscal consolidation. The update also laid emphasis on the need to strengthen debt management capacity owing to the bunched repayments in the coming years (US$ 750 million in 2017, US$ 750 million in 2019 and USD 2,000 million in 2024).

Outlook for Fiscal Year 2016/17

Total public and publicly guaranteed external debt is estimated at KSh 1,788.8 billion (24.6 percent of GDP), of which gross and net domestic debt amount to KSh 1,688.8 billion (23.3 percent of GDP) and KSh 1,446.5 billion (19.9 percent of GDP), respectively.

TABLE 8.4: Distribution of external public debt (Ksh billion)

	Jun-12	%	Jun-13	%	Jun-14	%	Jun-15	%	Jun-16	%
Bilateral	246.2	32.2	257.6	30.5	289.9	26.7	430.4	30.6	539.1	29.9
Multilateral	452.9	59.2	511.8	60.7	597.3	55.0	684.6	48.6	812.3	45.0
Commercial loans	50.5	6.6	58.9	7.0	182.2	16.8	276.9	19.7	442.6	24.5
Export Credit	14.8	1.9	15.2	1.8	16.5	1.5	16.6	1.2	9.2	0.5
Total	**764.5**	**100.0**	**843.6**	**100.0**	**1085.9**	**100.0**	**1408.6**	**100.0**	**1803.2**	**100.0**

Sources: Central Bank of Kenya and the National Treasury

9.0 BALANCE OF PAYMENTS

BALANCE OF PAYMENTS

Kenya's external position remained resilient despite heightened global uncertainties occasioned by weaker prospects for global growth and subdued commodity prices. The current account deficit improved to US$ 3,587 million in the financial year 2015/16 from US$ 5,905 million in the financial year 2014/15. This was occasioned by a decline in the value of oil imports reflecting lower oil prices in the international markets as well as, improved export earnings and, resilient remittance inflows, which continued to support the foreign exchange market in the year to June 2016.

Kenya's official international reserves position was strong at US$ 8,267 million by end-June 2016, equivalent to 5.5 months of imports. Kenya's Precautionary Arrangements with the IMF amounting to US$ 1,500 million approved in March 2016 provided additional buffer against short term external and domestic shocks.

Balance of Payments Developments

The current account balance improved to a deficit of US$ 3,587 million in the year to June 2016 from a deficit of US$ 5,905 million during the preceding financial year **(Table 9.1)**. The developments in the current account during the financial year 2015/16 were mainly attributable to improved merchandise trade especially during the third quarter in which the value of imports declined (Table 9.2). This reflected lower international oil prices as crude oil prices – simple average of Dated Brent, West Texas Intermediate, and the Dubai Fateh – remained relatively low averaging US$ 32.77 per barrel in the third quarter of the financial year 2015/16 from US$ 42.2 in the preceding quarter. Imports of machinery and transport equipment also declined against the backdrop of a peak of imports of transport equipment in 2014. The value of tea exports increased driven by favorable tea prices in the first and second quarters of the financial year 2015/16 of US$ 3.87 and US$ 3.63 per Kg, respectively. Tea production also increased by 20 percent over the review period attributed to improved weather conditions following the El Niño rains in the second quarter.

Earnings from exports of horticulture increased by 12.3 percent during the financial year 2015/16 reflecting increased supply of fresh vegetables, fruits and nuts as well as cut flowers. The improvement in part reflects continued corrective action by industry stakeholders in order to meet European market legal limits on maximum pesticide residue levels for fresh produce such as peas and beans– which were in the past intercepted for failing to meet the set standards.

Over the same period, the balance on services declined by 30.8 percent, mainly due to lower receipts from transport and travel services. Although lower international oil prices were favorable to the transport sector, net receipts from transport services declined by 35.5 percent, in part reflecting weak performance of the tourism industry. Receipts from travel services by decreased by 10.1 percent on a net basis during the review period to US$ 528 million from US$ 587 million reflecting low revenues from the tourism industry in 2015 due to security concerns and subsequent travel advisories on the coastal region. These have since been lifted by key Western markets, except

BALANCE OF PAYMENTS

Table 9.1: Balance of Payments (Us$ M)

		FY 2015_16**					FY 2015_16-2014_15	
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun			%
ITEM	**FY 2014_15***	**Q1**	**Q2**	**Q3**	**Q4**	**FY 2015_16****	**Change**	**Change**
1. Overall Balance	1,176.3	503.7	-858.7	-253.6	-490.6	-1,099.2	-2,275.5	-193.4
2. Current account n.i.e	-5,905.3	-911.7	-1,083.5	-475.8	-1,116.4	-3,587.3	2,318.0	-39.3
Exports (fob)	5,821.7	1,617.8	1,500.2	1,460.4	1,449.8	6,028.1	206.4	3.5
Imports (fob)	17,158.0	3,836.1	3,911.4	3,025.3	3,481.6	14,254.4	-2,903.6	-16.9
Services: credit	4,863.2	1,099.5	1,101.2	1,073.1	924.3	4,198.0	-665.2	-13.7
Services: debit	2,474.1	523.3	543.0	743.8	733.7	2,543.9	69.8	2.8
Balance on goods and services	-8,947.2	-1,761.0	-1,994.0	-1,326.1	-1,841.2	-6,922.4	2,024.8	-22.6
Primary income: credit	308.0	78.3	78.9	90.6	88.2	336.0	28.0	9.1
Primary income: debit	775.2	197.1	219.9	181.2	178.4	776.5	1.3	0.2
Balance on goods, services, and primary income	-9,414.4	-1,879.8	-2,135.0	-1,416.6	-1,931.5	-7,362.9	2,051.5	-21.8
Secondary income, n. i. e.: credit	3,574.4	863.9	925.0	870.4	823.0	3,482.3	-92.1	-2.6
o.w Remittances	1,492.1	392.5	401.9	415.6	455.3	1,665.3	173.2	11.6
Secondary income: debit	65.3	14.5	14.4	20.0	8.0	56.9	-8.3	-12.8
3. Capital Account, n.i.e.	**222.9**	**59.3**	**60.3**	**100.4**	**50.7**	**270.7**	**47.8**	**21.5**
4. Financial Account, n.i.e.	**-5,549.7**	**-892.1**	**-1,774.2**	**-1,694.0**	**-1,470.6**	**-5,831.0**	**-281.2**	**5.1**
* Revised								
** Provisional								

Sources: Central Bank of Kenya and the National Treasury

Lamu County. Efforts by the Kenya Government to revive the industry, which include substantial investment in security, aggressive marketing and charter incentive programs that began in January 2016 have started to pay off as reflected in increased receipts from tourism services during the third and fourth quarters of the financial year 2015/16. In addition, Kenya hosted key international events including the Papal visit in November and the World Trade Organization (WTO) Ministerial Conference in December 2015.

Remittance inflows– reflected in the secondary income account– increased by 11.6 percent to US$ 1,665 million in the financial year 2015/16 from US$ 1,492 million in the previous year. The upward trend reflects continued resilience of remittance inflows as well as the entry of additional money remittance providers into the market.

Balance of Payments

Table; 9.3 Remittance Inflows US$ M (Cumulative 12 months)

Month/Year	2009	2010	2011	2012	2013	2014	2015	2016
January	596.9	614.6	661.0	916.7	1,184.1	1,298.6	1,432.2	1,570.9
February	599.8	607.6	675.3	959.9	1,182.5	1,306.6	1,445.0	1,584.6
March	595.8	604.6	694.5	994.6	1,179.7	1,322.8	1,451.6	1,599.5
April	576.1	609.1	711.9	1,020.1	1,189.1	1,331.2	1,462.7	1,618.5
May	576.7	611.1	728.9	1,053.0	1,198.2	1,340.7	1,472.2	1,636.2
June	573.6	617.3	748.2	1,080.6	1,198.5	1,357.0	1,492.1	1,665.3
July	579.8	617.6	770.4	1,100.5	1,218.6	1,361.3	1,506.0	
August	592.4	613.7	798.0	1,115.8	1,230.9	1,383.0	1,510.1	
September	596.8	618.9	824.3	1,123.5	1,245.8	1,403.0	1,511.2	
October	588.7	624.3	847.1	1,133.8	1,267.1	1,411.0	1,527.5	
November	592.8	632.7	871.5	1,150.5	1,283.0	1,411.5	1,544.2	
December	609.0	641.9	891.1	1,170.9	1,290.6	1,428.5		
Annual Total	**7,078.3**	**7,413.5**	**9,222.1**	**12,819.9**	**14,668.2**	**16,355.2**	**17,902.7**	**9,675.0**

Sources: Central Bank of Kenya and the National Treasury

Table 9.4: Kenya’s Exports: Main Destination Countries (Us$ M)

IMPORTS (in millions of US dollars)				Share of Imports (%)			EXPORTS (in millions of US dollars)				Share of Exports (%)		
	Year to June			Year to June				Year to June			Year to June		
Country	2014	2015	2016	2014	2015	2016	Country	2014	2015	2016	2014	2015	2016
Africa	1,715	1,649	1,362	10.4	9.6	9.6	Africa	2,724	2,456	2,393	44.2	42.2	39.7
Of which							Of which						
South Africa	834	659	541	5.1	3.8	3.8	Uganda	719	593	648	11.7	10.2	10.7
Egypt	282	285	257	1.7	1.7	1.8	Tanzania	499	402	341	8.1	6.9	5.7
Others	599	705	563	3.6	4.1	4.0	Egypt	198	184	220	3.2	3.2	3.7
							Sudan	73	64	58	1.2	1.1	1.0
EAC	350	484	322	2.1	2.8	2.3	South Sudan	193	213	165	3.1	3.7	2.7
COMESA	634	744	625	3.9	4.3	4.4	Somalia	171	140	164	2.8	2.4	2.7
Rest of the World	14,703	15,509	12,893	89.6	90.4	90.4	DRC	221	230	197	3.6	4.0	3.3
Of which							Rwanda	166	151	171	2.7	2.6	2.8
India	3,178	2,892	2,328	19.4	16.9	16.3	Others	485	479	428	7.9	8.2	7.1
United Arab Emirates	1,052	980	897	6.4	5.7	6.3							
China	2,355	3,264	3,145	14.3	19.0	22.1	EAC	1,453	1,234	1,230	23.6	21.2	20.4
Japan	1,002	946	858	6.1	5.5	6.0	COMESA	1,696	1,551	1,631	27.6	26.6	27.1
USA	915	1,871	978	5.6	10.9	6.9	Rest of the World	3,432	3,366	3,635	55.8	57.8	60.3
United Kingdom	544	478	385	3.3	2.8	2.7	Of which						
Singapore	205	98	91	1.2	0.6	0.6	United Kingdom	425	393	413	6.9	6.8	6.8
Germany	514	518	449	3.1	3.0	3.2	Netherlands	439	424	449	7.1	7.3	7.5
Saudi Arabia	479	760	512	2.9	4.4	3.6	USA	395	413	412	6.4	7.1	6.8
Indonesia	554	508	439	3.4	3.0	3.1	Pakistan	242	279	390	3.9	4.8	6.5
Netherlands	274	216	184	1.7	1.3	1.3	United Arab Emirates	262	244	318	4.3	4.2	5.3
France	243	244	221	1.5	1.4	1.6	Germany	115	128	113	1.9	2.2	1.9
Bahrain	496	128	63	3.0	0.7	0.4	India	108	86	115	1.8	1.5	1.9
Italy	232	246	221	1.4	1.4	1.6	Afghanistan	141	125	166	2.3	2.1	2.8
Others	2,660	2,360	2,121	16.2	13.8	14.9	Others	1,305	1,274	1,258	21.2	21.9	20.9
Total	**16,418**	**17,158**	**14,254**	**100.0**	**100.0**	**100.0**	**Total**	**6,156**	**5,822**	**6,028**	**100.0**	**100.0**	**100.0**
EU	2,543	2,479	2,198	15.5	14.4	15.4	EU	1,340	1,267	1,291	21.8	21.8	21.4
China	2,355	3,264	3,145	14.3	19.0	22.1	China	65	83	79	1.1	1.4	1.3

Sources: Central Bank of Kenya

Direction of Trade

Kenya sourced most of her imports from China with the share increasing to 22.1 percent during the review period, reflecting ongoing infrastructure projects which include the Standard Gauge Railway. The share of Kenya's imports from the European Union increased to 15.4 percent from 14.4 percent, while that from India decreased to 16.3 percent. Imports from Africa stabilized at 9.6 percent during the same period **(Table 9.4)**.

Kenya's exports to Africa declined from the preceding quarter, especially those to Tanzania, South Sudan and the Democratic Republic of Congo **(Table 9.4)**. Kenya's trade with South Sudan contracted reflecting political developments in the country in 2016.

Exports to the rest of the world however, increased. The share of exports to China decreased to 1.3 percent during the year to June 2016 while that to the European Union decreased to 21.4 percent. The share of exports in the category of 'others' to the rest of the world also declined to 20.9 percent from 21.9 percent in the year to June 2015.

Capital and Financial Account

Financial account flows remained increased by 5.1 percent to US$ 5,831 million in the year to June 2016 compared to US$ 5,550 million in the year to June 2015. Inflows were mainly in the form of direct investment and other investment which stood at US$ 1,480 million and US$ 4,777 million respectively in the year to June 2016 (Table 9.5). Other investment inflows mainly reflected concessional Chinese bilateral funding for ongoing infrastructure projects.

Foreign Exchange Reserves

The banking system's total foreign exchange holdings stood at US$ 10,499 million in June 2016. Official reserves held by the Central Bank increased to USD 8,267 million. In terms of months of import cover, the ratio stood at 5.5 months in June 2016 which was well above the 4.5 months target. Foreign exchange reserves held by commercial banks decreased to US$ 2,232 in June 2016 from US$ 2,262 in June 2015 **(Table 9.6)**.

BALANCE OF PAYMENTS

Table 9.6: Foreign Exchange Reserves and Residents' Foreign Currency Deposits USD M(end of period)

	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16
1. Gross Reserves	9,473	9,249	9,265	8,899	9,324	9,411	9,794	9,629	9,501	9,809	10,063	10,102	10,499
of which:													
Official	7,212	6,963	6,963	6,711	7,274	7,161	7,534	7,481	7,566	7,807	7,986	8,032	8,267
import cover*	4.5	4.3	4.4	4.2	4.6	4.5	4.8	4.8	4.9	5.1	5.2	5.3	5.5
Commercial Banks	2,262	2,286	2,302	2,188	2,050	2,250	2,259	2,148	1,935	2,002	2,077	2,070	2,232
2. Residents' foreign currency deposits	4,488	4,228	4,203	4,278	4,098	4,317	4,389	4,261	4,122	4,191	4,238	4,313	4,443

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

Sources: Central Bank of Kenya

10.0 FINANCIAL SECTOR DEVELOPMENTS

Structure of the Kenyan Banking Sector

During the fiscal year ended June 30, 2016, the Kenyan banking sector comprised 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 8 representative offices of foreign banks, 79 foreign exchange bureaus, 17 money remittance providers and 3 credit reference bureaus **(Chart 10A)**.

The notable changes in the structure reflect:-

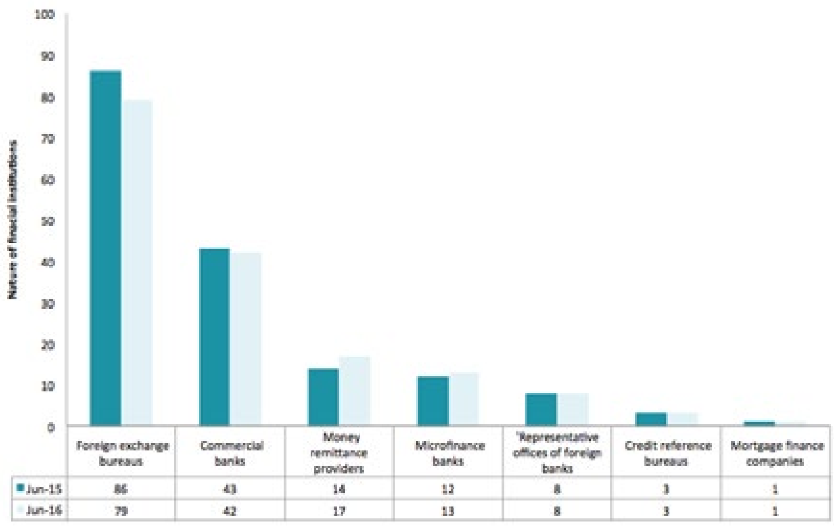
- Seven forex bureaus that converted to money remittance providers (MRPs) within the period.
- Placement of Dubai Bank Limited under liquidation on August 24, 2015, thereby reducing the number of banks to 42 in June 2016.
- Licensing of four remittance money providers namely; Upesi Money Remittance Provider, Real Money Remittance Provider, Value Money Remittance Provider and Global Money Remittance Provider.
- Licensing of Maisha Microfinance Bank Limited on May 21, 2016.

Financial Position and Performance of the Kenyan Banking Sector

The banking sector registered improved performance in the year ended June 30, 2016 as follows:-

- Assets increased by KSh 76.5 billion or 2.1 percent to KSh 3.7 trillion as at June 30, 2016 from KSh 3.6 trillion in June 30, 2015.
- Loans and advances grew by KSh 100.4 billion or 4.6 percent to KSh 2.3 trillion in June 30, 2016 compared to KSh 2.2 trillion as at June 30, 2015.
- The deposit base expanded by KSh 53.4 billion or 2.3 percent to KSh 2.62 trillion in June 30, 2016 from KSh 2.57 trillion reported in June 30, 2015.
- Profit before tax increased by 5.4 percent to KSh 81.2 billion from KSh 77.0 billion reported in the year to June 30, 2015.

Chart 10A: Structure of the Kenyan Banking Sector



Sources: Central Bank of Kenya

Structure of the Balance Sheet

The banking sector balance sheet expanded by 0.3 percent from KSh 3.60 trillion in June 2015 to KSh 3.7 trillion in June 2016. The main components of the balance sheet on the asset side were loans and advances, government securities and placements, which accounted for 58.7 percent, 23.2 percent and 4.3 percent of total assets, respectively. Customer deposits were the main component on the liabilities side accounting for 71.4 percent of the total liabilities **(Table 10.1)**.

