BANKI KUU YA KENYA

Central Bank of Kenya

Twenty Third Bi-Annual Report of the Monetary Policy Committee

October 2019

LETTER OF TRANSMITTAL

In accordance with section 4D of the Central Bank of Kenya Act, it is my pleasure to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the 23rd Monetary Policy Committee Report. The Report outlines the monetary policy formulation, developments in the key indicators of the economy, and other activities of the Committee in the six months to October 2019.

Dr. Patrick Njoroge

Governor

CONTENTS

MEMBERS OF THE MONETARY POLICY COMMITTEE

Dr. Patrick Njoroge
Governor

Mrs. Sheila M'Mbijjewe
Deputy Governor

Dr. Margaret Chemengich
External Member

Dr. Julius Muia
PS, The National Treasury

Prof. Jane K. Mariara
External Member

Mr. William Nyagaka
Director, Financial Markets

Mr. Humphrey Muga
External Member

Dr. Benson Ateng'
External Member

Mr. Raphael O. Otieno
Acting Director, Research

EXECUTIVE SUMMARY

The twenty third bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments that affected the economy during the six months to October 2019. Consistent with the price stability objective of the Central Bank of Kenya (CBK), the conduct of monetary policy during the period was aimed at maintaining inflation within the Government's target range of 2.5 percent on either side of the 5 percent medium-term target.

The MPC held three bi-monthly meetings between May and October 2019 to review the outcome of its previous policy decisions and economic developments, and to put in place appropriate measures to maintain price stability. The MPC retained the Central Bank Rate (CBR) at 9.0 percent during the period as the monetary policy stance was appropriate to anchor inflation expectations. The monetary policy stance together with the CBK liquidity management ensured both price and market stability. The MPC continued to monitor the impact of interest rate capping on the effectiveness of monetary policy transmission. The MPC noted that the gradual demonetisation (withdrawal of the older KSh 1,000 notes) and the close monitoring by CBK ensured that the process was not disruptive to the economy.

Overall inflation remained well anchored within the target range during the period, supported by lower fuel prices, and muted demand pressures. The overall inflation declined to 4.9 percent in October 2019 from 6.6 percent in April 2019. Non-food-non-fuel inflation remained low and stable, indicating muted demand pressures in the economy. The CBK continued to monitor the overall liquidity in the economy as well as any threats to exchange rate stability which could fuel demand driven inflationary pressures.

Global financial markets remained volatile during the period, due to heightened uncertainties with regard to escalation of trade tensions between the US and China and delayed Brexit resolution. The foreign exchange market remained relatively stable, supported by a narrowing current account deficit to 5.2 percent of GDP in the 12 months to October 2019 from 6.0 percent in October 2018. This narrowing largely reflected strong receipts from transport services, resilient diaspora remittances and lower imports of food and SGR-related equipment. The CBK foreign exchange reserves, which stood at USD8,934 million (5.6 months of import cover) in October 2019, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient in the six months to October 2019. Average commercial banks' liquidity and capital adequacy ratios remained strong above the statutory requirements. The ratio of gross non-performing loans (NPLs) to gross loans declined to 12.3 percent in October from 12.9 percent in April, largely reflecting decreases in NPLs in the real estate, transport and communication, and building and construction sectors due to increased repayments and the enhanced recovery efforts by banks. The CBK also continued to implement measures aimed at strengthening the sector to ensure greater transparency and stronger governance, and to promote effective business models and innovation. Banks have adopted the Banking Sector Charter, which defines a commitment to entrench a responsible and disciplined banking sector which is cognizant of, and responsive to, the needs of their customers.

The MPC held meetings with stakeholders in the financial and real sectors after every Meeting, to provide a background to its decisions and obtain feedback. The Governor's post-MPC media briefings provided the basis of policy decisions, and updates on the economy. The meetings improved the understanding of the conduct of monetary policy.

The Bank continued to monitor and remained vigilant to the risks posed by developments in the domestic and global environments on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The global economic outlook growth weakened in the six months to October 2019, due to heightened trade tension, geopolitics and policy uncertainties. In October 2019, the IMF projected global to slow down to 3.0 percent in 2019 from 3.6 percent in 2018, and to improve modestly to 3.4 percent in 2020. The weakening global trade was a key factor expected to undermine global growth as the World trade volume was projected to decline to 1.1 percent in 2019 from 3.6 percent in 2018.

Growth in advanced economies was projected to decline to 1.7 percent in 2019 from 2.3 percent in 2018. The trade related uncertainties negatively affected investment and growth in the US, while Brexit-related uncertainty weakened growth in the United Kingdom and euro area. In emerging and developing economies, growth was projected to decrease to 3.9 percent from 4.5 percent, with the effects of trade tensions and weakening external demand dampening growth to varying extents across countries. Economic activity in sub-Saharan Africa (SSA) was expected to remain relatively stable at 3.2 percent in 2019, partly supported by oil exporting countries like Angola and Nigeria.

Central banks in major advanced economies continued to implement more accommodative monetary policy to support growth and financial stability. However, the risk of increased volatility in the global financial markets and downside risks to global activity intensified. The escalation of trade disputes among major economies and a further escalation of geopolitical tensions could lead to increase in trade barriers and may pose risks to global trade and increase the probability of a marked global downturn.

2. DEVELOPMENTS IN THE KENYAN ECONOMY

2.1 Overall economy

The domestic economic environment was characterized by macroeconomic stability during the six months to October 2019. The foreign exchange market remained stable, inflation was well anchored within the target range, there was modest recovery in private sector credit growth. However, uncertainties on the impact of the interest rates caps on monetary policy continued.

The economy remained strong in the first quarter of 2019, despite the effects of the delayed long rains on agricultural production. Real GDP grew by 5.6 percent compared to 6.5 percent in the first quarter of 2018, reflecting a stronger than expected performance of agriculture and a resilient services sector, particularly information and communication, accommodation and restaurants, and transport and storage. The agriculture sector recorded a growth of 5.3 percent compared to 7.5 percent in the first quarter of 2018, and contributed 1.4 percentage points to real GDP growth. The services sector grew by 6.3 percent compared to 6.9 percent in the first quarter of 2018, and contributed 2.9 percentage points to real GDP growth.