Loans and Advances

The banking sector gross loans and advances rose from KSh 2.2 trillion in June 2015 to KSh 2.3 trillion in June 2016 translating to a growth of 4.6 percent. The growth in loans and advances was recorded in most economic sectors **(Table 10.2)**.

Financial Services sector recorded the highest increase in loans, with an increase of KSh 34.2 billion or 42.7 percent. The sharp growth reflected bank lending to Microfinance banks and SACCO's to fund their activities in the year to June 2016.

Tourism, Restaurants and Hotels sector recorded an increase in lending of KSh19.5 billion or 6.0 percent. This demand indicates

Table 10.1: Extracts Of The Statement Of Financial Position (Ksh Million)

	Jun-15	Jul-16	Percent Change
Cash	57,032.00	55,350.46	-2.90%
Balances at CBK	178,940.00	171,154.97	-4.40%
Placements	189,664.00	157,585.47	-16.90%
Government Securities	734,404.00	854,248.01	16.30%
Other Investments	61,633.00	50,197.98	-18.60%
Loans & Advances (Net)	2,087,466.00	2,157,951.78	3.40%
Other Assets	292,273.00	231,379.37	-20.80%
Total Assets	3,601,412.00	3,677,868.04	2.10%
Customer Deposits	2,583,561.00	2,627,344.50	1.70%
Other Liabilities	474,529.00	473,354.63	-51.50%
Capital & Reserves	543,322.00	577,168.91	6.20%
Total Liabilities and Share-holder's Funds	3,601,412.00	3,677,868.04	2.10%

Source: Central Bank of Kenya

Table 10.2: Sectoral Distribution of Loans (Ksh Billion)

Sectors	Jun-15	Jun-16	Percent Change
Personal/Household	540.8	552.5	2.20%
Trade	430.2	446.5	3.80%
Real Estate	322.9	342.4	6.00%
Manufacturing	267.4	272.3	1.80%
Transport and Communication	180.7	179.1	-0.90%
Financial Services	80.1	114.3	42.70%
Energy and water	99.4	102	2.60%
Building and construction	90.7	97.3	7.30%
Agriculture	89.8	94.1	4.80%
Tourism, Restaurant and Hotels	49.4	54	9.30%
Mining and Quarrying	15.3	12.9	-15.70%
Gross Loans	**2,166.90**	**2,267.30**	**4.60%**

Source: Central Bank of Kenya

recovery of tourism sector underway following lifting of travel advisories, enhanced marketing and increased conferences/business tourism.

Mining and Quarrying sector recorded the highest decrease, largely a repayment of gross loans, by 15.7 percent.

Deposit Liabilities

Customer deposits were the main source of funding for the banking sector, accounting for 71.4 percent of total liabilities as at end of June 2016 which was close to 71.5 percent recorded as at end of June 2015. The deposit base increased by 2.3 percent from KSh 2.57 trillion in June 2015 to KSh 2.63 trillion in June 2016.

Customer deposits growth within the period was supported by:-

- Use of technological innovations for deposit mobilization - The number of commercial banks deposit accounts increased by 6.6 million or 20.9 percent, from 31.6 million in June 2015 to 38.2 million in June 2016. The new accounts were largely opened through the mobile phone platforms.
- Agency banking model - The number of transactions through agents increased by 211 million in the year to June 2016.
- Several banks adopted aggressive deposit mobilization strategies to increase their deposit levels.

Capital Adequacy

The Central Bank of Kenya Prudential Guideline on Capital Adequacy requires banks to adhere to the prescribed minimum ratios of Core Capital and Total Capital to Total Risk Weighted Assets of 10.5 percent and 14.5 percent, respectively. The ratio of core capital to total risk weighted assets increased from 15.7 percent in June 2015 to 16.3 percent in June 2016. This was attributable to 6.0 percent increase in core capital which outpaced 2.7 percent growth in risk weighted assets. Over the same period, total capital to total risk weighted assets remained unchanged at 18.9 percent **(Table 10.3)**.

Commercial banks are also required to maintain a core capital to total deposits ratio of not less than 8 percent. This ratio increased to 18.5 percent from 17.8 percent registered by end June 2015 following a higher growth in core capital (6.0 percent) compared to a 2.6 percent growth in customer deposits.

Asset Quality

Delayed payments by government agencies to contractors, challenges in the business environment, enhanced reclassification and provisioning of loans, and high interest rates led to downgrading of loan accounts by banks which impacted negatively on the quality of assets. As a result, the gross non-performing loans (NPLs) increased by 54.3 percent from KSh 123.9 billion in June 2015 to KSh 191.2 billion in June 2016. During the period under review, 9 out of 11 economic sectors registered increase in NPLs **(Chart 10B)**.

Table 10.3: Capital Adequacy Ratios

	Jun-15	Jun-16	Minimum Capital Adequacy Ratios
Core Capital/TRWA*	15.70%	16.30%	14.50%
Total Capital/TRWA*	18.90%	18.90%	10.00%
Core Capital/Total Deposits	17.80%	18.50%	8.00%
*Total Risk Weighted Assets			
Source: Central Bank of Kenya			

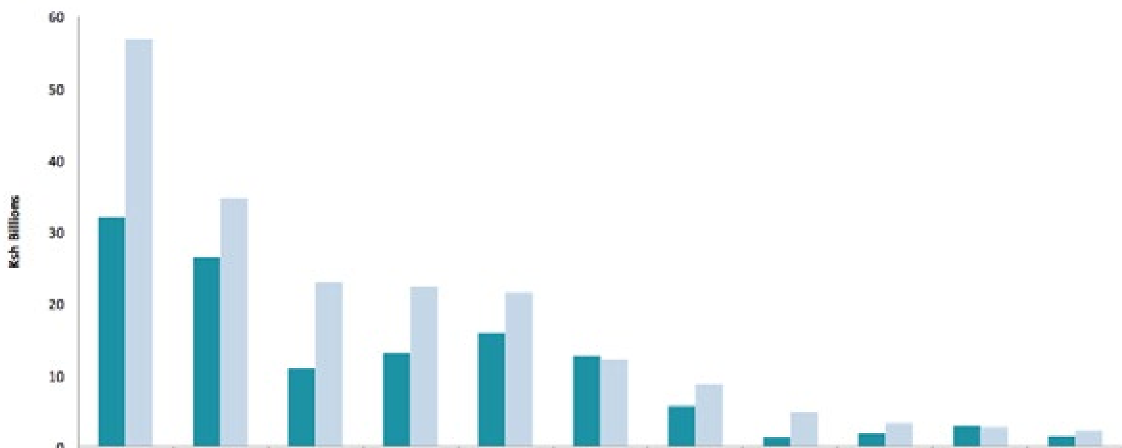
Transport and Communication sector registered NPLs decrease of KSh 0.7 billion or 5.1 percent between June 2015 and June 2016. This was occasioned by enhancement of road safety rules, which ensured continued business by transporters hence continued repayment of loans. The transport infrastructure has also been improved to the benefit of transporters.

The manufacturing sector in NPLs increased by KSh 12.0 billion or 109 percent between June 2015 and June 2016 as a result of cash flow constraints. Trade sector NPLS increased by KSh 24.9 billion or 78 percent on account of business cash flow challenges and constraints. Building and Construction sector NPLS increased by KSh 22.2 billion or 71.5 percent due to delayed payments to contractors.
Based on the movements of NPLs highlighted above, the gross NPLs to gross loans ratio increased from 5.7 percent in June 2015 to 8.4 percent in June 2016. **Chart 10C** highlights the detailed percentage increase in sectoral gross NPLs between June 2015 and June 2016.

Profitability

The banking sector registered KSh 81.2 billion pre-tax profits during the twelve months period ended June 30, 2016, which represented an increase of 5.9 percent from KSh 76.9 billion for the period ended June 2015. The banks recorded increase in earnings from government securities held and on advances made, by 24.8 percent and 14.8 percent, respectively. Commercial banks' investment in government securities increased by 16.3 percent and lending rates rose from an average of 15.8 percent in June 2015 to an average of 18.1 percent in June 2016.
Total income increased by 13.2 percent to KSh 256.2 billion from KSh 226.3 billion registered in the previous year. Meanwhile, total expenses increased by 17.1 percent from KSh 149.4 billion in June 2015 to KSh 175.0 billion in June 2016. Interest on loans and advances of KSh 156.6 billion constituted 61.1 percent of total income in the period ended June 2016. On the other hand, interest on deposits, staff costs and other expenses were the key components of expenditure, accounting for 35.3 percent, 23.4 percent and 20.6 percent of total expenses, respectively.

Chart 10B: Kenyan Banking Sector Gross NPLS (Ksh.Bn)

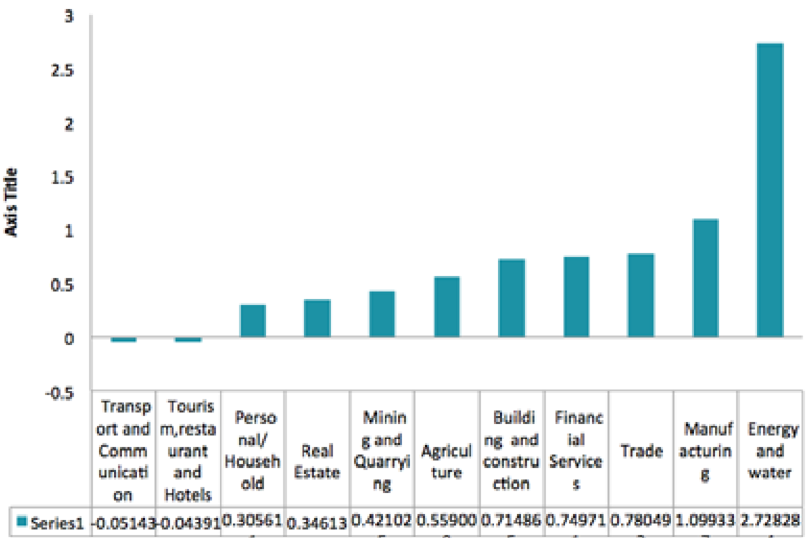


	Trade	Personal/ Household	Manufacturing	Building and construction	Real Estate	Transport and Communication	Agriculture	Energy and water	Financial Services	Tourism,restaurant and Hotels	Mining and Quarrying
Jun-15	31.888876	26.463703	10.945757	12.96485	15.864197	12.7156	5.610155	1.29093	1.831057	2.850217	1.49891
Jun-16	56.77788582	34.55130896	22.97883752	22.2329669	21.35527802	12.06160843	8.746274203	4.81295346	3.20381967	2.725050718	2.129988616

Sources: Central Bank of Kenya

The return on assets increased from 3.3 percent in June 2015 to 4.2 percent in June, 2016 while return on shareholders' funds increased from 28.3 percent in June 2016 to 33.8 percent in June, 2016 **(Table 10.4)**. The improvement is attributed to growth in the sector's profitability.

Chart 10C: Sectoral Increase in Grosss NPLs Between June 2015 & June 2016



Source: Central Bank of Kenya

Liquidity

Liquidity held by commercial banks underscore their ability to fund increases in assets and meet obligations as they fall due. Liquidity is one of the important financial stability indicators since liquidity shortfall in one bank can cause systemic crisis in the banking sector due to interconnected operations.

The banking sector's overall liquidity ratio in June 2016 was 40.4 percent as compared to 38.7 percent recorded in June 2015. The liquid assets increased more rapidly than short term liabilities. Banks in large peer group invested surplus liquidity in government securities, while microfinance banks increased their borrowing from banks to fund their lending activities during the year to June 2016. The banking sector liquidity ratio was well above the minimum statutory level of 20 percent.

Table 10.4: Extracts of Statement of Comprehensive Income (Ksh.billion)

Item	Jun-15	Jun-16	Change
Total income	226.3	256.2	13.20%
Expenses before provisions	149.4	164.17	9.90%
Profit before provisions	84.3	92.03	9.20%
Provisions for bad debts	7.6	17.59	131.50%
Profit before tax	76.7	81.22	5.90%
Return on Assets	3.30%	4.20%	0.90%
Return on Shareholders' Funds	28.30%	33.80%	5.50%

Source: Central Bank of Kenya

11.0 OTHER BANKING SECTOR DEVELOPMENT

Performance of Microfinance Banks

The performance of microfinance banks (MFBs) deteriorated as reflected in KSh128.3 million loss reported for the operations in the year to June 2016 compared to profit before tax of 489 million for the twelve months period ended June 2015 **(Table 11.1)**. The decline in profits is underscored by increase in borrowing expenses due to tight liquidity in the market. The total interest on deposits decreased from KSh 1.2 billion in June 2015 to KSh 0.9 billion as at June 2016 due to slower growth of customer deposits. The interest expense fee on loans increased from KSh 0.4 billion for the twelve months to June 2015 to KSh 0.9 billion for the twelve months to June 2016. This was attributable to increased borrowing by microfinance banks to fund their lending activities.

Customer deposits increased marginally by 1.8 per cent or KSh 0.7 billion in the year to June 2016 and net loan portfolio increased by 12 per cent from KSh 42.3 billion in June 2015 to KSh 47.4 billion in June 2016. The MFBs' ratio of core capital to risk weighted assets decreased from 20 per cent in June 2015 to 19 per cent in June 2016 and was above the minimum requirement of 10 percent. The ratio of total capital to total risk weighted assets decreased, from 24 percent in June 2015 to 22 percent in June 2016 against the minimum statutory requirement of 12 percent.

Table 11.1: Performance of MFBs - KSH 'M'

Parameter	Jun-15	Jun-16	% Change
Pre-Tax Profits	489	-128.4	-126%
Customer Deposits	39,688	40,395	2%
Loan Portfolio (Net)	43,327	49,064	13%
Core Capital/Total Risk Weighted Assets	20%	19%	-1%
Total Capital/Total Risk Weighted Assets	24%	22%	-2%

Source: Central Bank of Kenya

Agency Banking

The use of the agency banking model by banks has continued to improve access to banking services since its launch in 2010. As of 31st June 2016, 17 commercial banks had contracted 43,675 active agents compared to 38,590 active agents in June 2015. Active agents therefore increased by 13.2 percent during the year under review.

The number of banking transactions undertaken through agents increased by 200 percent from 69.3 million registered in the year ended June 2015 to 211 million transactions registered in the year ended June 2016. The value of banking transactions moved by the agents increased by 76.4 percent from KSh 358.5 billion in the year ended June 2015 to 632.5 billion for the year ended June 2016.

Three microfinance banks contracted a total of 1,185 agents as at June 2016, which was close to 300 percent increase from 300 agents as at June 2015. This is evidence of continued growth in confidence and acceptability of the agency banking model as an efficient and effective delivery channel.

OTHER BANKING SECTOR DEVELOPMENTS

Credit Information Sharing Mechanism

The credit information sharing mechanism remained a key input in the decision making process of credit providers in Kenya as they sought to mitigate risks associated with information asymmetry. The credit reports requested in the twelve months to June 2016 by banks, microfinance banks and customers increased by 107 percent, 67 percent and 100.7 percent, respectively **(Table 11.2)**.

The increased uptake of credit reports by bank customers is an indication of growing awareness for credit status through the CRBs.

Challenges in the Banking Sector

Despite the banking sector stability and resilience, three non-systemic banks were placed under receivership.

Dubai Bank was put under receivership on August 14, 2015 arising from capital and liquidity deficiencies that culminated in the bank's inability to meet its obligations'. The bank was subsequently placed in liquidation on August 24, 2015. On 13th October 2015, CBK appointed the Kenya Deposit Insurance Corporation (KDIC) as the receiver of Imperial Bank Limited (IBL). This followed a submission by the Board of IBL to CBK of information on suspected fraudulent activities at the bank. Chase Bank Limited was placed in receivership on April 7, 2016 due to failure to meet its financial obligations.

Receivership for the three small banks impacted the liquidity distribution within the interbank market, which accentuated segmentation leading to marked reduction of interbank credit lines to small and medium tier banks. However, the Central Bank of Kenya rendered support to the affected banks through reverse repos and the discount window.

Banking sector 2016 Outlook

Performance of the Kenyan banking sector is expected to improved performance in 2016 largely on the back of positive economic outlook. Credit and liquidity risks, which are currently elevated, are expected to decrease going forward as the business environment and liquidity distribution in the banking sector improves.

Table 11.2: Credit Report Requests

	Jun-15	Jun-16	Change	% Change
Credit reports requests - Banks only	3,043,938	6,300,246	3,256,308	107.00%
Credit reports requests - MFBs only	176,619	294,893	118,274	67.00%
Credit reports requests -Customers	44,023	88,371	44,348	100.70%
Totals	**3,264,580**	**6,683,510**		

Source: Central Bank of Kenya

12.0 NATIONAL PAYMENTS SYSTEM

Payments systems in Kenya have grown rapidly supported by developments in internet and mobile phones, e-commerce, technological developments and Near Field Communication (NFC) infrastructures. Cross-border payments can now be made in exactly the same way as national payments through;

i. East African Payment System (EAPS) which has integrated the respective country Real Time Gross Settlement (RTGS) Systems.
ii. Regional Payment and Settlement System (REPSS), a multilateral netting system managed by the Common Market for Eastern and Southern Africa (COMESA). REPSS objective is to facilitate settlement of payment instructions on trade among the 19 COMESA members in either EURO or USD currencies.

Kenya Electronic Payment and Settlement System (KEPSS) and East African Payment System (EAPS)

The National Payments System continued to record increased usage of the Real Time Gross Settlement System (RTGS), the Kenya Electronic Payments and Settlement System (KEPSS) and the East African Payment System (EAPS). Owned and operated by Central Bank of Kenya, the National Payments System was resilient and available to users (commercial banks) throughout the year to June 2016. The system is anchored on a secure SWIFT network to transmit payment instructions from a participant to the beneficiary.

KEPSS and EAPS moved a volume of 3,342,423 transactions worth KSh 29,301 billion in the year to June 30, 2016, compared to 2,855,376 transactions worth KSh 2 7,002 billion in the same period last year. The flow during the year represent increases of 17.1 percent and 8.5 percent in volume and value, respectively. The average amount moved per transaction reduced from KSh 9.6 million to KSh 8.9 million, a decrease of 7.3 percent which indicates increased usage for lower value payments.

The increase in uptake reflect continued expansion of trade within the East African Community buoyed by increased awareness by the public of the RTGS as a safe and efficient mode of payment for both high value and time critical payments for local and regional payments. The proportion of direct payments through KEPSS increased from 98.7 percent to 98.8 percent, while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS decreased from 1.3 percent 1.2 to percent in the year to June 2016 **(Tables 12.1** and **12.2)**.

Table 12.1 Trends in Total Annual Flows

Year to June 30	Total Value moved per year (Ksh m)	No of Transactions	Average Value per Transaction	Days Worked	Per day	
					Value (Kshs m)	Transactions
2006	7,641,197	120,249	61.38	227	32,919	532
2007	7,929,003	155,131	51.38	249	32,038	627
2008	14,506,951	232,516	62.3	247	59,419	949
2009	15,441,446	232,516	55.67	248	62,139	1,121
2010	16,806,252	673,368	28.78	254	66,259	2,663
2011	18,792,538	1,048,206	17.81	252	74,758	4,163
2012	20,886,830	1,406,886	14.98	252	82,884	5,583
2013	20,686,221	1,757,482	11.81	252	82,417	7,006
2014	24,311,160	2,230,049	10.94	250	97,443	8,954
2015	27,001,797	2,855,376	9.56	251	107,557	11,413
2016	29,301,126	3,342,423	8.93	255	115,382	13,122

Source: CBK, Banking/National Payments Division

Table 12.2: Direct Payments versus Net Settlement Instructions (NSI)

Year to June 30	Total Value moved per year (Ksh m)	Settlement proportions Direct (Kshs m)	%	Indirect {NSI (Kshs m)}	%
2006	7,461,197	6,878,229	92.2	582,968	7.8
2007	7,929,003	7,234,837	91.2	694,166	8.8
2008	14,506,951	13,606,759	93.79	900,193	6.21
2009	15,441,446	14,549,876	94.23	891,570	5.77
2010	16,806,252	14,549,876	86.57	2,256,376	13.43
2011	18,792,538	16,360,759	87.06	2,431,779	12.94
2012	20,866,830	20,549,173	98.48	317,657	1.52
2013	20,686,221	20,355,986	98.4	330,235	1.6
2014	24,311,160	23,956,098	98.54	355,061	1.46
2015	26,903,894	26,558,355	98.72	345,539	1.28
2016	29,301,126	28,953,707	98.81	347,419	1.19

Source: CBK, Banking/National Payments Division

KEPSS dominated the national payments system and accounted for 79.23 percent of the value of transactions in FY 2015/16; followed by the Nairobi Automated Clearing House (NACH) at 8.63 percent; Mobile Payments Platform at 8.37 percent and cards payment at 3.77 percent. In terms of volume moved, the payments system is dominated by Mobile Payments Platform at 83.33 percent due to the large number of small transactions involved, followed by cards payments at 14.49 percent, NACH at 1.97 percent and KEPSS at 0.21 percent **(Table 12.3)**.

Table 12.3: National Payments System Throughput during FY 2015/16

	VALUE (KSh Bn)	VOLUME (m)	Value %	Volume %
KEPSS	29,301.13	3.34	79.23	0.21
CHEQUES & EFT's	3,193.00	30.81	8.63	1.97
PAYMENT CARDS	1,392.80	226.81	3.77	14.49
MOBILE MONEY TRANSFER	3,094.92	1,304.52	8.37	83.33

Source: Central Bank of Kenya

The Automated Clearing House Operations

The Central Bank of Kenya operates the NACH on behalf of Kenya Bankers Association. The system operated smoothly. The clearing and settlement of Cheques and EFTs is guided by T+1 policy implemented in August 2013.

Domestic Local Currency Cheques and Electronic Funds Transfer (EFT)

The NACH throughput for the FY 2015/16 amounted to 30.81 million transactions worth KSh 3,193 billion for both Debit and Credit instruments compared to 30.97 million transactions valued at KSh 3,117 billion during FY 2014/15 **(Table 12.4)**.

Cheques accounted for 63.4 percent of total volume of transactions through the Clearing House. The value of EFT transactions based payments increased by 4.3 percent during this period from KSh513 billion to KSh535 billion **(Table 12.4)**.

Table 12.4: Clearing House Kshs Transactions to June 30, 2016

Financial Year	Items	Values (Ksh bn)	Volumes ('000')
2005	Debit	1,943	11,287
	Credit	676	5,496
	Total	**4,292**	**24,166**
2009	Debit	3,901	18,549
	Credit	766	7,859
	Total	**4,667**	**26,408**
2010	Debit	1,954	15,732
	Credit	367	9,304
	Total	**2,321**	**25,036**
2011	Debit	1,939	16,713
	Credit	345	11,942
	Total	**2,284**	**28,655**
2012	Debit	2,134	18,222
	Credit	363	9,409
	Total	**2,497**	**27,631**
2013	Debit	2,196	18,436
	Credit	411	9,386
	Total	**2,607**	**27,821**
2014	Debit	2,419	19,221
	Credit	471	10,328
	Total	**2,890**	**29,548**
2015	Debit	2,604	19,828
	Credit	513	11,146
	Total	**3,117**	**30,974**
2016	Debit	2,658	19,530
	Credit	535	11,281
	Total	**3,193**	**30,811**

Source: Central Bank of Kenya

Table 12.5: Domestic Foreign Currency Cheque Clearing Transactions

Currency	USD		GBP		EURO	
	Value (m)	Volume ('000')	Value (m)	Volume ('000')	Value (m)	Volume ('000')
2005	1,202.67	159.4	19.83	2	78.37	5.1
2006	1,812.80	240.8	23.07	2.6	114.3	7.2
2007	2,124.75	272.4	23.86	2.6	108.13	7.5
2008	2,457.48	278	35.82	2.7	99.06	7.9
2009	2,637.32	282	52.98	2.9	138.31	9.8
2010	1,500.33	302.4	17.57	2.6	75.75	10
2011	1,239.25	337.2	11.41	2.3	77.01	12.3
2012	1,475.46	393.9	6.43	1.97	57.02	11
2013	1,566.31	402.4	5.86	1.88	47.35	11.2
2014	1,436.98	408.6	6.93	1.74	40.48	10.2
2015	1,294.95	374.7	4.04	1.21	35.49	9.37
2016	1,157.24	363.1	5.85	1.32	34.07	8.87
Growth (%)	-0.11	-0.031	0.448	0.091	-0.04	-0.053

Source: CBK, Banking/National Payments Division

Domestic Foreign Currency Cheques (DFCC)

The value of US dollar and Euro denominated cheques processed through the clearing house decreased by 10.63 percent and 4.0 percent, respectively. However, the Great Britain Pound denominated cheques recorded significant growth at 44.80 percent and 9.09 percent in value and volume, respectively. Meanwhile, the US dollar dominated the domestic foreign currency cheque clearing followed by the Euro and the Pound, respectively.

Automated Teller Machines (ATMs) and Plastic Card Usage

The Payments Card Industry (PCI) recorded mixed performance across various infrastructure for accessing customer accounts and making payments using cards. Automated Teller Machines (ATMs) decreased from 2,698 to 2,682 while Electronic Fund Transfer Point of Sale Terminals (EFTPOS) increased from 19,259 to 26,742 in the period to June 2015 and June 2016, respectively.

Uptake of payment cards exclusive of prepaid cards declined from 12.9 million in June 2015 to 11.5 million in June 2016. Debit cards which accounted for 06.2 percent of payment cards uptake declined for the first time since 2010, by 1.5 million cards (or 11.6 percent) from 12.5 million cards in June 30, 2015.

Meanwhile, the number of credit cards issued increased by 8.0 percent from 220,475 in June 2015 to 238,068 in June 2016. This increase is attributed to initiatives by commercial banks to promote usage of credit cards in delivering consumer credit more efficiently **(Table 12.6)**.

Mobile Phone Usage for Funds Transfer

Since inception, mobile money service usage has continued to grow among the Kenyan public. Convergence between mobile phone technology and commercial banks platforms has made banking services more accessible, especially for low-income customers, previously under-served by the formal

Table 12.6 : Number of Credit cards in circulation

	2010	2011	2012	2013	2014	2015	2016
Number of ATMs	1,943	2,183	2,292	2,439	2,618	2,698	2,682
ATM Cards	1,252,893	1,439,729	1,640,004	1,625,895	906,908	240,817	199,054
Debit Cards	4,156,187	7,002,091	8,121,460	9,126,946	11,588,007	12,477,834	11,024,230
Credit Cards	111,383	117,835	131,397	133,137	187,765	220,475	238,068
Charge Cards	791	1,418	2,877	772	652	285	890
Total	5,521,254	8,561,073	9,895,738	10,886,750	12,683,332	12,939,411	11,462,242

Source: NPS Card Statistics

Table 12.7: Mobile Money Transfer Services

Year to	2010	2011	2012	2013	2014	2015	2016
Amount transferred (Ksh billion)	597.31	919.22	1,375.83	1,689.04	2,148.13	2,575.44	3,094.92
Number of agents	31,902	46,588	61,313	103,165	120,781	131,761	162,465
Number of transactions (million)	251.25	364.06	507.90	643.01	824.26	1,002.25	1,304.52
Number of 'registered' customers/ accounts (million)	10.44	17.99	19.80	23.75	25.93	26.50	31.39

Source: Service providers

banking system. During the year to June 2016, mobile money service providers recorded increased volumes and values. This is has been sustained by continued collaborations and innovations in the industry such a: Commercial Bank of Africa-Mshwari in 2012 and KCB-Mpesa launched in 2015.

The number of mobile money service accounts increased from 26.50 million to 31.39 million in June 30, 2016. The 18.4 percent growth is supported by widespread ownership of mobile phones, the need to access financial services by public; and the relatively low cost of mobile money transactions. Transactions increased by 30.2 percent from 1,002.25 million transactions in the year to June 30, 2015 to 1,304.5 million transactions over the period under review **(Table 12.7)**.

The number of mobile money service provider agents increased by 23.3 percent from 131,761 to 162,465 in the year to June 2016 with Safaricom accounting for 66.4 percent, Orange 11.4 percent and Airtel 8.4 percent. The value transferred through mobile money services increased by 20.2 percent from KSh 2,575.44 billion in the year to June 30, 2015 to KSh 3,094.92 billion for the year to June 30, 2016.

Currency in Circulation

Currency in circulation during FY 2015/16 increased by 5.69 percent, from KSh 222.32 billion in June 2015 to KSh 234.96 billion **(Table 12.8)**. The currency was issued through the Central Bank of Kenya, Nairobi office, which lone accounted for 109 percent of the outstanding stock as at June 30, 2016 **(Table 12.8).** Bank notes accounted for 96.78 percent, and coins 3.22 percent of currency in circulation **(Table 12.9)**

Table 12.8: Currency in Circulation

CENTRE	CIRCULATION JUNE 30TH 2015 (KES)	CIRCULATION JUNE 30TH 2014 (KES)
Nairobi	239,079,353,178.00	218,927,072,178.00
Mombasa	54,034,840,481.00	48,438,182,481.00
Kisumu	3,895,555,170.00	9,986,368,170.00
Eldoret	-58,682,200,122.00	-66,532,197,122.00
Nyeri	1,959,337,000.00	3,738,344,000.00
Nakuru	-36,509,770,000.00	-27,283,014,000.00
Meru	18,499,810,000.00	12,614,017,000.00
Total	**222,276,925,707.00**	**199,888,772,707.00**

Source: Central Bank of Kenya

Notes in circulation increased by 2.01 percent from 465 million pieces in the year to June 30, 2015 to 474 million pieces in the year to June 30, 2016 **(Table 12.11)**. There was notable increase in the usage of KSh 1,000 and KSh 50 notes, by 8.52 percent, and 7.18 percent in the year to June 30, 2016. Coins in circulation respectively increased by 6.01 percent over the same period with the KSh 20, KSh 10 coin, KSh 5 coin and KSh 1 coin up by 8.18 percent, 10.57 percent, 9.87 percent and 5.44, respectively. Public preference for bank notes explains the high proportion of currency in circulation held as Bank notes.

Table 12.9: Currency in Circulation

	Jun-13		Jul-14		Jun-15		Jun-16	
Item	**Ksh bn.**	**%**	**Ksh bn.**	**%**	**Ksh bn.**	**%**	**Ksh bn.**	**%**
Currency in circulation	183.04	100.00	199.97	100	222.32	100.00	234.96	1.00
Bank Notes	177.49	96.97	193.64	96.83	215.33	96.86	227.4	0.97
Coins	5.55	3.03	6.33	3.17	6.988	3.14	7.557	0.03

Source: Central Bank of Kenya, Currency Division

Table 12.10: Currency in Circulation (Ksh m)

	2013/2014	2014/2015	2015/2016	%		2013/2014	2014/2015	2015/2016	%
	Pieces (m)	Pieces (m)	Pieces (m)	Change		Pieces (m)	Pieces (m)	Pieces (m)	Change
1000/=	151.52	171.33	185.92	8.52%	40/=	9.36	9.41	9.18	-2.49%
500/=	37.83	39.00	35.98	-7.73%	20/=	110.84	123.20	133.28	8.18%
200/=	46.71	49.45	44.9	-9.20%	10/=	184.56	209.81	232	10.57%
100/=	95.81	101.96	98.46	-3.43%	5/=	214.50	239.95	263.62	9.87%
50/=	77.86	81.07	86.89	7.18%	1/=	677.35	710.26	748.93	5.44%
20/=	9.97	9.96	9.94	-0.18%	/50=	275.02	274.96	274.77	-0.07%
10/=	11.92	11.91	11.91	-0.02%	/10=	0.00	0.00	0.00	0.00%
5/=*	0.00	0.00	0	0.00%	/05=	0.00	0.00	0	0.00%
	431.61	464.68	474.00	2.01%		1,471.63	1,567.59	1,661.77	6.01%

*Demonetised December 31, 2011

Source: Central Bank of Kenya, Currency Division

Table 12.11 Currency Inflows and Outflows (KSH 'M')

Inflow by banks	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Bank Notes	175,149	384,996	403,678	458,568	489,713	513,024
Coins	29	21	9	18	55	63
Total	**175,178**	**385,017**	**403,687**	**458,585**	**489,768**	**513,086**
Outflow by banks	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**
Bank Notes	194,935	395,599	426,495	474,643	511,439	524,751
Coins	147	204	726	791	717	818
Total	**195,082**	**395,803**	**427,221**	**475,434**	**512,156**	**525,569**
Net Outflows	**(19,904)**	**(10,786)**	**(23,534)**	**(16,848)**	**(22,388)**	**(12,483)**

Source: Central Bank of Kenya

Table 12.12: Counterfeit Notes by Denomination

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/2015	2014/2016	Proportion 2015/16
1000/=	1,376	485	259	165	118	88	83	84	70.00%
500/=	442	113	75	35	10	27	43	31	25.83%
200/=	411	297	204	123	17	34	11	4	3.33%
100/=	60	143	72	8	5	9	1	1	0.83%
50/=	7	4	29	4	0	0	1	0	0.00%
20/=	0	0	0	2	0	0	0	0	0.00%
10/=	0	0	0	0	0	0	0	0	0.00%
5/=	0	0	0	0	0				
Total	**2,296**	**1,042**	**639**	**353**	**150**	**158**	**139**	**120**	**100%**

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/2015	2014/2016	Proportion 2015/16
1000/=	1,376,000	485,000	259,000	165,000	118,000	88,000	83,000	84,000	83.67%
500/=	221,000	56,500	37,500	15,500	5,000	13,500	21,500	15,500	15.44%
200/=	82,200	59,400	40,800	24,600	34,000	6,800	2,200	800	0.80%
100/=	6,000	14,300	7,200	2,800	500	900	100	100	0.10%
50/=	350	200	1,450	200	0	0	50	0	0.00%
20/=	0	0	0	80	0	0	0	0	0.00%
10/=	0	0	0	0	0	0	0	0	0.00%
5/=	0	0	0	0	0	0	0		
Total	**1,685,550**	**615,400**	**345,950**	**208,180**	**126,900**	**109,200**	**106,850**	**100,400**	**100%**

Source: Central Bank of Kenya, Currency Department

Cash Inflows and Outflows

Bank notes deposit by banks (i.e. cash inflows) increased from KSh 489.7 billion as at June 30, 2015 to KSh 513.0 billion as at June 2016. Similarly bank notes withdrawals (i.e. cash outflows) increased from KSh 511.4 billion to KSh 524.8 billion in the same period. The net currency outflow in the year to June 30, 2016 of KSh 12.5 billion, was about half the KSh 22.4 billion in the previous year **(Table 12.11)**.

Counterfeiting

Counterfeit activity declined marginally with the number of counterfeit notes down from 139 counterfeit notes in the year to June 30, 2015 to 120 counterfeit notes in the year to June 30, 2016 **(Table 12.12)**. In value terms counterfeits decreased from KSh0.106 million in the FY 2014/15 to KSh0.100 million in FY2015/16. The counterfeits were largely in the large denomination notes by value and volume.

Combating Counterfeiting

The Central Bank of Kenya continued to create and enhance public awareness on security features of Banknotes as a way of minimizing counterfeiting. Collaboration with commercial banks and other educational institutions formed a key part of the anti-counterfeiting strategies through public education. The Bank continues to encourage the public to visit its website to learn more on the various security features on our currency.

Current and Future Developments

Legal Framework

Subsequent to enactment of the National Payment System Act (2011) and issuance of the National Payment System Regulations (2014), CBK has continued to enhance compliance by Payment Service Providers (PSPs) with the legal framework. In addition, the Bank requires all PSPs to comply with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 requirements. These are in line with CBK mandate of formulating and implementing such policies as best to promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems that promote social and economic activities.