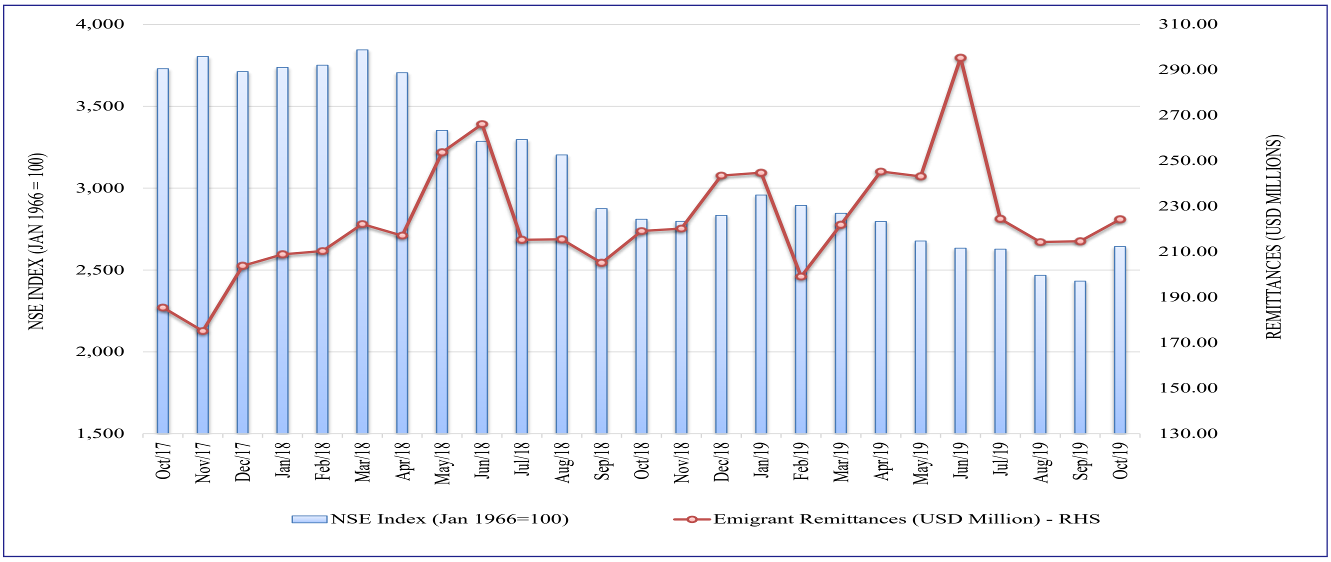
In the second quarter, the economy remained strong with growth of 5.6 percent compared to 6.4 percent in the second quarter of 2018, supported by resilient service sector. The services sector grew by 6.7 percent compared to 7.1 percent in the second quarter of 2018, reflecting strong performance in information and communication, accommodation and restaurant, transport and storage, finance and insurance, real estate and wholesale and retail trade. Overall, the economy grew by 5.6 percent in the first half of 2020 supported by the non-agriculture sector particularly services, while agricultural production slowed down following delayed onset and below average rainfall. The main upside risks to growth in the six months to October 2019 were good rains during the short rains season expected to boost agricultural production, ongoing reforms to improve the business environment and continued Government support of the ***Big 4*** agenda. However, the main downside risk to growth in the period was weakening global economy with increased global uncertainties and volatility in international markets due to protracted US and China trade tensions, delayed Brexit resolution and other geo-political tensions.

2.2 Financial Market Developments

The global financial markets experienced volatility during the period due to heightened uncertainties associated with escalation of trade tensions between the US and China and concern over delayed Brexit resolution. These developments impacted movements on asset and commodity prices, and a significant strengthening of the US dollar. Central banks in major advanced and emerging market economies implemented more accommodative monetary policy to support growth and financial stability.

In the domestic economy, the foreign exchange market remained relatively stable in the six months to October 2019, supported by balanced flows and a narrowing current account deficit to 5.2 percent of GDP from 6.0 percent in the 12 months to October 2018. The diaspora remittances remained resilient over the period **(Chart 1a)**. Like in other emerging market economies, activity at the Nairobi Securities Exchange (NSE) declined, partly reflecting increased uncertainties in global financial markets. The NSE 20-Share index declined from 2,796.8 points in April to 2,643.4 points in October.

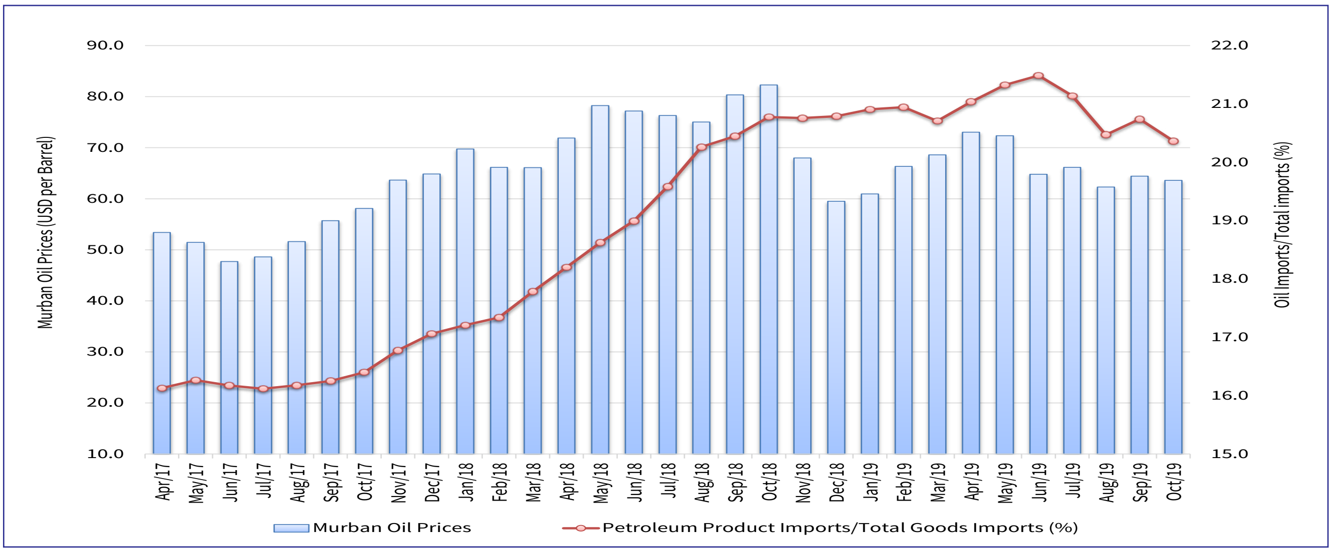
Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE Index (Jan 1966=100)



Source: Central Bank of Kenya and Nairobi Securities Exchange

Developments in international oil prices have implications on the balance of payments position, particularly when the proportion of imports of petroleum products in total imports is high. Murban crude oil prices fell steadily to USD 63.6 per barrel in October 2019 from USD 73.1 per barrel in April and USD 82.3 per barrel in October 2018, reflecting reduced demand as global growth slowed down. As a result, the proportion of imports of petroleum products in total imports of goods declined to 20.4 percent in October 2019 from 21.0 percent in April **(Chart 1b)**. These developments supported stability in the foreign exchange market.