Interoperability has been a key issue in the National Payments System and notably the retail payments sector. In this regard;

i. The CBK continued to participate in interoperability consultations with stakeholders aimed to improve the end-to-end efficiency and affordability, while preserving market competition and incentives for investment and innovation.

ii. The private sector initiated a process to establish a Payment System Management Body as provided for in the National Payment System Act 2011 and National Payment System Regulations 2014. To this end, the sector is in the process of registering an Association named "payment Association of Kenya"

Internet Banking

The new Constitution led to devolution of functions to 47 county governments and required the Bank to extend its banker to the government mandate to all County Governments. This was to ensure counties could process their payments in a timely and efficient manner while minimizing risk. This was done through the implementation of T24 Core Banking system by the Central Bank.

The roll-out of the T24 system has been successfully carried out to Ministries, Departments and Agencies (MDA's), County Executives and County Assemblies as well as internal clients. The internet banking benefits includes online access of statements, accounts and transactions as well as creation and viewing of mandates/signatories.

Regional Currency Convertibility

The Bank in partnership with other EAC Central Banks are operationalizing acceptance of the EAC domestic currencies as a way to enhance trade in the region and lower transaction costs.

13.0
REGIONAL INTEGRATION DEVELOPMENTS

The Central Bank of Kenya participates in various regional initiatives on monetary and financial integration. These initiatives include the implementation of monetary and financial cooperation programmes of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB). This chapter reviews Kenya's macroeconomic progress under the monetary cooperation programme and other financial and monetary developments in the EAC, COMESA and AACB in 2015/16.

The EAC Monetary Cooperation Programme

Background

The Treaty for the establishment of the East African Community encapsulates the integration process of the EAC, commencing with a Customs Union which came into force in 2005 followed by the Common Market in 2010. The East African Monetary Union (EAMU) is the third stage in the process of East African Community (EAC) regional integration. The protocol on the establishment of the EAMU was signed on 30th November 2013 and lays groundwork for a monetary union within 10 years.

The EAMU Protocol sets out the scope of monetary and financial cooperation which includes harmonization and coordination of fiscal policy, formulation and implementation of a single monetary and exchange rate policy, development and integration of financial, payment and settlement systems and adoption of common principles and, rules for regulation and prudential supervision of the financial system amongst others. To facilitate the process towards the monetary union, the EAC Monetary Affairs Committee (MAC) which constitutes the Governors of the EAC Central Banks developed an action plan to coordinate all areas of monetary and financial cooperation. The Political Federation is the fourth stage and ultimate goal of EAC Regional Integration.

Developments in EAC Regional Integration

The EAC Common Market

The EAC Common Market provides a big opportunity for private sector growth and poverty reduction. The EAC Common Market Protocol covers several commitments by Partner States – also known as four freedoms – on free movement of goods, labour, persons, services and capital, in its implementation. On services, Partner States committed to remove restrictions in 7 of 12 sectors. With regard to goods, Partner States committed to remove all internal tariffs, implement a common external tariff and remove non-tariff barriers to trade.

However, according to the EAC Common Market Scorecard for 2014 –published jointly by the EAC Secretariat and the World Bank– which tracks EAC compliance in the movement of capital, services and goods, progress on implementation of the EAC Common Market Protocol has been slow. For instance, all Partner States have restrictions on the movement of capital. In addition, exemptions were introduced reflecting government concerns for example on money laundering and financial market stability, and, without following the proper mechanism of notifying the other Partner States. As reported in the Common Market Scorecard, the Republic of Kenya had liberalised 17 out of the 20 operations identified in the EAC Common Market Schedule by 2014. The three restrictions related to inward investment and the derivatives market. Subsequently in October 2015, the Nairobi Securities Exchange (NSE) received formal approval from the Capital Markets Authority (CMA) to operate a derivatives market, following satisfactory fulfilment of the requirements stipulated under Section 63A of the CMA Act and the Capital Markets (Futures Exchange) (Licensing Requirements) Regulations. The remaining restrictions relate to inward direct investments and include licensing and shareholding for specific sectors such as insurance and telecommunication, as well prudential supervision and regulation.

With regard to services, the EAC Common Market Scorecard identified 63 measures which were inconsistent with the liberalization of services. These measures were predominantly in professional services specifically engineering, accounting and legal services. On goods, 51 non-tariff barriers (NTBs) reflecting government regulatory measures were identified between 2008 and 2013. The NTB's were mostly related to sanitary and phytosanitary measures, rules of origin, additional taxes and charges, and technical barriers to trade.

The EAC Monetary Union

In accordance with the roadmap for implementation of the EAMU Protocol, four institutions are scheduled to be established by 2018. These are the East African Community Monetary Institute (EAMI) – responsible for preparatory work for the Monetary Union, the East African Community Surveillance, Compliance and Enforcement Commission (EASCEC); East African Community Statistics Bureau (EASB); and East African Community Financial Services Commission (EAFSC). The draft bills establishing the EAMI, EASCEC and EASB were developed during the FY 2015/16 and are at different stages of review before being forwarded to the East African Legislative Assembly for enactment and the Summit for assent. A study on "EAC Financial Sector Regulatory and Supervisory Architecture" is being undertaken and will inform the drafting of the Bill on the Financial Services Commission.

With regard to monetary and financial cooperation, while Partner States' Central Banks implemented different monetary policy frameworks, monetary policy tools were to a large extent harmonized. Governors of the EAC Central Banks also commissioned studies on the exchange rate in the FY 2015/16, which will inform the roadmap to a common exchange rate mechanism. Significant progress was also made on harmonizing economic statistics. For instance, all Partners States migrated to 6th Edition of the IMF's Balance of Payments Manual in the FY 2015/16. Substantial progress was also made towards harmonizing Government Finance Statistics in line with the 2014 manual. Partner States' Central Banks also cooperated on the adoption of common principles and rules for the regulation and supervision of the financial system. In this area, supervisory frameworks were continuously updated in readiness for the envisaged East African Monetary Union.

INTEGRATION DEVELOPMENTS

In line with the EAMU protocol, Partner States developed a roadmap for attaining macroeconomic convergence. Most Partner States developed Medium Term Convergence Programs for monitoring progress on attainment of macroeconomic convergence targets. Partner States are assessed on the following performance convergence criteria:

- A ceiling on headline inflation of 8 percent.
- A ceiling on fiscal deficit, including grants, of 3 percent of GDP.
- A ceiling on gross public debt of 50 percent of GDP in net present value terms.
- Reserve cover of 4.5 months of imports.

In addition, each Partner States is expected to monitor the following indicative convergence criteria:

- A ceiling on core inflation of 5 percent.
- A ceiling on fiscal deficit, excluding grants, of 6 percent of GDP.
- A tax to Gross GDP ratio of 25 percent.

INTEGRATION DEVELOPMENTS

Table 13.1: Kenya's Macroeconomic Progress Under the EAC Monetary Cooperation Programme

	Status		
1. Implementation of the Common Market Protocol: Liberalisation of the Capital account:			Full liberalisation of the Capital account yet to be achieved.
Restrictions limiting full liberalisation			
a) Restrictions on inward direct investments			Restrictions found in laws relating to investment, insurance and telecommunications resulting in discriminatory treatment for EAC domiciled investors and restriction of market access in selected sectors.
b) Article 25 (1) of the EAC Common Market Protocol allows Partner States to restrict the freedom of movement of capital for reasons of prudential supervision, public policy, money laundering, and financial sanctions agreed to by Partner States. Article 25 (2) of the protocol however, requires Partner States that adopt any of the restrictions stipulated in Article 25 (1) to notify the EAC Secretariat and other Partner States and furnish proof that a restriction was reasonable and justified.			Kenya exercises two exemptions related to prudential supervision (controlling bank transactions between residents and non-residents through requiring central bank authorization) and anti-money laundering (placing ceilings on transportation of monetary instruments within the EAC). Kenya is required to notify EAC Partner States of these exemptions, which it has not done.
2. Implementation of prerequisites for the Monetary Union	2013_14	2014_15	2015_16
a) Central Bank lending to Government and Public entities	0.0	0.0	0.0
b) Performance convergence criteria			
8% ceiling on headline inflation \1	7.05	6.63	6.46
Ceiling on fiscal deficit, including grants of 3% of GDP\2	-5.7	-8.3	-8.3
Ceiling on gross public debt of 50 percent of GDP in Net Present Value terms\3	41.08	41.79	
Reserve cover of 4.5 months of imports\4	5.57	4.50	5.45
c) Indicative convergence criteria			
5% ceiling on core inflation\5	4.47	4.63	5.01
A ceiling on fiscal deficit, excluding grants of 6% of GDP\2	-6.2	-9.1	-8.7
Tax to GDP ratio of 25%\6	18.0	17.6	20.7

\1 Inflation annual average: CBK inflation data
\2 Quarterly Budget Reviews and Annual Economic Surveys
\3 Analysis of Key Fiscal Ratios, Economic Survey 2016, pg 104
\4 Based on 36 months of imports, CBK data
\5 Excludes food and fuel, CBK data
\6 Computed using Total Tax revenues-Economic Survey 2016, pg 105

2. The Comesa Monetary Cooperation Programme

2.1. Background

The Authority of Heads of State and Government in 1992 adopted the COMESA Monetary Cooperation Programme towards the establishment of a Monetary Union in the year 2025. The date for the Achievement of the Monetary Union was later changed to 2018 by the COMESA Council of Ministers in 2006.

The primary objective of the COMESA Monetary Cooperation Programme is to create a common area of monetary and financial system stability which will facilitate integration of the financial markets and achieve economic integration and economic growth. The achievement of monetary and financial system stability entails the attainment of economic convergence by removing all macroeconomic disharmonies which exist among member states as a result of pursuit of divergent macroeconomic policies.

The revised COMESA convergence criteria are categorized into primary (preconditions for convergence) and secondary (reinforcement conditions) criteria, to be implemented in three phases;

- Stage 1 (2005-2010),
- Stage 2 (2011-15) and;
- Stage 3 (2016-18).

The following are convergence criteria in the second stage.

Primary Criteria:

(a) Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 3 percent.
(b) Annual average inflation rate not exceeding 3 percent.
(c) Eliminate central bank financing of the budget.
(d) Equal to or more than 6 months of imports of goods and non-factor services.

Secondary Criteria

(a) Achieve and maintain stable real exchange rates.
(b) Achieve and maintain market based positive real interest rates.
(c) Achieve a sustainable real GDP growth rate of not less than 7 percent.
(d) Pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to a sustainable level.
(e) Total domestic revenue to GDP ratio of at least 20 percent.
(f) Maintenance of current account deficit as a percentage of GDP to sustainable level.
(g) Achieve and maintain domestic investment rate of at least 20 percent.
(h) Gradual liberalisation of the Capital Account.

INTEGRATION DEVELOPMENTS

Table 13.2: Kenya's Progress in Implementation of COMESA Monetary Cooperation Programme

	Stages of implementation					
Convergence criteria	**Stage I: 2005-2010**	**Stage 2: 2011-2015**	**Stage 3: 2016-2018**	**2013_14**	**2014_15**	**2015_16**
Primary Criteria						
Overall Budget Deficit to GDP ratio\1	Overall Budget Deficit to GDP Ratio (excluding grants) of not more than 5 percent	Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 4 percent	Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 3 percent	-6.2	-9.1	-8.7
Annual average Inflation Rate\2	Not exceeding 5 percent	Not exceeding 3 percent	Not exceeding 3 percent	7.05	6.63	6.46
Central Bank financing of the budget deficit	Minimise towards 0 percent	Eliminate	Eliminate	0.0	0.0	0.0
External Reserves (months of import of imports of goods and non-factor services)\3	Equal to or more than 4 months of imports of goods and non-factor services	Equal to or more than 5 months of imports of goods and non-factor services	Equal to or more than 6 months of imports of goods and non-factor services	5.57	4.50	5.45
Secondary Criteria						
Stable real exchange Rates	To be achieved and maintained	To be achieved and maintained	To be achieved and maintained	Stable	Stable	Stable
Market based positive real interest rates\4	To be achieved and maintained	To be achieved and maintained	To be maintained	9.81	8.26	7.25
Achievement and maintenance of sustainable real growth rate of real GDP\5	Not less than 7.0 percent	Not less than 7.0 percent	Not less than 7.0 percent	5.8	5.3	5.6
Debt reduction initiative on domestic and foreign debt; i.e reduction of total debt as a ratio of GDP\6	To be kept at a sustainable level	To be kept at a sustainable level	To be sustained	41.08	41.79	
Total domestic revenue to GDP ratio\7	Not less than 20 percent	At least 20 percent	At least 20 percent	19.2	19.0	22.5
Current Account Deficit (excluding grants) percentage to GDP	To be reduced to a sustainable level	To be maintained and sustained	To be maintained and sustained	-8.1	-9.6	-5.7
Achievement and maintenance of domestic investment rate\8	At least 20 percent	At least 20 percent	At least 20 percent	20.2	22.5	21.2
Liberalisation of the capital account		Gradual	Full	Full liberalisation of the Capital account yet to be achieved.	Full liberalisation of the Capital account yet to be achieved.	Full liberalisation of the Capital account yet to be achieved.

Convergence criteria source: Assessing Integration in Africa III, Economic Commission for Africa

\1 Quarterly Budget Reviews and Annual Economic Surveys
\2 Overall inflation, annual average: CBK inflation data
\3 Based on 36 months of imports, CBK data
\4 91 day T-bill rate
\5 GDP at market prices, Calendar years 2013, 2014, 2015
\6 Public debt ratio to GDP, Analysis of Key Fiscal Ratios, Economic Survey 2016, pg 104
\7 Computed using total ordinary revenue, Economic Survey 2016, pg105
\8 Calendar years 2013, 2014, 2015

3. The Association of African Central Banks

3.1. Background

The Association of African Central Banks (AACB) was established at the Summit Conference of African Heads of State and Government in May 25, 1963 in Addis Ababa, Ethiopia. The main objectives of the Association are to: promote co-operation in the monetary, banking and financial spheres in the African region and strengthen efforts aimed at bringing about and maintaining price and financial stability in the African region. Membership of the AACB is open to all African central banks. The Association comprises an assembly of African Central Bank Governors which is the governing body, the Bureau and, sub-regional committees composed of Governors of Central Banks of the five (5) sub-regions as defined by the African Union. In addition, the AACB has a Secretariat, which is headed by an Executive Secretary, and provides secretarial services to the Association.

- The Association adopted, in 2000, an African Monetary Cooperation Programme (AMCP) whose aim is to establish a harmonized monetary system with a view to setting up a common organ to work towards the creation of a single monetary zone by 2021. The AMCP spells out a hierarchy of primary and secondary criterion, with their relative target values and deadlines for compliance.

- To strengthen banking regulatory and supervisory frameworks in Africa, the Community of African Central Banks (CABS) was established as a subsidiary body of the AACB and held its inaugural meeting in January, 2013 in Algiers, Algeria. The main objective of CABS is to contribute to ongoing efforts to strengthen financial sector stability with the view of maintaining and deepening the dialogue with and among African Banking Supervisors and giving them a greater voice in international forums.

- To facilitate implementation of the AACB objectives, the association is required to provide for periodic meetings of Governors of central banks; promote the exchange of ideas and experiences on monetary, financial and banking matters and co-operation in Africa and facilitate the collection, pooling and dissemination of information on monetary, banking, financial and other economic matters of interest to its members. To this end, the Association holds the Assembly of Governors meetings, a symposium of governors and continental seminars on annual basis.

3.2. Recent Developments

The Assembly of Governors meeting was held on the 19th August 2016 in Abuja, Nigeria. The meeting was preceded by the symposium of Governors on the theme “Unwinding of Unconventional Monetary Policies: Implications for Monetary Policy and Financial Stability in Africa” held on the 18th August 2016. The Assembly of Governors meeting reviewed the status of implementation of the decisions of the 39th Ordinary meeting of the Assembly of Governors. The meeting deliberated amongst other issues on the need for a step by step approach on African monetary integration, specifically by putting more emphasis on strengthening monetary integration at the sub-regional level; and synchronizing the AACB agenda with Agenda 2063 and any other target set at the continental level.

3.2.1. Status of Implementation of the AMCP for 2015

- After taking cognizance of the adverse impact of the international economic environment and, regional as well as domestic factors on the macroeconomic performance of African States, which had made it difficult to meet the convergence criteria under stage III, the Assembly agreed that the commencement of Stage IV of the convergence programme be deferred for an additional two years until 2016. The criteria under stage III was originally set to cover the years 2009-2012. An experts group drawn from central banks of the AACB Bureau was set up to refine the macroeconomic convergence criteria in terms of definition, measurement and harmonization.

- Kenya met the criterion of eliminating the Central Bank financing to Government during the fiscal year 2015/16. However, performance of the remaining primary criterion was below the AMCP targets under stage III. The overall budget deficit (excluding grants) was 8.7 percent of GDP in FY 2015/16, compared to the AMCP target of 3 percent of GDP. The higher deficit was mainly attributed to higher development expenditure reflecting infrastructure projects, including the Standard Gauge Railway, expansion of the road network, energy and water. The annual average headline inflation declined to 6.5 percent in FY 2015/16 from 6.6 percent in FY 2014/15. However, it remained slightly above the AACB target of 5 percent per annum. The external reserves cover increased to 5.5 months of imports of goods and services from 4.5 months, reflecting higher inflows during the period, but remained below the AMCP target of 6 months of import cover.

- Kenya met all the five Stage III targets set under the secondary criterion. The share of domestic fiscal receipts to GDP increased from 22.5 percent in the fiscal year 2015/16 from 19.0 percent in the fiscal year 2014/15. The share of salary mass to total domestic fiscal receipts declined to 28.3 percent from 33 percent in the fiscal year 2014/15. The Government capital investment as a share of domestic fiscal receipts was also above the 20 percent target, while the real effective exchange rate remained stable.

3.2.2 AACB Continental Seminar

- The 2015 AACB Continental Seminar was hosted by the Central Bank of Kenya on May 13-15, 2015 in Nairobi – Kenya and was attended by delegates from Central Banks, Regional and International Institutions. The Seminar was based on the theme, “Monetary Policy Frameworks in Africa in a Changing Financial Landscape”. Three main sub-topics discussed: Monetary Policy Frameworks in Africa: Stocktaking, Challenges and Future Direction; Adapting Monetary Policy Frameworks and Strategies to the Specific Circumstances and realities for African Financial Systems: Stakes and Limits; and Key Changes in the Financial Landscape and Implications for the Conduct of Monetary Policy in Africa. Following the recommendations of the Seminar, a survey of monetary policy frameworks of the AACB member central banks’ was conducted and it revealed the diversity in the conduct of monetary policy frameworks within the member countries. The Assembly agreed that the Survey be institutionalized and be conducted periodically and that a Board of Directors responsible for monetary policy, be put in place for purpose of designing a harmonized monetary policy framework for African central banks.
- The 2016 Continental Seminar was hosted by the Central Bank of Egypt on May 9-11, 2016 in Cairo, Egypt. The Seminar was based on the theme “Financial Stability: New Challenges for Central Banks”. The key recommendation included: the need to strengthen prudential oversight and regulatory framework within the financial system to address new innovations, de-risking and weaknesses in existing frameworks; the need for AACB members to take appropriate measures to fast track application and implementation of statutory AML/CTF rules in compliance with international standards; and the need to enhance MoUs to incorporate cross-border financial institutions, including procedures, communication and responsibilities during crisis period and information sharing taking into account consumer protection issues and national laws.

Table 13.3 : Kenya's Macroeconomic Performance against convergence criteria under the African Monetary Cooperation Programme

Primary Criteria					
	Stage III (to be achieved by 2016)	**Stage IV (After 2016)**	**2013_14**	**2014_15**	**2015_16**
Overall Budget deficit/GDP excluding grants1/	not exceeding 3 percent	Continued observance of stage 3 criteria	-6.2	-9.1	-8.7
Inflation rate Annual Average2/	less than 5 percent per annum	less than 3 percent per annum	7.05	6.63	6.46
Elimination of Central Bank Credit to Government	Eliminate	Eliminate	0.0	0.0	0.0
External reserves months of Imports cover 3/	equal or greater than 6 months	Continued observance of stage 3 criteria	5.57	4.50	5.45
Secondary Criteria					
	Stage III (to be achieved by 2016)	Stage IV (After 2016)	2013_14	2014_15	2015_16
Domestic fiscal Receipts/GDP ratio 4/	equal to or more than 20%	Continued observance of stage 3 criteria	19.2	19.0	22.5
Salary mass/total domestic fiscal receipt ratio5/	Less than 35 percent	Continued observance of stage 3 criteria	34.7	32.8	28.3
The sourcing of minimum of 20% Government investment capital from fiscal receipts 6/	equal to or more than 20%	Continued observance of stage 3 criteria	13.9	28.2	24.3
Current Account/GDP ratio	Sustainable level	Continued observance of stage 3 criteria	-8.1	-9.6	-5.7
Real effective exchange rate	Maintenance of real exchange rate stability	Continued observance of stage 3 criteria	Stable	Stable	Stable

1/Quarterly Budget Reviews and Annual Economic Surveys
2/Overall inflation,annual average: CBK inflation data
3/Based on 36 months of imports, CBK data
4/Total ordinary revenue to GDP ratio based on ordinary revenues, Economic Survey 2016, pg 105
5/Ratio of Compensation of employees to total ordinary revenue, Economic Survey 2016, pg 105, 110
6/Ratio: Acquisition of non financial assets/total ordinary revenue, Economic Survey 2016, pg 103, 105

14.0 HUMAN RESOURCES MANAGEMENT

Internship Program

The Bank introduced an internship programme, the Central Bank Internship Program (CBKIP) in February 2016 with the aim of providing selected young graduates (interns) with knowledge regarding the structure and operations of Kenya's financial system, thereby creating a pool of highly skilled young professionals for the broader financial sector.

The programme was launched on April 11th, 2016. It featured an intensive selection procedure to identify suitable candidates /interns based on merit, equity and diversity. The first group of nine (9) interns reported to work on July 1st, 2016, and were posted to Finance, Kenya School of Monetary Studies, Research, Strategic Management, Communication and Legal Services units in the Bank. Two (2) among the interns are physically challenged. The interns will have an opportunity to undergo six (6) specialised training programs, visit a branch and be given an overview of the entire CBK operations.

Year 2015 Inter-Branches/Financial Institutions (KIB) Sports Competitions

The Bank, which is a leading financial institution and member of the Kenya Institute of Bankers (KIB), participated in the 2015 annual Inter-Banks and Financial Institutions Games. This is an important social event for the Bank as the games bring together members of the banking community to interact in a friendly, cordial and sporting atmosphere. The Bank took 2nd position overall in the competitions.

Cbk's Participation in Agricultural Society of Kenya Shows

The Bank continues to spread awareness on its mandate, services and products at the Agricultural Society of Kenya (ASK) shows. It teamed up with other Financial Sector Regulators at a common stand in the ASK shows held in Nairobi, Mombasa, Kisumu, Kisii, Meru, Nyeri, Nakuru and Eldoret.

OFFICE OF THE AUDITOR GENERAL

REPORT

OF

THE AUDITOR-GENERAL

ON

THE FINANCIAL STATEMENTS OF CENTRAL BANK OF KENYA

FOR THE YEAR ENDED 30 JUNE 2016

14.0 FINANCIAL PERFORMANCE

REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE CENTRAL BANK OF KENYA AT JUNE 30, 2016

Table of contents

REPORT AND FINANCIAL PERFORMANCE

Board of Directors

Mr. Mohammed Nyaoga	Chairman
Dr. Patrick Njoroge	Governor
Dr. Kamau Thugge	Principal Secretary, the National Treasury

Executive Management

Dr. Patrick Njoroge	Governor
Ms. Sheila M'Mbijjewe	Deputy Governor

Heads of Department

Mr. Kennedy Abuga	Director - Governors' Office
Mr. Charles Koori	Director - Research Department
Mr. Gerald Nyaoma	Director - Bank Supervision Department
Mr. Mark Lesiit	Director - Banking, National Payments and Risk Management Department
Ms. Rose Detho	Director - Strategic Management Department
Mr. William Nyagaka	Director - Internal Audit Department
CPA. Peter Rotich	Director – Finance and ICT Department
Mr. John Birech	Acting Director - Financial Markets Department
Ms. Terry Nganga	Acting Director - Human Resource and Administration Department
Mr. Paul Wanyagi	Acting Director – Currency Operations and Branch Administration Department
Eng. Erastus Miriti	Acting Director - Department of Procurement, Logistics and Supplies
Prof. Kinandu Muragu	Executive Director – Kenya School of Monetary Studies

Registered office and principal place of business

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Haile Selassie Avenue
P.O. Box 60000
00200 Nairobi, Kenya
Tel.(+254) (02) 2860000

Branches

Mombasa Branch	Kisumu Branch	Eldoret Branch
Central Bank of Kenya Building	Central Bank of Kenya Building	Kiptagich House
Nkurumah Road	Jomo Kenyatta Highway	Uganda Road
P.O. Box 86372	P.O. Box 4	P.O. Box 2710
80100 Mombasa	40100 Kisumu	30100 Eldoret

Currency centres

Nyeri Currency Centre	Meru Currency Centre	Nakuru Currency Centre
Kenya Commercial Bank Building	Co-operative Bank Building	Central Bank of Kenya Building
Kenyatta Street	Njuri Ncheke Street	George Morara Street
P.O. Box 840	P.O. Box 2171	P.O. Box 14094
10100 Nyeri	60200 Meru	20100 Nakuru

REPORT AND FINANCIAL PERFORMANCE

Subsidiary

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Oraro and Co. Advocates
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P.O. Box 51236
00200 Nairobi

Auditor

Deloitte & Touche
Deloitte Place Waiyaki way, Muthangari
P.O. Box 40092
00100 Nairobi

On behalf of:-
The Auditor General Kenya National Audit Office
Anniversary Towers
P.O. Box 30084
00100 Nairobi

REPORT AND FINANCIAL PERFORMANCE

1. Statement of Corporate Governance

The Central Bank of Kenya (the "Bank"/"CBK") is established under Article 231 of the Constitution, 2010 and is wholly owned by the Government of Kenya. Under this Article the Central Bank has the responsibility of formulating monetary policy, promoting price stability, issuing currency and performing any other functions conferred on it by an Act of Parliament. Whilst the Constitution grants the Bank authority and autonomy, the Bank is committed to maintaining the highest standards of integrity, accountability, professionalism and business ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act (the "Act") provides that the Board of Directors (the "Board") shall be composed of a Chairperson, a Governor, and the Principal Secretary to the National Treasury who is a non-voting member and five Non-Executive Directors. Previously, all the Board members were appointed directly by the President of the Republic of Kenya, (the "President") without an intermediate vetting process. With effect from 2 May 2012, however, the Act was amended and now requires that the President appoints the Governor after the conduct of a competitive process and following the approval of Parliament. The proposed procedure for appointing the Chairperson is similar to the appointment procedure applicable to the Governor. Other than the Principal Secretary to the National Treasury who is an ex-officio member, all the Non-Executive members of the Board are appointed by the President for terms of four years each and are eligible for reappointment provided that no Board Member holds office for more than two terms. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

The Chairman of the Board of Directors, Mr Mohammed Nyaoga, was appointed on 19th June 2015 through a competitive recruitment process. The independent Non-Executive Board members are yet to be appointed to replace the retired members.

The Board is required to meet once every two months and has a formal schedule of agenda items due for deliberations. The Board Members are given appropriate and timely information to enable them provide and maintain full and effective direction and control over strategic and policy issues of the Bank. The Board is not involved in the conduct of day-to-day business as this is the responsibility given to the Governor by the Act. It however, retains responsibility for determining the policies of the Bank.

The Members of the Board (all Kenyan) in the year ended 30 June 2016 are listed in the table below. No meetings were held in the year under review due to lack of quorum.

No	Name	Position	Discipline/Professional Background	Date of Appointment	Meetings Attended
1	Mr. Mohammed Nyaoga	Chairman	Lawyer	Appointed - 19 June 2015	-
2	Dr. Patrick Njoroge	Governor	Economist	Appointed - 19 June 2015	-
3	Principal Secretary/ National Treasury	Ex-Officio	Economist	Permanent Member of the Board	-

The remuneration paid to the Board Directors for services rendered during the financial year 2015/2016 is disclosed in Note 28 to the financial statements. The Non-Executive Board Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Board Directors during the year, while Executive Directors are paid a monthly salary and are eligible for staff loans.

1. Statement of Corporate Governance (continued)

1.2 Monetary Policy Committee (MPC)

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

During the FY2015/16, the MPC formulated monetary policy to achieve and maintain overall inflation within the allowable margin of 2.5 percent on either side of the 5 percent target. Overall month-on-month inflation remained within the Government target range except in December 2015 and January 2016, largely due to high food prices and the impact of the revised Excise taxes implemented from 1st December 2015. The foreign exchange market was volatile at the beginning of the FY2015/16 due to the impact of the devaluation of the Chinese Yuan, and strengthening of the U.S. dollar against most currencies. Nevertheless, the foreign exchange market stabilised since September 2015 supported by a narrower current account deficit due to lower imports of petroleum products, improved earnings from tea and horticulture exports, and strong diaspora remittances. The moderate petroleum product prices coupled with the stability of the Shilling moderated any risks of imported inflation

The CBK held regular meetings with the Chief Executive Officers of banks to discuss the background to MPC decisions, and obtain feedback from the market. The Governor also held regular press conferences to brief the media on the background to MPC decisions and financial sectors developments. The forums have improved the understanding of monetary policy decisions and enhanced the transmission mechanism of monetary policy.

The MPC held 7 meetings in the year ended 30 June 2016 and attendance was as follows:

No	Name	Position	Discipline	Meetings Attended
1	Dr. Patrick Njoroge	Chairman	Economist	7
2	Ms. Sheila M'Mbijjewe	Vice Chairperson	Finance/ Accountancy	7
3	Dr. Haron Sirima ≠	Vice Chairman	Economist	3
4	Mr.Nzomo Mutuku	Representative of the Principal Secretary of the National Treasury	Economist	5
5	Prof. Francis Mwega	Member	Economist	7
6	Mrs. Farida Abdul	Member	Economist	7
7	Mr. Charles Koori	Member (Internal)	Economist	6
8	Mr. John Birech	Member (Internal)	Economist	7

≠ Was Vice Chairman up to 23rd October 2015 when his term ended.

REPORT AND FINANCIAL PERFORMANCE

1.3 Management Structure

The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Governor and the Deputy Governor constitute the Central Bank's Senior Management and meet regularly with the heads of the Bank's various departments indicated on page 1, to review the overall performance of the Bank.

There are several other management committees, which advise the Governor on specific issues to enable him to discharge his responsibilities as the Chief Executive Officer of the Bank.

1.4 Code of Ethics

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests, which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct embedded the *Staff Rules and Regulations* and the Employment Act 2007, apply to the entire Bank's staff.

1.5 Internal Controls

The Management of the Bank has put in place a series of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2015. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

1.6 Authorizations

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

1.7 Internal Audit and Risk Management

The internal audit function is performed by Internal Audit Department. The Risk Management Unit is a separate function under Banking Department and is responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit Department and the Risk Management Unit are availed to the Audit Committee of the Board.

1.8 Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explain current monetary policy and also provide the expected monetary policy stance. In addition, the Bank issues policy briefs to the National Treasury on both the monetary and fiscal policies. On an annual basis, the financial statements are published in the Kenya Gazette and are also placed in the Bank's website.

2. Financial Performance

The Bank's financial Performance is affected by monetary policy stance adopted, money supply, interest rates and exchange rates. The Bank's financial performance is presented on page 10 of these financial statements.

During the financial year ended 30 June 2016, the Bank's net interest income after the impairment charge was Shs 11,917 million (2015: Shs 4,245 million). This category generated income of Shs 15,933 million against the budgeted estimates of Shs 8,960 million with the foreign earnings almost doubling on account of increased USD, GBP & AUD deposit levels as well as higher than anticipated interest earnings. The growth in deposits was achieved largely through flows from syndicated loan which helped boost Foreign exchange reserves.

However, this increase was diminished by higher monetary policy expenses arising from volatile market conditions and the monetary policy stance adopted. This resulted in increased sale of repos as well as rediscounted securities during the year. The Bank incurred unrealized foreign exchange loss of Shs 19,969 million against a record gain of Shs 40,740 million in June, 2015. The loss arose largely from the weakening of the Sterling Pound against other major currencies following the outcome of Brexit referendum vote in the last week of June, 2016.

Trading income generated mainly from the sale of foreign currency declined to Shs 6,446 million (2015: Shs 8,198 million) due to lower market interventions in the year under review. Additionally, there were lower earnings from the processing of foreign currency transactions.

Administrative expenses declined to Shs 8,091 million (2015: Shs 8,762 million) as a result of revaluation gains from retirement benefits assets of Shs 1,835 million (2015: Shs 1,241 million). In addition, currency costs decreased during the year to Shs 1,880 million from Shs 1,965 million in 2015. Staff expenses stood at Shs 2,122 million (2015: 3,059 million).

The outcome of the Bank's operations was a net deficit of Shs 4,640 million compared to a net surplus of Shs 49,725 million in June, 2015 that has been added to the General Reserve Fund.

The financial position for the year is set out on page 11. The Bank's assets increased to Shs 982,849 million (2015: Shs 805,369 million) attributed partially to receipt of syndicated loan proceeds of USD 343M (equivalent to Shs 35,000 million) in October, 2015 and USD 385 million (equivalent to Shs 39,300 million) received in December, 2015 and sold to CBK through SCB (London).

Advances to banks, mainly through discounting of securities, grew to Shs 44,679 million (2015: Shs 75 million), this was to address challenges posed by liquidity segmentation in the interbank market.

Liabilities also increased to Shs 865,856 million (2015: Shs 683,736 million) attributed mainly to growth in Government deposits arising from increased funding of State projects by development partners. The increase in Government deposits was shs172,000 million which accounted for 98% of the change in liabilities.

REPORT AND FINANCIAL PERFORMANCE

Director's Report

The Directors submit their report together with the audited financial statements for the year ended 30 June 2016, which shows the state of affairs of Central Bank of Kenya (the "Bank"/"CBK").

Incorporation

The Bank is incorporated under Article 231 of the Constitution of Kenya, 2010.

Principal Activities

The Bank is established and administered under the Constitution of Kenya, 2010 with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

Results and Dividend

The deficit for the year of Shs 4,640 million (2015: Shs 49,725 million) has been added to the General Reserve Fund. The Directors do not recommend the payment of a dividend (2016: Nil).

Board of Directors

The members of the Board of Directors who served during the year and up to the date of this report are listed on page 113.

Auditor

The Auditor General is responsible for the statutory audit of the Bank's financial statements in accordance with Section 35 of the Public Audit Act, 2015. Section 23(1) of the Act empowers the Auditor General to appoint other auditors to carry out the audit on his behalf. Accordingly, Deloitte & Touche were appointed to carry out the audit for the year ended 30 June 2016.

By order of the Board

Kennedy Abuga
Board Secretary

9th September 2016

REPORT AND FINANCIAL PERFORMANCE

The Directors are responsible for the preparation of financial statements for each financial year that give a true and fair view of the state of affairs of the Bank as at the end of the financial year and of the Bank's surplus or deficit. The Directors also ensure that the Bank keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the Bank. They are also responsible for safeguarding the assets of the Bank.

The Directors accept responsibility for the preparation and fair presentation of financial statements that are free from material misstatements whether due to fraud or error. They also accept responsibility for:

(i) Designing, implementing and maintaining internal control necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;

(ii) Selecting and applying appropriate accounting policies; and

(iii) Making accounting estimates and judgments that are reasonable in the circumstances.