Chart 1b: Murban Oil Prices and the ratio of 12-Month Cumulative Petroleum Product Imports to Total Imports of Goods (%)



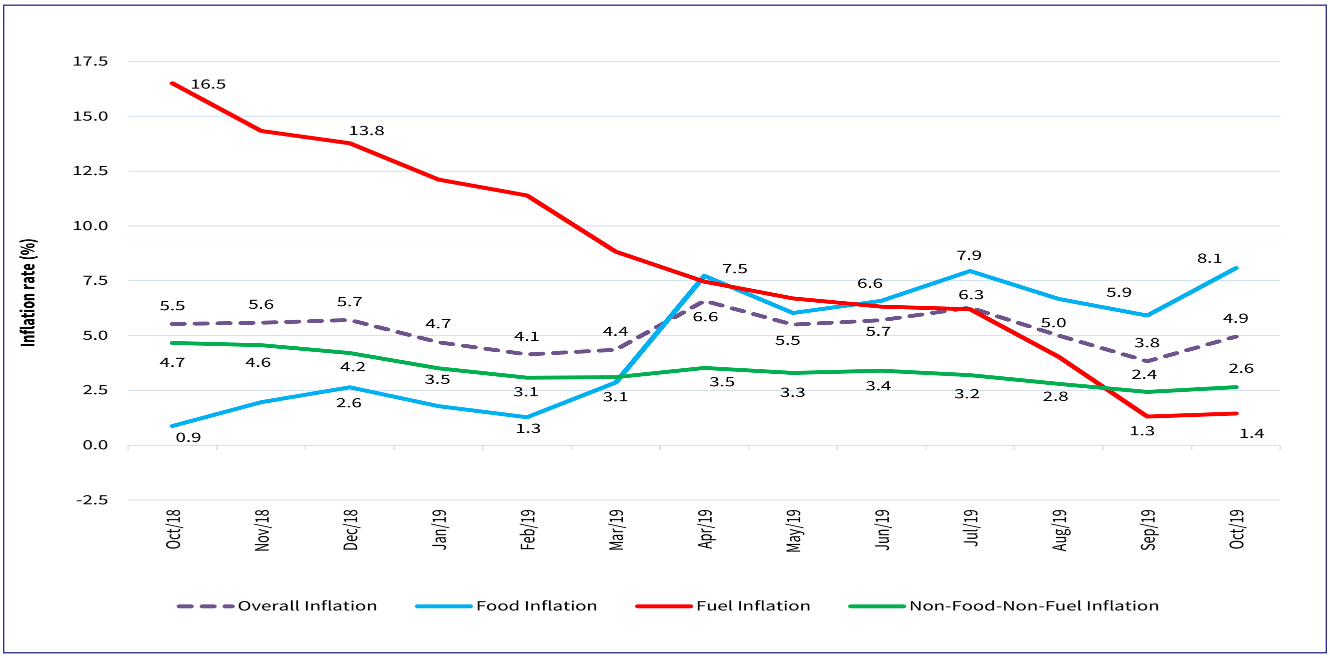
Source: Abu Dhabi National Oil Company and Kenya Revenue Authority

2.3 Developments in Key Economic Indicators

2.3.1 Inflation

The 12-month overall inflation remained well anchored within the target range during the six months to October 2019 **(Charts 2a)**. It declined to 4.9 percent in October 2019 from 6.6 percent in April 2019, largely supported by lower fuel prices, muted demand pressures and spillover effects of the excise tax indexation in July. Fuel inflation declined to 1.4 percent in October from 7.5 percent in April 2019, in line with trends of domestic and international energy prices. Food inflation moderately increased to 8.1 percent in October from 7.7 percent in April 2019, largely reflecting increases in the prices of maize products and tomatoes.

Chart 2a: Overall and Non-Food-Non-Fuel Inflation (%)