The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial position of the Bank at 30 June 2016 and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

Nothing has come to the attention of the Directors to indicate that the Bank and its subsidiary will not remain a going concern for at least twelve months from the date of this statement.

Approved by the Board of Directors and signed on its behalf by:

Mr Mohammed Nyaoga
Chairman, Board of Directors

9th September, 2016

Patrick Njoroge
Dr Patrick Njoroge
Governor, Central Bank of Kenya

9th September, 2016

REPUBLIC OF KENYA

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OFFICE OF THE AUDITOR-GENERAL

REPORT OF THE AUDITOR-GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2016

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Central Bank of Kenya set out on pages 10 to 51 which comprise the consolidated statement of financial position as at 30 June 2016, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Delloitte and Touché, auditors appointed under Section 23 of the Public Audit Act, 2015 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

Auditor-General's Responsibility

My responsibility is to express an opinion on these financial statements based on the audit and report in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229 of the Constitution. The audit was conducted in accordance with International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Central Bank of Kenya as at 30 June 2016, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Central Bank Act, Cap 491 of the Laws of Kenya.

FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

27 September 2016

REPORT AND FINANCIAL PERFORMANCE

Independent Auditors’ Report to the Auditor General on Central Bank of Kenya

We have audited the accompanying financial statements of Central Bank of Kenya, set out on pages 10 to 51 which comprise the consolidated statement of financial position as at 30 June 2016, the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors’ responsibilities for the financial statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act, and for such internal controls as directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors’ Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we considered the internal controls relevant to the bank’s preparation of financial statements that give a true and fair view in order to design audit procedures that were appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company’s internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of financial affairs of the Bank as at 30 June 2016 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

The engagement partner responsible for the audit resulting in this independent auditors’ report is
CPA Fred Aloo P/No 1537.

Certified Public Accountants (Kenya)
Nairobi, Kenya
________ September, 2016

REPORT AND FINANCIAL PERFORMANCE

Consolidated Statement of Profit or Loss and other Comprehensive Income

	Notes	Year ended 30 June 2016	2015
		Shs' million	Shs' million
Interest income	4	15,933	6,230
Interest expense	5	(3,957)	(1,977)
Net interest income		**11,976**	**4,253**
Impairment of loans and advances	15	(59)	(8)
Net interest income		11,917	4,245
Fees and commission income		3,000	3,000
Net trading income	6	6,446	8,198
Other income	7	536	686
Operating income		**21,899**	**16,129**
Operating expenses	8	(8,091)	(8,762)
Operating surplus before unrealised (losses)/ gains		**13,808**	**7,367**
Unrealised (losses) /gains:			
Foreign exchange (loss) /gain		(19,969)	40,740
Fair value gain on financial assets held for trading		347	24
(Deficit)/ surplus for the year		**(5,814)**	**48,131**
Other comprehensive income			
Actuarial gain/ (loss) in retirement benefit asset	17	1,174	(4,343)
Land and buildings revaluation gain	18	-	5,937)
Total comprehensive (loss)/ income for the year		**(4,640)**	**49,725**

The notes on pages 15 to 51 are an integral part of these financial statements.

REPORT AND FINANCIAL PERFORMANCE

Consolidated Statement of Financial Position

	Notes	2016 Shs' million	2015 Shs' million
Assets			
Balances due from banking institutions	10	696,004	591,962
Funds held with International Monetary Fund (IMF)	13(a)	1,923	4,385
Securities discounted by banks and other advances	14	44,679	75
Loans and advances	15	2,566	2,333
Financial assets at fair value through profit or loss	11	133,253	113,006
Investments securities – Available-for-sale	12	9	9
Other assets	16	4,285	4,531
Property and equipment	18	22,385	20,743
Intangible assets	19	207	494
Retirement benefit asset	17	7,776	4,668
Due from Government of Kenya	20	69,762	63,163
Total assets		**982,849**	**805,369**
Liabilities			
Currency in circulation	21	234,751	222,178
Deposits from banks and government	22	496,044	331,316
Due to International Monetary Fund (IMF)	13(b)	122,438	125,775
Liquidity deposits	23	7,843	-
Other liabilities	24	4,780	4,467
Total liabilities		**865,856**	**683,736**
Equity and reserves			
Share capital	25	5,000	5,000
General reserve fund		97,203	101,843
Revaluation reserve		14,790	14,790
Total equity		**116,993**	**121,633**
Total equity and liabilities		**982,849**	**805,369**

The financial statements on pages 127 to 153 were autholised for issue by the Board of Directors on 9th September 2016 and signed on its behalf by.

Mr. Mohammed Nyaoga
Chairman, of the Board

Patrick Njoroge

Dr. Patrick Njoroge
Governor, Central Bank of Kenya

REPORT AND FINANCIAL PERFORMANCE

Consolidated Statement of Changes in Equity

	Notes	Share Capital Shs' million	General Reserve Fund Shs' million	Revaluation reserve Shs' million	Total Shs' million
Year ended 30 June 2015					
Balance at 1 July 2014 as previously reported		5,000	56,539	8,853	70,392
Restatement on change in accounting policy for coin minting costs	16	-	1,516	-	1,516
As restated on 1 July 2014		5,000	58,055	8,853	71,908
Surplus for the year		-	48,131	-	46,779
Land and buildings revaluation gain	18	-	-	5,937	5,937
Actuarial losses in retirement benefit asset	17	-	(4,343)	-	(4,343)
Total comprehensive income for the year		-	43,788	5,937	49,725
Balance at 30 June 2015		5,000	101,843	14,790	121,633

Note:

- *The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.*
- *The share capital and proposed dividend reserve have been described in note 2 (n) and 2 (o) respectively.*

The notes on pages 15 to 51 are an integral part of these financial statements.

Consolidated Statement of Changes in Equity (continued)

	Notes	Share Capital Shs' million	General Reserve Fund Shs' million	Revaluation reserve Shs' million	Total Shs' million
Year ended 30 June 2016					
Balance at 1 July 2015		5,000	101,843	14,790	121,633
Deficit for the year		-	(5,814)	-	(5,814)
Actuarial gains in retirement benefit asset	17	-	1,174	-	1,174
Total comprehensive loss for the year		-	(4,640)	-	(4,640)
Balance at 30 June 2016		5,000	97,203	14,790	116,993

Note:

- *The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.*
- *The share capital and proposed dividend reserve have been described in note 2 (n) and 2 (o) respectively.*

The notes on pages 15 to 51 are an integral part of these financial statements.

Consolidated Statement of Cash flows

	Notes	2016 Shs’ million	2015 Shs’ million
		Year ended 30 June	
Net cash generated from/ (used in) operating activities	26	172,352	(44,802)
Cash flows from investing activities			
Purchase of property and equipment	18	(2,592)	(1,726)
Purchase of intangible assets	19	-	(98)
Proceeds from disposal of property and equipment		8	17
Net (purchase) / sale of financial assets			
- Fair value through profit or loss		(9,309)	(38,352)
- Held to maturity		69,906	(361,154)
- Available-for-sale		-	(3)
-Advances to the Bank		(2,762)	
- Funds held with International Monetary Fund (IMF)		2,462	(3,693)
Net cash generated from/ (used in) investing activities		57,713	(405,009)
Cash flows from financing activities			
Repayments to the International Monetary Fund (IMF)		(3,337)	(4,289)
Net cash used in financing activities		(3,337)	(4,289)
Increase/ (decrease) in cash and cash equivalents		226,728	(454,100)
Cash and cash equivalents at start of year		194,865	648,965
Cash and cash equivalents at end of year	27	421,593	194,865

The notes on pages 15 to 51 are an integral part of these financial statements.

1 General information

Central Bank of

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS). The measurement basis applied is the historical cost basis, except where otherwise stated in the accounting policies below. The financial statements are presented in Kenya Shillings (Shs), rounded to the nearest million.

Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

Amendments to IAS 19 Defined Benefit Plans: Employee Contribution clarify the accounting treatment for contributions from employees or third parties to a defined benefit plan. According to the amendments, discretionary contributions made by employees or third parties reduce service cost upon payment of these contributions to the plan. When the formal terms of the plan specify contributions from employees or third parties, the accounting depends on whether the contributions are linked to service. The amendment did not have a significant effect on the Bank financial statements.

Annual Improvements to IFRSs 2010 - 2012 Cycle which include amendments to a number of IFRSs:

- IFRS 3 Business Combinations, that clarifies that contingent consideration should be measured at fair value at each reporting date, irrespective of whether or not the contingent consideration falls within the scope of IFRS 9 or IAS 39. Changes in fair value (other than measurement period adjustments as defined in IFRS 3) should be recognised in profit and loss.
- IFRS 8 Operating Segments,that requires an entity to disclose the judgements made by management in applying the aggregation criteria to operating segments, including a brief description of the operating segments aggregated and the economic indicators assessed in determining whether the operating segments share similar economic characteristics.
- IFRS 13 Fair Value Measurement. The amendment to the basis for conclusions of IFRS 13 clarifies that the issuance of IFRS 13 and consequential amendments to IAS 39 and IFRS 9 did not remove the ability to measure short- term receivables and payables with no stated interest rate at their invoice amounts without discounting.
- IAS 24 Related Party Disclosures. The amendment clarifies that a management entity providing key management personnel services to the reporting entity or to the parent of the reporting entity is a related party of the reporting entity.

The Bank has applied the amendments and there has been no significant impact on the Bank financial statements as a result.

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

Changes in accounting policy and disclosures (continued)

(i) New and amended standards adopted by the Bank (continued)

Annual Improvements to IFRSs 2011 - 2013 Cycle which include amendments to a number of IFRSs:

-IFRS 13 Fair Value Measurement. The amendment clarifies that the scope of the portfolio exception for measuring the fair value of a Bank of financial assets and financial liabilities on a net basis includes all contracts that are within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, even if those contracts do not meet the definitions of financial assets or financial liabilities.

The application of other amendments and interpretations which are effective for the financial year beginning on 1 July 2015 had no impact on the disclosures or amounts recognised in the financial statements.

(ii) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 July 2016, and have not been applied in preparing these financial statement. None of these is expected to have a significant effect on the financial statements of the Bank, except the following set out below:

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2015. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Bank is yet to assess IFRS 9's full impact.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2017 and earlier application is permitted. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

Changes in accounting policy and disclosures (continued)

Amendments to IAS 1 Disclosure Initiative. The amendments were a response to comments that there were difficulties in applying the concept of materiality in practice as the wording of some of the requirements in IAS 1 had in some cases been read to prevent the use of judgement. An entity should not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions. The amendments to IAS 1 are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted. Application of the amendments need not be disclosed.

IFRS 16 Leases specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance and lessor accounting remain substantially unchanged from its predecessor, IAS 17. IFRS 16 was issued in January 2016 and applies to annual reporting periods beginning on or after 1 January 2019

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Bank.

(b) Accounting for currency costs

The cost of unissued bank note stocks is recognised in the statement of financial position as deferred currency costs under 'other assets'. Bank note costs are charged to profit or loss in the year in which the bank notes are issued.

Coin minting costs are charged to profit or loss when issued to the public. Also, the cost of new currency coins not yet issued is recognised as inventory within 'other assets' consistent with the accounting for the cost of unissued bank note stocks.

(c) Consolidation

Kenya School of Monetary Studies is a subsidiary of the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

The group uses the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

The excess of the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Bank's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between group entities are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

2 Summary of significant accounting policies (continued)

(d) Functional currency and translation of foreign currencies

i. Functional and presentation currency

Items included in the financial are measured using the currency of the primary economic environment in which the Bank operates (the "Functional Currency"). The financial statements are presented in Kenya Shillings ("Shs") which is the Bank's Functional Currency.

ii. Transactions and balances

Foreign currency transactions are translated into the Functional Currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/(losses)'.

(e) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in investments by banks.

Securities purchased under agreements to resell ('reverse repos') are recorded as advances to banks. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

The Bank from time to time mops up money from the financial market ('repos') or injects money into the market ('reverse repos') with maturities of 4 - 7 days. The Bank engages in these transactions with commercial banks only. These have been disclosed in the financial statements as 'advances to banks' and 'liquidity deposits'.

(f) Financial assets and liabilities

i. Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale financial assets. The directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

2 Summary of significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

i. Financial assets (continued)

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would
- otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consist of debt host and embedded derivatives that must be separated.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as Fair value loss on financial assets held for trading '. Interest income and expense and dividend income and expenses on financial assets held for trading are included in interest income' and 'interest expense' respectively.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method. The Bank operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The loans are granted to staff at an interest rate of 3% per annum which generally below the prevailing market interest rates. Loans issued at non market rates are initially be measured at fair value (by discounting the related cash flows using market rates of interest) and subsequently carried at amortised cost. The difference between the fair value of the loans and the carrying amount at inception is treated as a long term employee benefit and is accounted for as a deferred cost. The resulting loan adjustment account is released to interest income over the loan period in line with the unwinding of the discount, while the deferred cost is expensed to staff costs as the services are rendered to the Bank over the period of the loan.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period. Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value re-measurements are included in other comprehensive income.

ii. Financial liabilities

The Bank's holding in financial liabilities represents mainly deposits from banks and government and other liabilities. Such financial liabilities are initially recognised at fair value and subsequently measured at amortised cost.

Cash Reserve Ratio are statutory deposits taken from commercial banks and non-bank financial institutions for liquidity management as part of monetary policies in accordance with the Kenyan Banking Act and are interest free.

2 Summary of significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

iii. Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial instruments is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

iv. De-recognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

v. Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2016	2015
				Shs' million	Shs' million
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank Reserve Asset Management Programme (RAMP) financial assets	30,515	28,822
			Fixed income securities	102,662	84,118
		Designated at initial recognition	Gold holdings	75	66
	Loans and receivables	Securities discounted by banks and other advances to banks		44,679	75
		Funds with IMF		1,923	4,385
		Net advances to staff and banks under liquidation		2,566	2,333
		Due from Government	Government loan	25,559	26,669
			Overdraft facility to Government	44,203	36,494
		Balances due from banking institutions	Foreign denominated Term deposits	695,932	523,189
	Available-for-sale	Investment securities	SWIFT shares	9	9
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Cash reserve ratio and current account deposits	218,491	193,661
		Due to IMF		122,438	125,775
		Investment by Banks		7,843	-
		Deposits from Government institutions		277,481	136,780

vi. Impairment of financial assets

a. ***Loans and receivables***

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss on loans carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount, and for a collateralised loan, after taking into account any value of the security which has been realised.

2 Summary of significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

vi. Impairment of financial assets (continued)

b. **Available for sale financial assets**

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

If any such evidence exists for available-for-sale financial assets, impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

vii. **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(g) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

(h) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Bank is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Land and buildings are stated at valuation less accumulated depreciation. Valuations are carried out every three years.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is de-recognised. All other repair and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

Freehold land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Asset classification	Useful life	Depreciation rate
Leasehold land	Over the period of the lease	
Buildings	20 years	5%s
Motor vehicles	4 years	20%
Furniture and equipment	5 - 10 years	20-10%

No depreciation is charged on work in progress and assets held in clearing accounts. Depreciation of property and equipment is made from date of placement to use and it ceases when the asset is obsolete, classified as held for sale, fully depreciated or derecognized as per policy.

2 Summary of significant accounting policies (continued)

(i) Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

i. it is technically feasible to complete the software product so that it will be available for use;
ii. management intends to complete the software product and use or sell it;

- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and

iii. the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years. Computer software under installation and not yet place in use is held in software clearing account and not amortized until commissioned.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

(j) Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(k) Employee benefits

The Bank operates a defined benefit and defined contribution pension schemes. The schemes are funded through payments to trustee-administered funds on a monthly basis.

On the defined contribution scheme, the Bank pays fixed contributions to the scheme. The payments are charged to the profit or loss in the year to which they relate. The Bank has no further payment obligation once the contributions have been paid.

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on age, years of service and compensation.

2 Summary of significant accounting policies (continued)

(k) Employee benefits (continued)

The assets of the scheme are held by the Bank in an independent trustee administered fund. The asset recognised in the statement of financial position in respect of the defined benefit pension scheme is the fair value of the scheme's assets less the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of Kenya treasury bonds that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The Bank and all its employees contribute to the National Social Security Fund, which is a defined contribution scheme.

A defined contribution plan is a retirement benefit plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank's contributions to the defined contribution scheme are charged to the profit or loss account in the year in which they fall due.

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

(l) Income tax

Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

(m) Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation at a rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2 Summary of significant accounting policies (continued)

(n) Dividend payable

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

Dividends on ordinary shares are charged to equity in the period in which they are declared.

(o) Share capital

Ordinary shares are classified as 'share capital' in equity.

(p) Leases

Bank as lessee
The leases entered into by the Bank are primarily operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Bank as lessor
The group leases certain property, plant and equipment where it does not transfer substantially all the risks and benefits of ownership of the assets. The operating leases generate rental income which is recorded in the income statement on a straight-line basis over the period of the lease.

(q) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

(r) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided.

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

2 Summary of significant accounting policies (continued)

(s) Commitments on behalf of the Kenya Government and National Treasury

The Bank issues Treasury bills and bonds on behalf of the National Treasury. Commitments arising on such transactions on behalf of Kenya Government and the National Treasury are not included in these financial statements as the Bank is involved in such transactions only as agent.

(t) Currency in circulation

Notes and coins in circulation are measured at fair value. Currency in circulation represents the nominal value of all bank notes and coins held by the public and commercial banks.

(u) Deferred currency costs (Inventories)

The Bank's inventory is comprised of new currency not issued. Inventories are stated at the sum of the production costs. Cost is determined using the first-in, first-out (FIFO) method.

Bank notes printing expenses and coin minting costs for each denomination which include ordering, printing, minting, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the profit or loss from the deferred costs account. The deferred amount is recognised as prepayment and represents un-issued bank notes and coins stock.

(v) Loan due from the Government of Kenya

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act to limit the Bank's lending to Government of Kenya to 5% of Government of Kenya audited revenue.