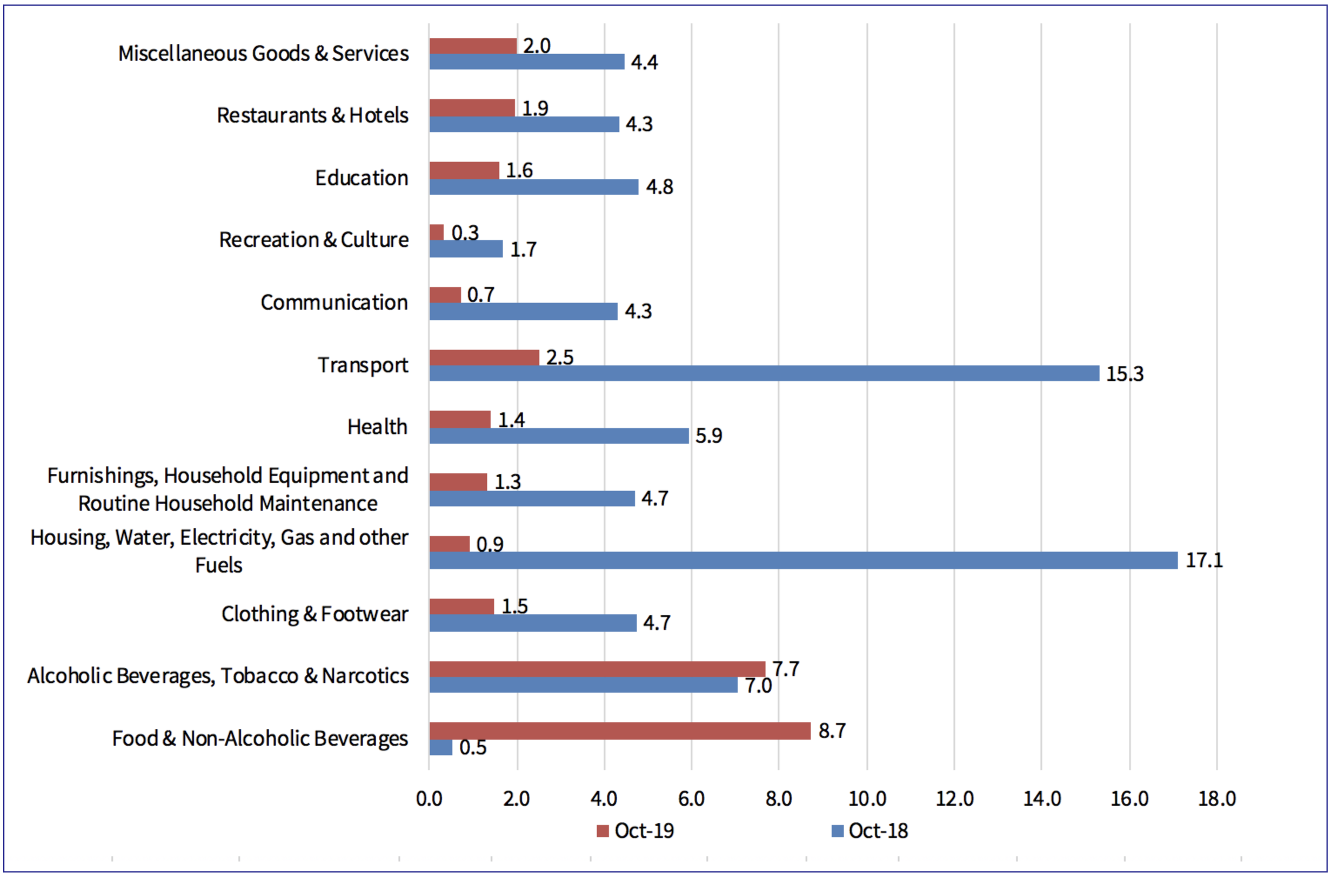


Source: Kenya National Bureau of Statistics and Central Bank of Kenya

Non-food-non-fuel inflation remained low and stable below 5 percent during the period, indicating that demand pressures in the economy were muted **(Charts 2a).** Overall, inflation of all broad categories in the CPI basket except housing, water, Electricity, gas and other fuels; transport; and food and beverages were within the target range in October 2019 **(Chart 2b)**.

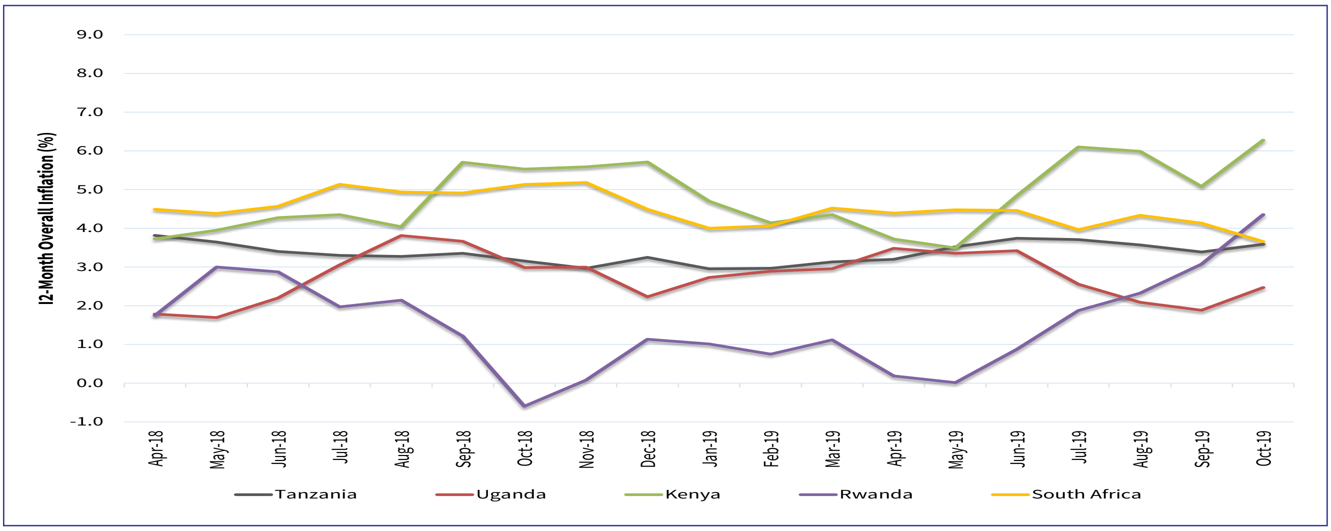
The trend in the overall inflation rates across the East African Community (EAC) countries, displayed similar patterns over the period **(Chart 2c)**.

Chart 2b: 12-Month Inflation by Broad CPI Category (%)



Source: Kenya National Bureau of Statistics

Chart 2c: 12-Month Inflation in the Region (%)



Source: Respective country central bank websites

2.3.2 Foreign Exchange Market Developments

The foreign exchange market remained relatively stable in the six months to October 2019, supported mainly by narrowing current account deficit. The current account deficit narrowed to 5.2 percent of GDP in the 12 months to October 2019 from 6.0 percent in October 2018, largely reflecting strong receipts from transport services, resilient diaspora remittances and lower imports of food and SGR-related equipment. Diaspora remittances averaged USD 236.0 million per month in the six months to October 2019 compared to USD 229.2 million per month in the six months to April 2019.

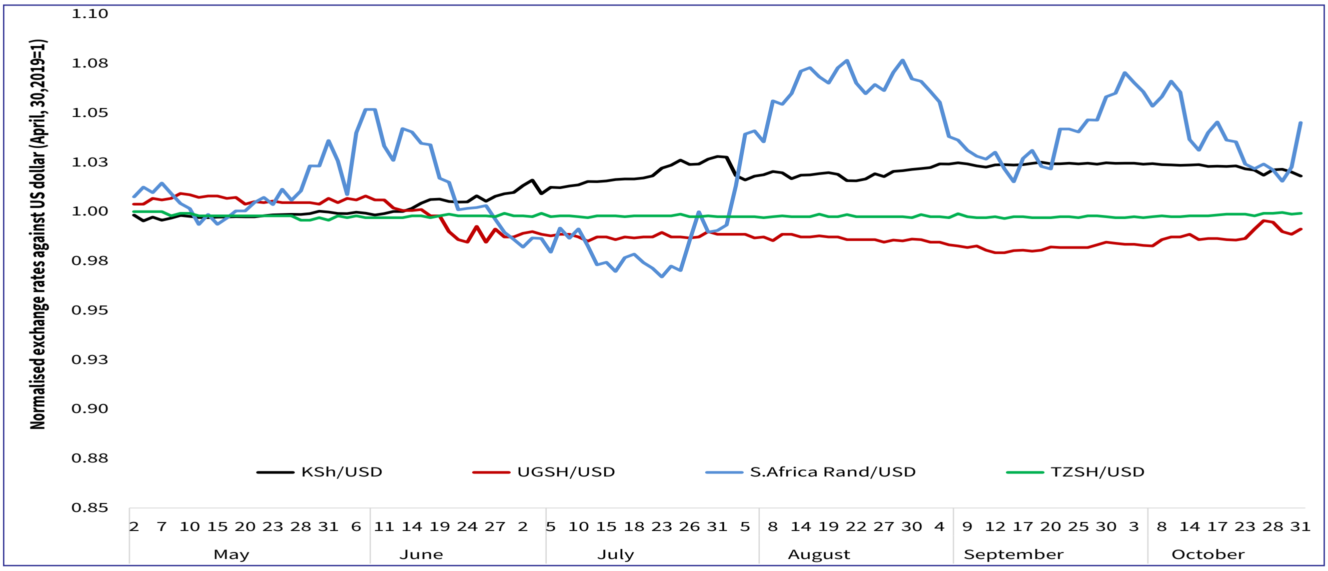
The CBK foreign exchange reserves, which stood at USD 8,934 million (5.6 months of import cover) in October 2019, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

Most major international and some regional currencies were volatile against the US dollar largely due to heightened global uncertainties and volatility in international markets **(Charts 3a and 3b)**. The uncertainties were particularly with regard to escalation of trade tensions between US and China, increased concern with regard to the resolution of Brexit, and volatility in international oil prices due to heightened geo-political tensions. The relative stability in the Kenya Shilling was supported by resilience of Kenya's external sector.

2.3.3 Balance of Payments Developments

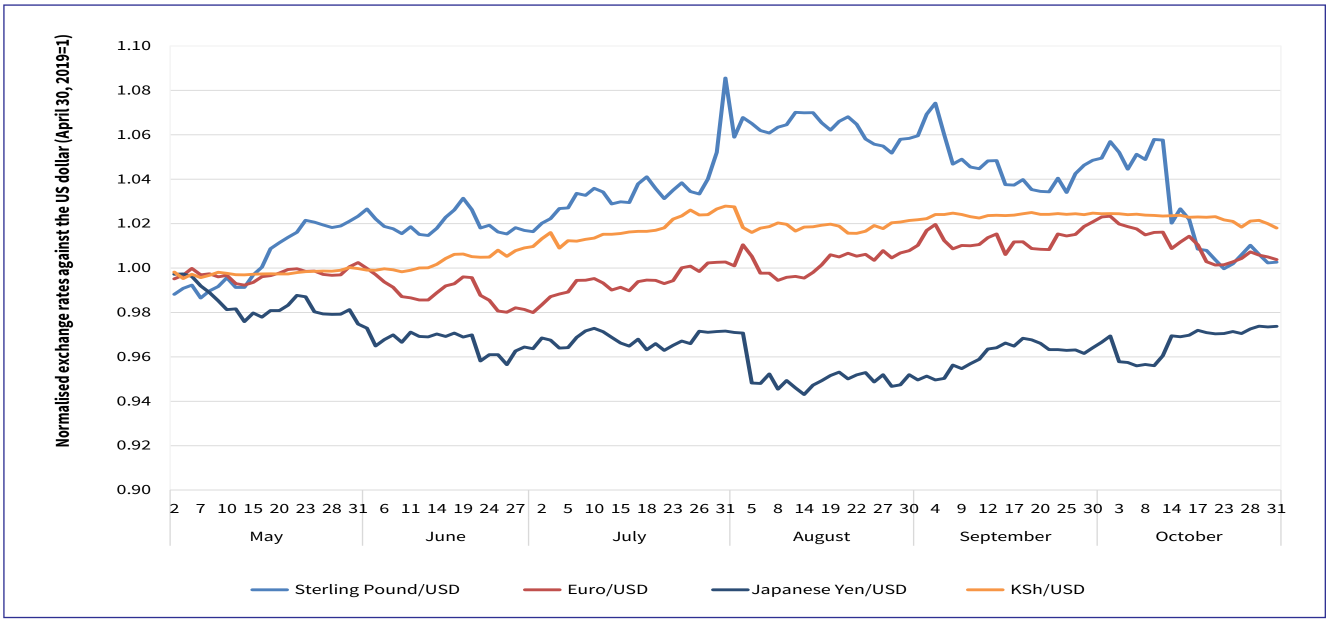
The current account deficit improved to USD 5,002 million in the 12 months to October 2019 (5.2 percent of GDP) from USD 5,243 million (6.0 percent of GDP) over a similar period in 2018. The narrower deficit mainly reflected slowdown in goods imports by 0.8 percent, and increase in service exports by 7.8 percent, particularly transportation services (21.7 percent) and diaspora remittances flows (7.3 percent).

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (April 30, 2019 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (April 30, 2019 = 1)



Source: Central Bank of Kenya

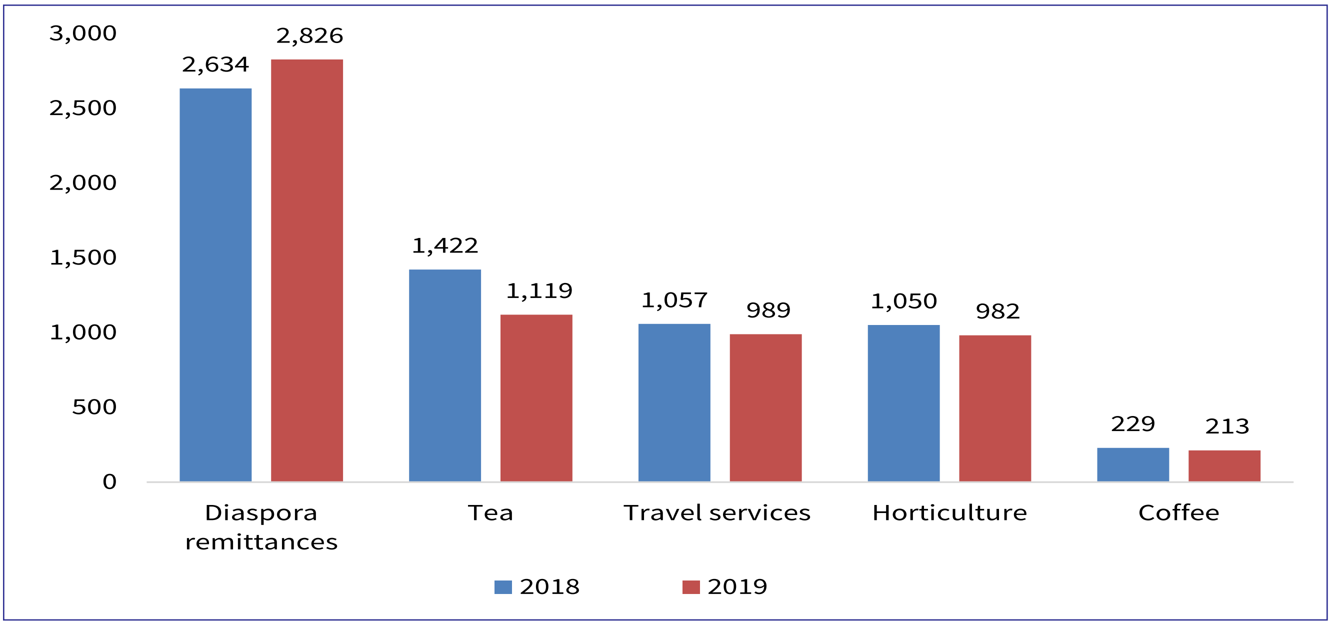
The financial account recorded lower net inflows of USD 6,156 million in the 12-months to October 2019 from USD 6,291 million over a similar period in 2018. This largely reflected lower inward Direct Investments, and Other Investment liabilities mainly due to decrease in external borrowing by government and private sector. The capital account inflows moderately declined to USD 219 million in the 12 months to October 2019 compared to USD 262 million in the 12-months to October 2018, primarily reflecting inflows of government grants.