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the Government agreed to repay the loan at Shs 1.11 billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

The loan due from the Government of Kenya is categorised as a loan and receivables and is measured at amortised cost.

2 Summary of significant accounting policies (continued)

(w) Funds held at/ due to International Monetary Fund (IMF)

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

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

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF’s depository. The security issued is in part payment of Kenya’s quota of IMF shares.

(x) Comparatives

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

3 Critical accounting estimates and judgements in applying accounting policies

(i) Critical estimates in applying the entity’s accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a. Post-retirement benefits

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 17 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

b. Loans and advances

Critical estimates are made by the management in determining the recoverable amount of impaired loans and receivables.

c. Fair value of financial assets

The fair value of financial instruments that are not traded in an active market and off market loans are determined by using valuation techniques.

d. Property and equipment

Land and buildings are carried at fair value; representing open market value determined periodically by internal professional valuers.

(ii) Critical judgements in applying the entity’s accounting policies

In the process of applying the Bank’s accounting policies, management has made judgements in determining:
- the classification of financial assets and leases
- whether assets are impaired.

4 Interest income

	2016 Shs' million	2015 Shs' million
Financial assets - held to maturity	4,065	1,878
Loans and advances	10,858	3,860
Financial assets at fair value through profit or loss	1,010	492
	15,933	6,230
Interest income from loans and advances comprises:		
Due from Government of Kenya – loan	794	825
Due from Government of Kenya - overdraft	4,077	2,240
Staff loans and advances	195	260
Securities discounted by banks and other advances	5,393	204
Local commercial banks overnight loans	61	65
Other interest income	338	266
	10,858	3,860

5 Interest expense

	2016 Shs' million	2015 Shs' million
Interest on monetary policy issues – investments by banks	3,819	1,894
Interest paid to IMF	138	83
	3,957	1,977

6 Net trading income

	2016 Shs' million	2015 Shs' million
Net gain on sale of foreign exchange currencies	6,496	8,169
Net (loss)/gain on held for trading financial assets	(50)	29
	6,446	8,198

7 Other income

	2016 Shs' million	2015 Shs' million
Licence fees from commercial banks and foreign exchange bureaux	250	248
Penalties from commercial banks and foreign exchange bureaux	40	16
Rent income from Thomas De La Rue Kenya Limited	2	2
Kenya School of Monetary Studies operating income - hospitality services and tuition fee	217	372
Gain on disposal of property and equipment	4	17
Miscellaneous income	23	31
	536	686

8 Operating expenses

	2016 Shs' million	2015 Shs' million
Employee benefits (Note 9)	2,122	3,059
Currency production expenses	1,880	1,965
Property maintenance and utility expenses	834	1,203
Depreciation (Note 18)	946	733
Amortisation (Note 19)	287	243
Provision for impairment loss on other assets (Note 16)	13	23
Auditor's remuneration	10	6
Transport and travelling	176	189
Office expenses	245	195
Postal service expense	120	126
Legal and professional fees	48	83
Other administrative expenses including KSMS	1,410	937
	8,091	8,762

9 Employee benefits

	2016 Shs' million	2015 Shs' million
Wages and salaries	3,390	3,614
Medical expenses	330	200
Other staff costs	210	424
Directors' emoluments (Note 27)	27	62
Net income relating to the retirement benefit asset (Note 17)	(1,835)	(1,241)
		33
	2,122	3,059

10 Balances due from banking institutions

	2016 Shs' million	2015 Shs' million
Current accounts	69,108	31,118
Foreign denominated term deposits	266,363	125,542
Accrued interest on term deposits	1,060	475
Special project accounts	16,693	25,778
Domestic foreign currency cheque clearing	15,413	11,704
Repos clearing and regional central banks	101	173
Cash in cash and cash equivalents (note 26)	368,738	194,790
Foreign denominated term deposits	327,266	397,172
	696,004	591,962

10 Balances due from banking institutions (Continued)

Special project accounts relate to amounts received by the Government of Kenya (or its ministries) for specific projects or purposes. An equal and corresponding liability is recorded and disclosed under "Deposits from banks and government (note 22)". The movement in the year is mainly attributable to the proceeds from sponsors of various government projects. This has corresponding transaction leg on the growth of foreign reserves during the year.

11 Financial assets at fair value through profit or loss

	2016 Shs' million	2015 Shs' million
a. Designated at initial recognition		
Gold holdings	75	66

Movements in gold holdings are due to mark to market movements.

b. Held for trading		
Fixed income securities	102,663	84,118
Fixed income securities under World Bank RAMP	30,515	28,822
	133,178	112,940
	133,253	113,006

12 Investments securities – Available-for-sale

	2016 Shs' million	2015 Shs' million
Unlisted equity securities	9	9
At start of year	9	6
Additions	-	3
At end of year	9	9

"Unlisted equity securities" relate to the Bank's investment in shares of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) which member is owned co-operative with its headquarters in Belgium. The Bank held 24 (2015: 24) SWIFT shares at 30 June 2016.

13 Funds held at/ due to International Monetary Fund (IMF)

	2016 SDR million	2016 Shs’ million	2015 SDR million	2015 Shs’ million
(a) Assets				
IMF balances (SDR asset account)	14	1,923	32	4,385
(b) Liabilities				
International Monetary Fund Account No. 1	20	2,837	19	2,631
International Monetary Fund Account No. 2		-	-	2
International Monetary Fund – PRGF Account	588	82,995	631	87,236
IMF - SDR Allocation account	260	36,606	260	35,906
	868	122,438	910	125,775

The National Treasury is the Government of Kenya’s Fiscal Agent. Commitments arising on transactions between IMF, Kenya Government and the National Treasury are not included in these financial statements as the Bank is not the Government’s fiscal agent.

Kenya’s quota in IMF of SDR 271.4 million (2014: SDR 271.4 million) are not included in the financial statements of the Bank as these are booked in the National Treasury with the Government of Kenya’s Fiscal Agent and allocations of SDR 258.3 million (2015: 258.3 million) are included in the financial statements of the Bank as custodian.

14 Securities discounted by banks and other advances

	2016 Shs’ million	2015 Shs’ million
Treasury bonds discounted	2,629	38
Treasury bills discounted	6,751	36
Accrued interest Bonds Discounted	96	1
Repo Treasury Bills(Injection)	28,592	-
Accrued interest Repo	114	-
Liquidity Support framework	6,497	-
	44,679	75

Securities discounted by banks and other advances

As at 30 June 2016

	Maturity period			
	1-3 months Shs’ million	3-12 months Shs’ million	Over 1 year Shs’ million	Total Shs’ million
Treasury bonds discounted	-	1,467	1,162	2,629
Treasury bills discounted	6,714	37	-	6,751
Accrued interest Bonds Discounted	-	96	-	96
Repo Treasury Bills(Injection)	28,592	-	-	28,592
Accrued interest Repo	114	-	-	114
Liquidity Support Framework	6,497	-	-	6,497
	41,917	**1,600**	**1,162**	**44,679**

14 Securities discounted by banks and other advances (continued)

At 30 June 2015	1-3 months Shs' million	3-12 months Shs' million	Over 1 year Shs' million	Total Shs' million
Treasury bonds discounted	38	-	-	38
Treasury bills discounted	36	-	-	36
Accrued interest Bonds	1	-	-	1
	75	-	-	**75**

Financial sector reforms implemented during the year under review have since stabilized the industry which is now on a sound footing.

15 Loans and advances

	2016 Shs' million	2015 Shs' million
Due from banks under liquidation	3,656	3,656
Advances to employees	2,657	2,365
	6,314	6,021
Allowance for impairment	(3,747)	(3,688)
Net advances	2,566	2,333
Movement in the loan impairment allowance is as follows:		
At start of year	3,688	3,680
Increase in impairment allowance	59	8
At end of year	3,747	3,688

16 Other assets

	2016 Shs' million	2015 Shs' million
Prepayments	889	526
Deferred currency cost	2,078	3,704
Sundry debtors	5,837	5,102
Items in the course of collection	297	82
Un cleared effects	80	-
	9,181	9,414
Provision for impairment	(4,896)	(4,883)
	4,285	4,531

16 Other assets (continued)

All other assets balances are recoverable within one year.

Movement in the impairment allowance is as follows:

	2016 Shs' million	2015 Shs' million
At start of year	4,883	4,860
Increase in impairment allowance	13	23
At end of year	4,896	4,883

17 Retirement benefit asset

	2016 Shs' million	2015 Shs' million
Present value of funded obligations	17,623	17,820
Fair value of plan assets	(27,161)	(27,156)
Net underfunding in funded plan	(9,538)	(9,336)
Limit arising from asset ceiling	1,762	4,668
Asset in the statement of financial position	(7,776)	(4,668)

Movements in the net defined benefit asset recognised are as follows:

	2016	2015
At start of year	4,668	7,659
Net income recognised in the income statement	1,835	1,241
Net income/(expense) recognized in other comprehensive income (OCI)	1,174	(4,343)
Employer contributions	99	111
At end of year	7,776	4,668

Movements in the plan assets are as follows:

	2016	2015
At start of year	27,156	24,665
Expected return on scheme assets	3,646	3,205
Actuarial loss	(3,517)	(539)
Employer contributions	99	111
Employee contributions	48	56
Benefits expenses paid	(1,119)	(942)
Adjustment for previous year values	848	600
At end of year	27,161	27,156

17 Retirement benefit asset (continued)

Movements in the plan benefit obligation are as follows:	2016 Shs’ million	2015 Shs’ million
At start of year	17,820	17,006
Current service cost net of employees’ contributions	347	404
Interest cost	2,313	2,160
Employee contributions	49	55
Actuarial loss	(1,787)	(863)
Benefits paid	(1,119)	(942)
At end of year	**17,623**	**17,820**

The principal actuarial assumptions at the reporting date were:	**2016**	**2015**
Discount rate (p.a.)	13.3%	12.90%
Salary increase (p.a.)	11.3%	10.90%
Expected return on plan assets (p.a.)	12.9%	12.90%
Future pension increases	3.0%	3.00%

Five year summary	2016 Shs’ million	2015 Shs’ million	2014 Shs’ million	2013 Shs’ million	2012 Shs’ million
Fair value of plan assets	27,161	27,156	24,665	21,173	17,103
Present value of funded obligations	(17,623)	(17,820)	(17,006)	(13,065)	(12,673)
Asset ceiling adjustment	(1,762)	(4,668)	-	-	-
Net retirement benefit asset	**7,776**	**4,668**	**7,659**	**8,108**	**4,430**

Plan assets are distributed as follows:

	2016 Shs’ million	2016 %	2015 Shs’ million	2015 %
Quoted shares	9,268	34%	10,770	40%
Investment properties	5,477	20%	4,137	15%
Government of Kenya treasury bills and bonds	9,672	36%	7,543	28%
Commercial paper and corporate bonds	1,760	6%	1,928	7%
Offshore investments	-		2,436	9%
Fixed and term deposits	603	2%	342	1%
Net current assets	381	1%	-	-
	27,161	100%	27,156	100%

18 Property and equipment

	Freehold land and Buildings Shs' million	Leasehold land and buildings Shs' million	Work in progress Shs' million	Motor vehicles Shs' million	Furniture and equipment Shs' million	Total Shs' million
Year ended 30 June 2015						
Opening net amount	5,390	1,737	4,481	141	2,064	13,813
Additions	-	-	1,437	40	249	1,726
Revaluation gain	4,513	397	-	-	-	4,910
Disposals	-	-	-	(34)	-	(34)
Charge for the year	(300)	(32)	-	(93)	(308)	(733)
Reversal of charge on disposals	-	-	-	34		34
Adjustment to revaluation reserve	926	101	-	-	-	1,027
At end of year	10,529	2,203	5,918	88	2,005	20,743
At 30 June 2015						
Cost	10,529	2,203	5,918	370	4,221	23,241
Accumulated depreciation	-	-	-	(282)	(2,216)	(2,498)
Net book amount	10,529	2,203	5,918	88	2,005	20,743
Year ended 30 June 2016						
Opening net amount	10,529	2,203	5,918	88	2,005	20,743
Additions	1,962	-	413	25	192	2,592
Disposals	-	-	-	(3)	(1)	(4)
Charge for the year	(421)	(46)	-	(53)	(426)	(946)
At end of year	12,070	2,157	6,331	57	1,770	22,385
At 30 June 2016						
Cost	12,491	2,203	6,331	388	4,435	25,848
Accumulated depreciation	(421)	(46)	-	(331)	(2,665)	(3,463)
Net book amount	12,070	2,157	6,331	57	1,770	22,385

Land and buildings were revalued by internal professional valuers in 2015 on an open market basis and the revaluation has been included in the revaluation reserve. Land and buildings are included in the level 2 of the fair valuation hierarchy (that is, the fair value is based on inputs other than quoted prices that are observable).

18 Property and equipment (continued)

The methods and significant assumptions applied in arriving at the revalued amounts are as follows:

- The Bank’s residential properties are all owner-occupied for purposes of carrying out its mandate. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property is comparable to going rentals for similar properties within the same location.
- The Bank has taken into account comparable values of similar properties (plot, construction standards, design, lay out, size, location, current sale prices of vacant plots and those developed) to derive the market prices. These were obtained from market transactions of comparable properties.

The Bank occupies all its properties and is in possession of all their title deeds.

19 Intangible assets

	Software Shs’ million	Work-in-Progress Shs’ million	Total Shs’ million
Year ended 30 June 2015			
Cost			
At start of year	1,618	9	1,627
Additions	98	-	98
Transfers	7	(7)	-
At end of year	1,723	2	1,725
Accumulated amortisation			
At start of year	988	-	988
Amortisation for the year	243	-	243
At end of year	1,231	-	1,231
Net carrying value	492	2	494
Year ended 30 June 2016			
Cost			
At start of year	1,723	2	1,725
Disposals	(4)	-	(4)
Transfers	2	(2)	-
At end of year	1,721	-	1,721
Accumulated amortisation			
At start of year	1,231	-	1,231
Eliminated on disposals	(4)	-	(4)
Amortisation for the year	287	-	287
At end of year	1,514	-	1,514
Net carrying value	207	-	207

Software relates to the computer systems the Bank uses in its operations.

20 Due from Government of Kenya

	2016 Shs' million	2015 Shs' million
Overdraft	44,203	36,494
Government loan	25,559	26,669
	69,762	63,163

The Government of Kenya overdraft account is used to fund the treasury bills and interest related accounts that overdraw as a result of shortfalls from primary issues in the market. Whenever the previously funded account receives funding as a result of proceeds from primary issues of call-ups, the overdraft account is refunded the previously owed amount.

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at the Bank at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit for the year ending 30 June 2016 is Shs 46,813 million (2015: Shs 39,123 million) based on the gross recurrent revenue for the year ended 30 June 2014 (which are the latest audited financial statements at the date of approval of these financial statements) was Shs 936,255 million and interest is charged at the Central Bank Rate currently at 10.5%.

The Bank has issued a loan to the Government of Kenya. Principal repayments of Shs 555 million plus interest accruing are paid half yearly. The movement in the balance in the current year includes the year repayment of principal of Shs 1,110 million which was received by 30 June, 2016.

21 Currency in circulation

	2016 Shs' million	2015 Shs' million
Kenya bank notes	227,192	
Kenya coins	7,559	6,988
	234,751	222,178
Movement in the account was as follows:		
At start of year	222,178	199,966
Deposits by banks	(513,086)	(489,768)
Withdrawals by banks	525,568	512,011
Net Withdrawals in bank	91	(31)
At end of year	234,751	222,178

22 Deposits from banks and government

	2016 Shs' million	2015 Shs' million
Local commercial banks clearing accounts and cash ratio reserve	179,835	176,520
Local banks foreign exchange settlement accounts	14,133	17,054
External banks foreign exchange settlement accounts	36	37
Other public entities and Special project accounts	24,559	32,185
Government of Kenya	277,481	105,520
	496,044	331,316

22 Deposits from banks and government (continued)

Special project accounts relate to amounts received by the Government of Kenya (GoK) or its ministries, for specific projects or purposes. An equal and corresponding asset is recorded and disclosed under "Balances due from banking institutions (note 10)". The increase was mainly in Government of Kenya account and commercial banks deposits. The GoK partially received a syndicated loan of USD343M equivalent to Kes.35B in October 2015 and USD385M equivalent to Kes.39.3B in December 2015 from SCB (London). The movement is further attributed to the utilization of the overdraft facility by the Government of Kenya amounting to Kes.44bn in the year under review.

23 Liquidity deposits

	2016 Shs' million	2015 Shs' million
Liquidity deposits	7,843	-
	7,843	-

Liquidity deposits relates to amounts arising from mopping up of excess liquidity in the market. This is managed through selling of repurchase agreements ('repos') to commercial banks.

24 Other liabilities

	2016 Shs' million	2015 Shs' million
Impersonal accounts	1,399	3,496
Sundry creditors	2,402	409
Bonds pending payables	-	109
Refundable deposits	797	283
Leave accrual	126	122
Gratuity to staff members	56	48
	4,780	**4,467**

Impersonal accounts are accounts to which the Bank posts amounts from the National Treasury temporarily pending allocation to a Government of Kenya ministry.

25 Share capital

	Authorised share capital Shs' million	Authorised share capital Shs' million
Balance at 1 July 2014, 30 June 2015 and 30 June 2016	**5,000**	**5,000**

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

26 Cash generated from operations

	2016 Shs' million	2015 Shs' million
Reconciliation of net (deficit)/ surplus to cash flows from operations:		
(Deficit) /surplus for the year	(5,814)	48,131
Adjustments for:		
Depreciation (Note 18)	946	733
Amortisation (Note 19)	287	243
Gain on disposal of property and equipment (Note 7)	(4)	(17)
Net credit relating to the retirement benefit asset (Note 17)	(1,835)	(1,241)
Employer contributions on defined benefits scheme	(99)	(111)
Changes in working capital:		
Loans and advances	(233)	321
Other assets	246	351
Due from Government of Kenya	(6,599)	2,975
Currency in circulation	12,573	22,212
Deposits	164,728	(117,484)
Other liabilities	313	(915)
Liquidity deposits	7,843	-
Net cash generated from/(used in) operations	**172,352**	**(44,802)**

27 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include:

	2016 Shs' million	2015 Shs' million
Balances due from banking institutions (Note 10)	368,738	194,790
Financial assets - FVPL	10,938	-
Securities discounted by banks and other advances (Note 14)	41,917	75
	421,593	**194,865**

28 Related party transactions

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya (the ultimate owner of the Bank) and the Kenya Deposit Insurance Corporation (formerly, the Deposit Protection Fund Board - a corporation established by law as a deposit insurance scheme to provide cover for depositors and act as a liquidator of failed member institutions. It is managed by a Board comprising the Governor of the Central Bank of Kenya).