The value of merchandise exports decreased to USD 5,849 million in the 12 months to October 2019 from USD 6,156 million in the 12-months to October 2018. The decline in exports mainly reflected decrease in tea, coffee and horticulture exports by 21.3 percent, 7.1 percent and 6.5 percent respectively, that more than offset the 5.6 percent increase in manufactured goods exports **(Chart 4a)**.

Merchandise imports declined to USD 16,205 million in the 12-months to October 2019 from USD 16, 337 million over a similar period to October 2018. The decline in imports was mainly driven by imports of machinery and transport equipment (21.3 percent), reflecting completion of phase 1 and phase 2A of the SGR project, and petroleum products (2.8 percent) on account of lower global oil prices **(Chart 4b)**.

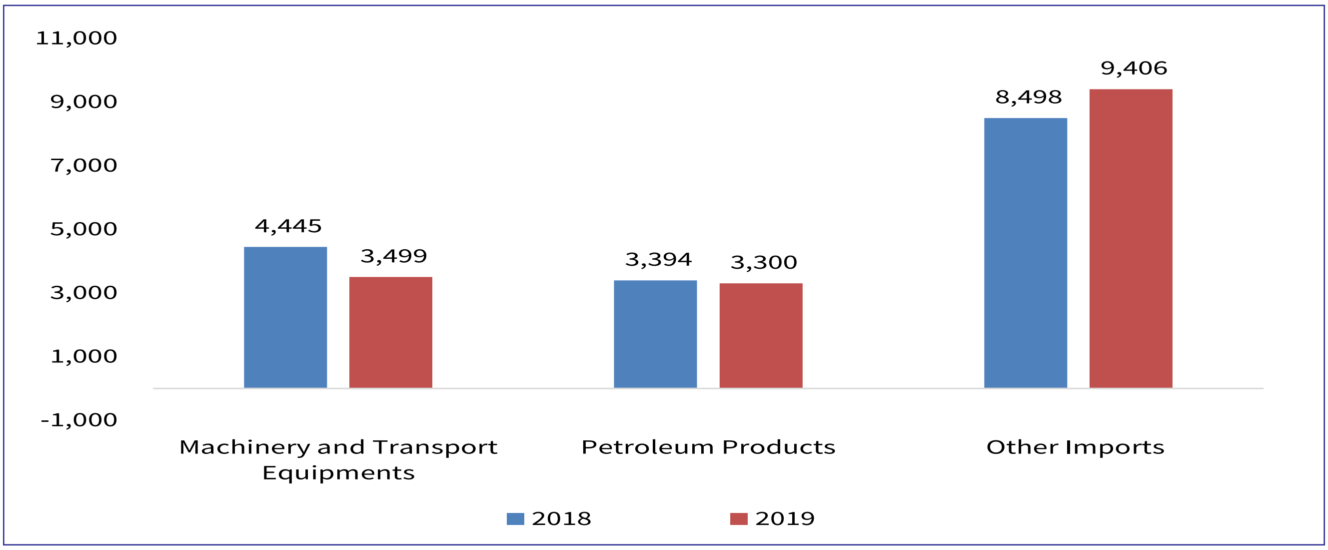
The CBK continued to monitor the impact of Brexit as well as the US economic and trade policies since these developments have implications on trade and investment. The U.K. and US accounted for 6.7 percent and 8.6 percent, respectively, of Kenya's total exports in the 12 months to October 2019. Kenya's exports to the US were mainly through the African Growth and Opportunity Act (AGOA) framework. Exports to other trading blocs such as the EAC, COMESA and the EU, respectively, accounted for 23.0 percent, 25.0 percent and 22.3 percent during the period.

Chart 4a: Foreign Exchange Inflows from Major Export Categories in the 12-Months to October (USD Million)



Source: Kenya National Bureau of Statistics, Kenya Revenue Authority and Central Bank of Kenya

Chart 4b: Imports by Major Categories in the 12-Months to October (USD Million)



Source: Kenya National Bureau of Statistics, Kenya Revenue Authority

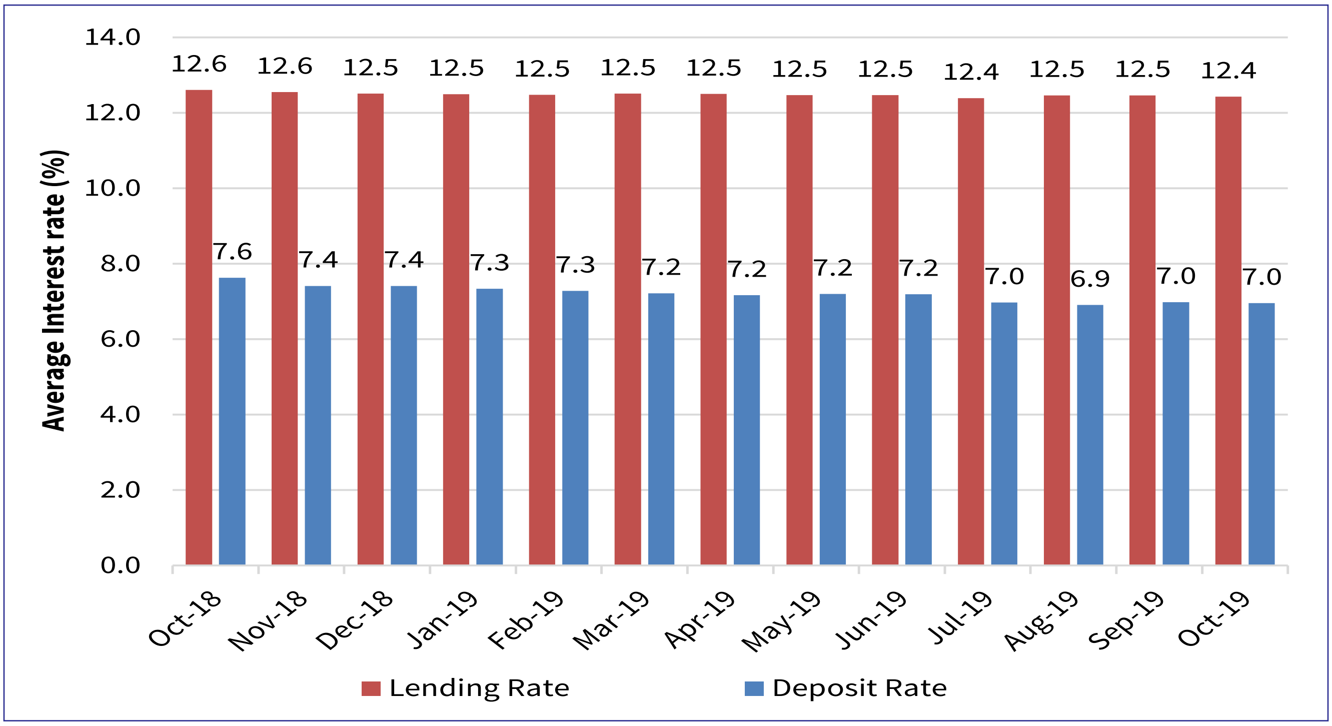
2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the six months to October 2019. Average commercial banks' liquidity and capital adequacy ratios remained largely unchanged at 51.2 percent and 18.3 percent, respectively, in October. The ratio of gross non-performing loans (NPLs) to gross loans declined to 12.3 percent in October from 12.9 percent in April, reflecting decreases in NPLs in the real estate, transport and communication, and building and construction sectors due to increased repayments and the enhanced recovery efforts by banks.