The main transactions include ordinary banking facilities to Government ministries included in Note 22 and lending to the Government of Kenya included in Note 20.

(i) Loans

The Bank extends loan facilities to the Governor and the Deputy Governors and other key management personnel. The advances are at rates of interest determined by the Bank.

28 Related party transactions (continued)

	2016	2015
Loans to executive director	**Shs' million**	**Shs' million**
At start of the year	-	8
Loan repayments	-	(8)
At end of the year	-	-
Loans to key management personnel		
At start of the year	60	71
Loans advanced during the year	8	12
Loan repayments	(16)	(23)
At end of the year	52	60
(ii) Directors' emoluments:		
Fees to non-executive directors	6	20
Other remuneration to executive directors	21	20
Gratuity for the Governor, who retired in the year	-	22
	27	**62**
(iii) Remuneration to senior management	**181**	**171**
(iv) Post–employment pension to senior management	**12**	**10**

(v) Government of Kenya

	2016	2015
	Shs' million	**Shs' million**
Due from Government of Kenya (Note 20)	69,762	63,163
Government of Kenya Deposits (Note 22)	277,481	105,520
Interest earned from Government of Kenya –Loan(Note 4)	794	825
Interest earned from Government of Kenya- Overdraft (Note 4)	4,077	2,240
Loans principal repayment	1,110	1,110

Transactions entered into with the Government include:

i. Banking services;

ii. Management of issue and redemption of securities at a commission, and;

iii. Settlement of Foreign currency denominated debt and other remittances, at a fee.

28 Related party transactions (continued)

(vi) Kenya Deposit Insurance Corporation (KDIC)

The Bank has a close working relationship with the KDIC (formerly the Deposit Protection Fund Board), an entity incorporated under the Kenya Deposit Insurance Act 2012. The Bank provides KDIC with staff incurs certain costs on its behalf. All such costs are fully reimbursed to the Bank.

The balance outstanding from the KDIC and included in other assets as at year end was Shs 2.4 million (2015: Shs 2.6 million).

The deposits relating to KDIC and included in deposits from banks and Government as at year end was Shs 143 million (2015: Shs 153 million).

The staff of the Corporation are contractually employees of the Central Bank but seconded to the Corporation. Salaries of these staff are met by the Central Bank and fully reimbursed by the Corporation. In the year, salaries paid to the staff of the Corporation by the Central Bank amounted to KShs 170,747 million (2015 - KShs 168.5 million).

(vii) Kenya School of Monetary Studies (KSMS)

The Kenya School of Monetary Studies (the "School") is a registered legal entity which is 99 % owned by the Bank and 1% by the National Treasury. The accounts of KSMS have been consolidated in these financial statements. The School is the strategic capacity building institution for the Bank and the financial sector.

The Bank's Board of directors also serves as part of the KSMS Board. The permanent staff working at the KSMS are employees of CBK. The fixed assets at the School are also wholly owned by the Bank and a letter of support is issued annually to the external auditor of the School as part of the commitment of the Bank for going concern purposes.

During the year under review, the School's physical developments projects continued as planned with significant percentage of completion recorded. The completed projects include the School's Library and Academic Block which are now in use while, the construction of the hostels and a new restaurant is on schedule and expected to be completed during the next financial year. These facilities are meant to modernize the School and enhance its accommodation capacity.

Key Highlights

	2016 Shs' million	2015 Shs' million
Grants from CBK	450	460
Buildings	3,223	1,261
Land	4,800	4,800
Deficit	47	7
Receivable from KSMS	58	58

(viii) Central Bank of Kenya Pension Fund and Banki Kuu Pension Scheme 2012

The pension schemes (that is, the Defined Benefit and Defined Contribution Schemes) are managed and administered by Secretariats appointed by the sponsor.

29 Financial risk management objectives and policies

The Group's activities expose it to a variety of financial risks, including credit risk and the effects of changes in debt and equity market prices, foreign currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance.

Risk management is carried out by the Finance department under policies approved by the Board of Directors. Other organs that monitor the assessment and management of risks within the Bank include: Board Audit Committee, Internal Audit Department and Risk Management Unit.

(a) Strategy in using financial instruments

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

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

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

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

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

(b) Risks facing the Bank

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

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

i. Credit risk

Credit risk arises from investment securities, balances due from banking institutions, funds held with IMF, loans and advances as well as other assets. The Bank has no significant concentrations of credit risk except for the lending to the Government of Kenya.

Management of the credit risk is through the choice of depository banks. The Bank's choice of depository banks is confined to top international banks that meet the set eligibility criteria of financial soundness on long-term credit rating (A), short-term credit rating (AA), composite rating and capital adequacy.

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

The amount that best represents the Group's maximum exposure to credit risk is per the statement of financial position.

The Bank does not grade the credit quality of these assets. None of the balances have had their terms renegotiated. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors. Provisions of Shs. 59 million (2015: Shs 64 million) have been recorded due to impaired balances to related parties.

The following amounts in loans and advances and other assets are neither past due nor impaired or individually impaired. All other financial instruments operate within their contractual terms.

	Neither past due nor impaired 2016 Shs' million	Individually impaired 2016 Shs' million	Neither past due nor impaired 2015 Shs' million	Individually impaired 2015 Shs' million
Balances due from banking Inst	696,004	-	591,962	-
Advances to banks	44,679	-	75	-
Investments securities – AFS	9	-	9	-
Funds held with (IMF)	1,923	-	4,385	-
Financial assets at FVPL	133,253	-	113,006	-
Due from Government of Kenya	69,762	-	63,163	-
Advances to employees	2,566	91	2,333	32
Due from banks under liquidation	-	3,656	-	3,656
Sundry debtors	4,285	4,896	4,531	4,883
	952,481	8,643	779,464	8,571
Allowance for impairment				
- other assets (Note 16)	-	(4,896)	-	(4,883)
- loans and advances (Note 15)	-	(3,747)	-	(3,688)
	-	**(8,643)**	**-**	**(8,571)**
	952,481	**-**	**779,464**	**-**

There were no past due but not impaired balances as at 30 June 2016 - (2015: Nil).

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

No.	List of Foreign Correspondent Banks - Current Accounts Balances	Type of Institution	Credit Ratings as of 30th June 2016		
			Fitch	S & P	Moody's
1	Reserve Bank of Australia	Central Bank	NR	NR	NR
2	Bank of Canada	Central Bank	NR	NR	NR
3	Schwerizerische National	Central Bank	NR	NR	NR
4	Bank of China	Commercial Bank	A	A	A1
5	Danmarks National Bank	Central Bank	NR	NR	NR
6	Commerz Bank AG	Commercial Bank	BBB	BBB+	Baa1
7	Bank of France	Central Bank	NR	NR	NR
8	Standard Chartered Bank, Germany	Commercial Bank	AA-	AA-	Aa3
9	Bank of England	Central Bank	NR	NR	NR
10	Bank of Japan	Central Bank	NR	NR	NR
11	Bank of Tokyo, Mitsubishi	Commercial Bank	A	A+	A1
12	Sverigs Riksbank	Central Bank	NR	NR	NR
13	Central Bank of Uganda	Central Bank	NR	NR	NR
14	J P Morgan Chase, New York	Commercial Bank	AA-	A+	Aa3
15	Citibank Na , New York	Commercial Bank	A	A+	A1
16	Federal Reserve , New York	Central Bank	NR	NR	NR
17	Bank of New York Mellon	Commercial Bank	AA-	A+	A1
18	South African Reserve Bank	Central Bank	NR	NR	NR

Note: Central Banks do not have a rating thus ***NR*** means ***No Rating***

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

No.	List of Active Depository Banks	Type of Institution	Credit Ratings as of 30th June 2016		
1	AUST AND NZ BANKING GROUP	Commercial Bank	AA-	AA-	Aa2
2	ABN AMRO BANK NV	Commercial Bank	A	A	A2
3	BANK OF NEW YORK MELLON CORP	Commercial Bank	AA-	A+	A1
4	BANK OF MONTREAL	Commercial Bank	AA-	A+	Aa3
5	BARCLAYS PLC	Commercial Bank	A	BBB	Baa3
6	BNP PARIBAS	Commercial Bank	A+	A+	A1
7	CAN IMPERIAL BK OF COMMERCE	Commercial Bank	AA-	A+	Aa3
8	COMMERZBANK AG	Commercial Bank	BBB	BBB+	Baa1
9	COMMONWEALTH BANK OF AUSTRAL	Commercial Bank	AA-	AA-	Aa2
10	RABOBANK	Commercial Bank	AA-	A+	Aa2
11	CREDIT AGRICOLE SA	Commercial Bank	A	A	A2
12	CREDIT SUISSE GROUP AG-REG	Commercial Bank	A	BBB+	Baa2
13	DANSKE BANK A/S	Commercial Bank	A	A	A2
14	DZ BANK AG DEUTSCHE ZENTRAL-	Commercial Bank	AA-	AA-	A1
15	ING BANK NV	Commercial Bank	A	A	A1
16	JPMORGAN CHASE & CO	Commercial Bank	A+	A	A3
17	LANDESBANK BADEN-WUERTTEMBER	Commercial Bank	A-	NR	A2
18	MIZUHO FINANCIAL GROUP INC	Commercial Bank	A-	A	NR
19	NATIONAL AUSTRALIA BANK LTD	Commercial Bank	AA-	AA-	Aa2
20	NORDEA BANK AB	Commercial Bank	AA-	AA-	Aa3
21	SKANDINAVISKA ENSKILDA BAN-A	Commercial Bank	A+	A+	Aa3
22	SOCIETE GENERALE SA	Commercial Bank	A	A	A2
23	STANDARD CHARTERED PLC	Commercial Bank	AA-	A-	Aa3
24	SVENSKA HANDELSBANKEN-A SHS	Commercial Bank	AA-	AA-	Aa2
25	SWEDBANK AB - A SHARES	Commercial Bank	A+	A+	Aa3

ii. Market risk

The Group takes on exposure to market risks, which is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios. Market risks arising from trading and non-trading activities are concentrated in Bank Treasury and are monitored by management with oversight from the Monetary Policy Committee.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with commercial banks or the market.

Non-trading portfolios primarily arise from the interest rate management of the Bank's investment andmonetary policy assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's held-to-maturity and World Bank RAMP financial assets.

Interest rate risk

The Bank's interest rate risk arises from interest bearing investments, loans and advances to commercial banks and investments by banks. Borrowings issued at variable rates expose the Bank to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the Bank to fair value interest rate risk.

The tables below summarise the Bank's financial assets and liabilities and analyses them into the earlier of contractual maturity or re-pricing.

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

At 30 June 2016	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institut ons	368,666	312,605	-	-	14,733	696,004
Securities discounted by banks and other advances	41,917	1,600	1,162	-	-	44,679
Financial assets at FVPL	10,938	31,862	90,378	-	75	133,253
Funds held with International Monetary Fund (IMF)	-	-	-	-	1,923	1,923
Investments securities – Available-for-sale	-	-	-	-	9	9
Loans and advances	111	342	1,109	1,004	-	2,566
Other assets	-	-	-	-	4,285	4,285
Due from Government of Kenya	-	45,303	4,440	20,019	-	69,762
Total financial assets	**421,632**	**391,712**	**97,089**	**21,023**	**21,025**	**952,481**
Liabilities						
Deposits from banks and government	-	-	-	-	496,044	496,044
Due to International Monetary Fund (IMF)	-	-	-	-	122,438	122,438
Other liabilities	-	-	-	-	4,780	4,780
Liquidity deposit	7,843	-	--	-	-	7,843
Total financial liabilities	**7,843**	**-**	**-**	**-**	**623,262**	**631,105**
Interest sensitivity gap	**413,789**	**391,712**	**97,089**	**21,023**	**(602,237)**	**321,376**

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

At 30 June 2015	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions	513,096	53,088	-	-	25,778	591,962
Securities discounted by banks and other advances	75	-	-	-	-	75
Financial assets at FVPL	-	84,164	-	28,776	66	113,006
Funds held with International Monetary Fund (IMF)					4,385	4,385
Investments securities – Available-for-sale	-	-	-	-	9	9
Loans and advances	22	84	656	1,571-	-	2,333
Other assets	-		-	-	4,531	4,531
Due from Government of Kenya	-	36,483	4,440	22,240	-	63,163
Total financial assets	**513,193**	**173,819**	**5,096**	**52,587**	**34,769**	**779,464**
Liabilities						
Deposits from banks and government	-	-	-	-	331,316	331,316
Due to International Monetary Fund (IMF)	-	-	-	-	125,775	125,775
Other liabilities	-	-	-	-	4,467	4,467
Total financial liabilities	**-**	**-**	**-**	**-**	**461,558**	**461,558**
Interest sensitivity gap	513,193	173,819	5,096	52,587	(426,789)	317,906

As at 30 June 2016, an increase/decrease of 10 basis points would have resulted in a decrease/increase in profit of Shs 92,361 million (2015: Shs 745 million).

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Monetary Policy Committee sets limits on the level of exposure by currency which is monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2015. Included in the table are the Bank's financial instruments categorised by currency:

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs ' million	Total Shs' million
At 30 June 2016						
Assets						
Balances due from banking institutions	372,302	162,392	-	-	161,310	696,004
Financial assets at fair value	133,253	-	-	-	-	133,253
Funds held with International Monetary Fund (IMF)	-	-	-	1,923	-	1,923
Total financial assets	**505,555**	**162,392**	**-**	**1,923**	**161,310**	**831,180**
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	122,438	-	122,438
Deposits from banks and government	35,573	1,652	1,451	-	84	38,760
Total financial liabilities	35,573	1,652	1,451	122,438	84	161,198
Net position	**469,982**	**160,740**	**(1,451)**	**(120,615)**	**161,226**	**669,982**

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign exchange risk

	USD Shs’ million	GBP Shs’ million	EUR Shs’ million	SDR Shs’ million	Others Shs ’ million	Total Shs’ million
At 30 June 2015						
Assets						
Balances due from banking institutions – Local	347,319	158,693	38,890	-	47,060	591,962
Financial assets at fair value	113,006	-	-	-	-	113,006
Funds held with International Monetary Fund (IMF)	-	-	-	4,385	-	4,385
Total financial assets	**460,325**	**158,693**	**38,890**	**4,385**	**47,060**	**709,353**
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	125,775	-	125,775
Deposits from banks and government	35,048	1,581	5,165	-	197	41,991
Total financial liabilities	**35,048**	**1,581**	**5,165**	**125,775**	**197**	**167,766**
Net position	**425,277**	**157,112**	**33,775**	**(121,390)**	**46,863**	**541,587**

As at 30 June 2016, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank’s profit would have been:

- USD Shs 23,499 million (2015: Shs 21,864 million)
- Euro Shs 8,037 million (2015: Shs 1,686 million)
- British Pound Shs 73 million (2015: Shs 7,856 million)
- SDR Shs 6,031 million (2015: Shs 6,070 million)

29 Financial risk management objectives and policies (continued)

iii. Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, Treasury maintains flexibility in funding by maintaining availability under committed credit lines.

Management monitors rolling forecasts of the Bank's liquidity reserve on the basis of expected cash flow.

The table below analyses the Bank's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	On demand	1 – 3 months	3-12 months	1 - 5 years	Over 5 years	Total
	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million
At 30 June 2016						
Currency in circulation	-	-	-	-	234,751	234,751
Deposits from banks and government	473,852	-	22,192	-	-	496,044
Due to International Monetary Fund (IMF)	-	-	-	-	122,438	122,438
Other liabilities	-	-	4,780	-	-	4,780
Repos sold to Banks	-	7,843	-	-	-	7,843
Total financial liabilities	**473,852**	**7,843**	**26,972**	**-**	**357,189**	**865,856**
At 30 June 2015						
Currency in circulation	-	-	-	-	222,178	222,178
Deposits from banks and government	314,284	-	17,104	-	-	331,388
Due to International Monetary Fund (IMF)	-	-	-	-	125,775	125,775
Other liabilities	-	-	4,467	-	-	4,467
Total financial liabilities	314,284	-	21,571	-	347,953	683,736

29 Financial risk management objectives and policies (continued)

Fair value of financial instruments

IFRS 7 specifies a fair value hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Bloomberg).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

	Level 1 Shs' million	Level 2 Shs' million	Level 3 Shs' million	Total Shs' million
At 30 June 2016:				
Financial assets at fair value	133,178	75	-	133,253
Investment securities – Available-for-sale	-	-	9	9
Total assets	133,178	75	9	133,262
As at 30 June 2015:				
Financial assets at fair value	112,940	66	-	113,006
Investment securities – Available-for-sale	-	-	9	9
Total assets	**112,940**	**66**	**9**	**113,015**

Changes in level 3 instrument are disclosed in Note 12 of the financial statements.

30 Contingent liabilities and commitments

The Bank is party to various legal proceedings. Based on legal advice, the directors believe that no loss will arise from these legal proceedings. Appropriate provisions have been made where a liability is considered probable.

At 30 June 2016, the Bank had capital commitments of Shs.2,059 (2015: Shs 2,921 million) in respect of property and equipment purchases

Operating lease commitments – Bank as lessee

	2016 Shs' million	2015 Shs' million
Not later than 1 year	151	166
Later than 1 year and not later than 5 years	176	325
	327	491

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50TH ANNIVERSARY
Central Bank of Kenya
1966 - 2016

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