With regard to interest rates, the average commercial banks' lending rate remained stable within the interest rate caps, at 12.4 percent in October compared with 12.5 percent in April. The average commercial banks' deposit rate decreased slightly to 7.0 percent in October from 7.2 percent in April, partly reflecting improved liquidity conditions and the repeal of minimum interest floor on deposits in 2018 **(Chart 5)**.

The CBK also continued to implement measures aimed at strengthening the sector to ensure greater transparency and stronger governance, and to promote effective business models and innovation. Banks have adopted the Banking Sector Charter, which defines a commitment to entrench a responsible and disciplined banking sector which is cognizant of, and responsive to, the needs of their customers.

Chart 5: Commercial Banks' Interest rates (%)



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Private sector credit growth increased to 6.6 percent in the 12 months to October 2019 from 4.9 percent in April 2019. Strong growth in credit was observed in trade, finance and insurance, consumer durables and private households **(Table 1)**. These sectors accounted for an average of 48.2 percent of total credit to the private sector during the period. Growth in private sector credit particularly to Micro, Small and Medium-sized Enterprises (MSMEs) was expected to increase due to the deployment of innovative credit products targeting the sector, and the repeal of interest rate caps.

The value of loan applications and approvals increased to KSh 174.1 billion and KSh 151.0 billion, respectively, in October 2019 from KSh 169.1 billion and KSh 147.2 billion in April 2019, indicating increased demand for credit and improved economic activities. The increase in value of loan applications was generally recorded across all sectors, but mainly in services sector (comprising of transport and communication, trade, finance and insurance and business services), which increased by 24.6 percent in October relative to April 2019 levels. Loans applications to productive sector (agriculture, manufacturing, building and construction, real estate, and mining and quarrying), increased by 7.3 percent, while loan applications to household sector (private households and consumer durables) increased by 9.1 percent over the same period.

Table 1: 12-Month Growth in Private Sector Credit (%)

	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19
Total Credit to Private Sector	**4.9**	**4.4**	**5.2**	**6.1**	**6.3**	**7.0**	**6.6**
Agriculture	2.5	2.7	3.9	7.6	6.6	5.5	-5.2
Manufacturing	7.9	6.5	11.4	10.3	7.5	7.5	6.4
Trade	8.4	7.6	5.5	8.0	8.4	7.6	10.2
Building & construction	-6.5	-4.1	-6.3	-5.4	-6.0	-5.3	-5.5
Transport & communication	6.4	6.2	5.8	6.4	5.8	5.0	4.8
Finance and insurance	13.3	6.7	4.7	5.3	8.2	14.5	15.1
Real estate	-0.7	-0.5	1.0	0.5	2.4	2.2	0.4
Mining & quarrying	-12.5	-7.9	-4.3	-13.5	-10.8	-5.1	0.1
Private households	7.9	7.8	7.6	7.1	8.6	8.8	5.3
Consumer durables	16.4	18.0	21.3	23.6	23.0	28.4	28.6
Business services	1.1	-1.2	-3.2	1.6	-0.1	3.2	-0.4
Other activities	-29.6	-32.0	-22.6	-17.2	-14.4	-13.6	12.7

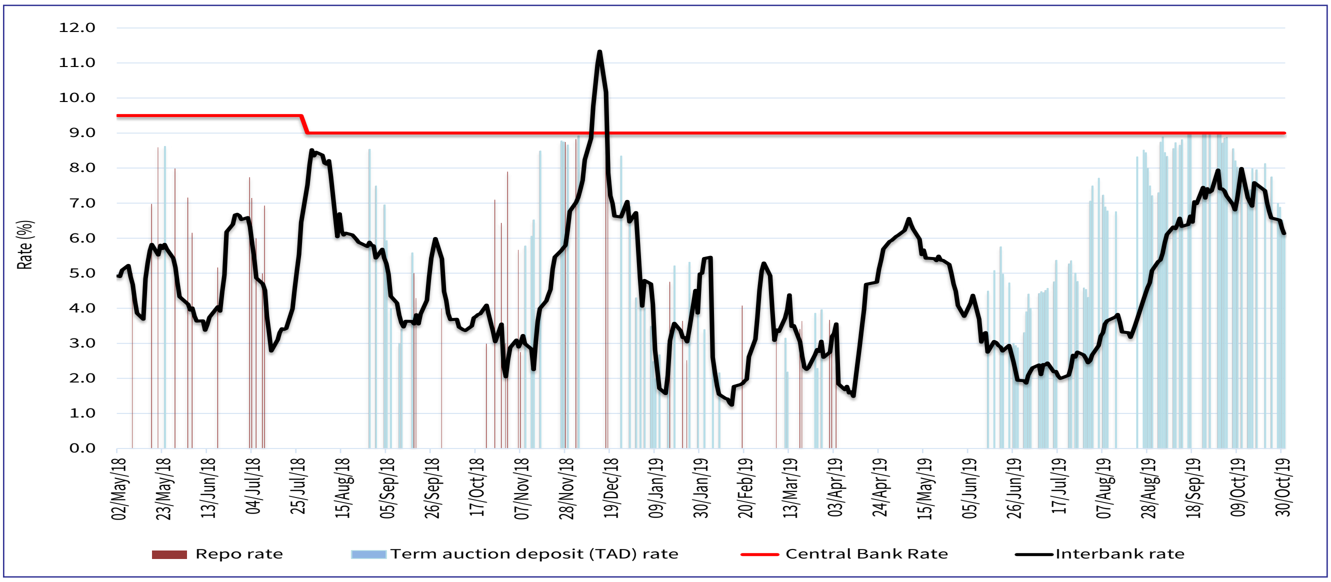
Source: Central Bank of Kenya

2.3.6 Interest rates

Short term interest rates remained below the CBR during the six months to October 2019, partly reflecting improved liquidity conditions in the market. In particular, the average interbank rate was 4.70 percent in the period compared to an average of 4.10 percent in the six months to April 2019. Liquidity management operations by the CBK continued to ensure stability in the market **(Chart 6a)**.

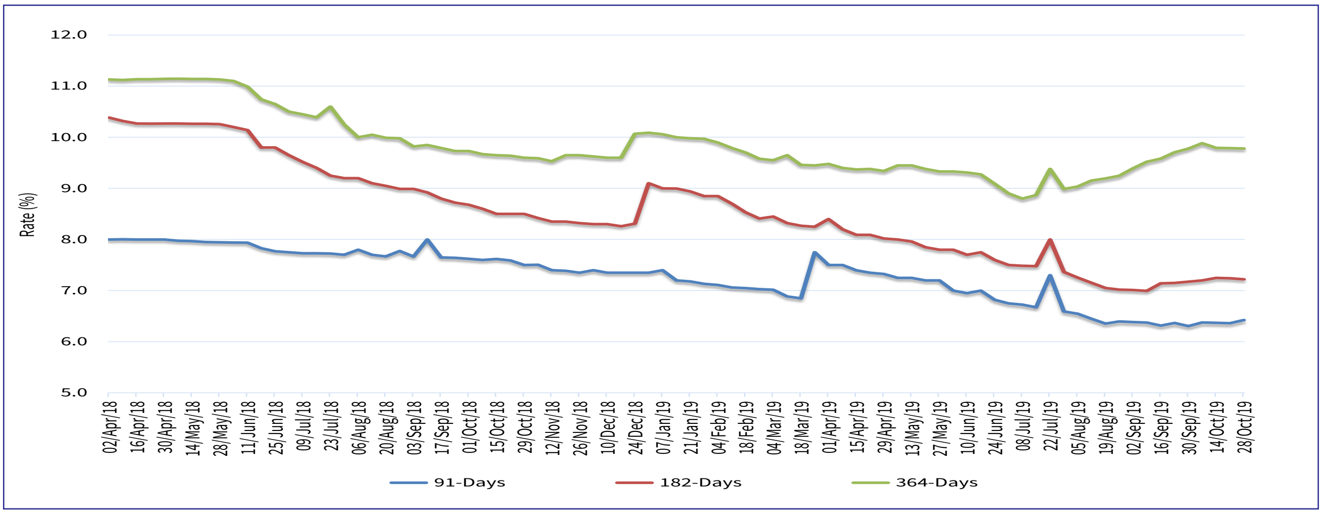
Similarly, interest rates on Government securities generally declined during the six months to October 2019 **(Chart 6b and 6c)**. The decline in the interest rates reflected improved liquidity in the money market, and is also an outcome of effective coordination of monetary and fiscal policies, particularly in the implementation by the Government domestic borrowing programme.

Chart 6a: Trends in Short Term Interest Rates (%)



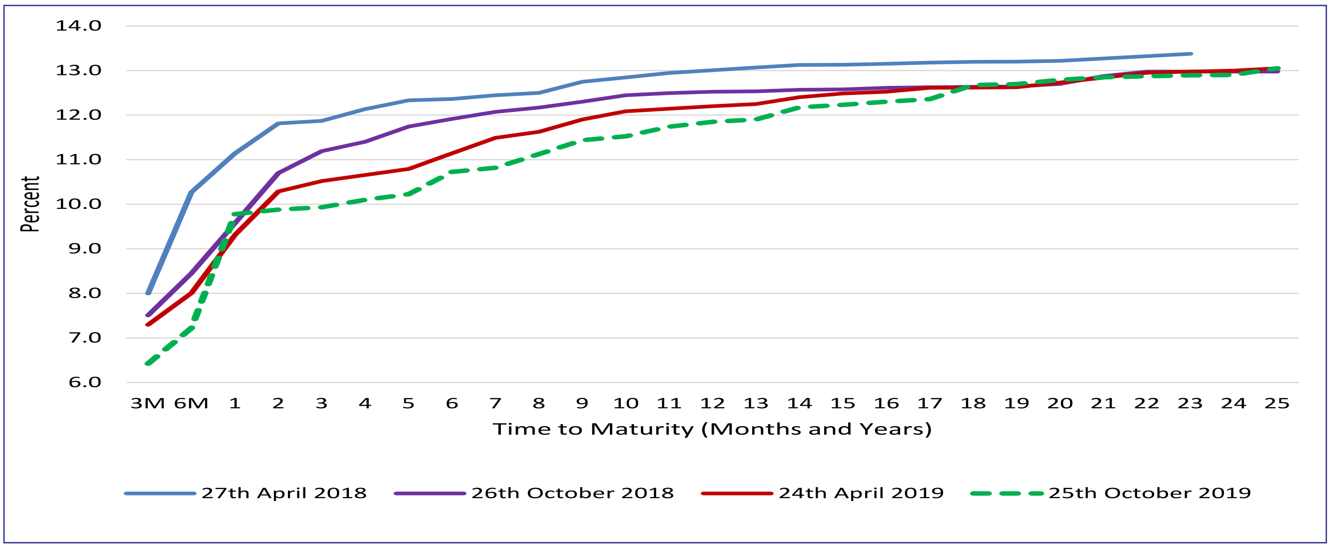
Source: Central Bank of Kenya

Chart 6b: Interest rates on Treasury Bills (%)



Source: Central Bank of Kenya

Chart 6c: Government Securities Yield Curve



Source: Central Bank of Kenya

3. MONETARY POLICY FORMULATION

3.1 Attainment of Monetary Policy Objectives and Targets

During the six months to October 2019, the MPC formulated monetary policy to achieve and maintain overall inflation within the target range as provided by the Cabinet Secretary for the National Treasury at the beginning of every fiscal year. The inflation target provided by the Cabinet Secretary for the National Treasury at the beginning of FY2019/20 was 5 percent with an allowable margin of 2.5 percent on either side. Overall inflation remained well anchored within target range throughout the period under review, while non-food-non-fuel inflation remained below 5.0 percent, indicating muted demand pressures in the economy.

The Central Bank Rate (CBR) remained the base for monetary policy operations and its adjustments both in direction and magnitude continued to reflect the stance of monetary policy. The monetary policy stance continued to be operationalized through various instruments including: Open Market Operations (OMO), changes in cash reserve requirements at CBK, and the CBK Standing Facility (Overnight Discount Window which is a lender of last resort facility). To achieve the desired level of money supply, OMO was conducted using Repurchase Agreements (Repos) and Term Auction Deposits (TAD).

The annual growth in the broad money (M3) and private sector credit remained within their projected growth paths in period under review. In particular, the 12-month growth in M3 was 7.5 percent in October 2019 compared to 9.1 percent in October 2018, reflecting decreased net domestic assets of the banking system mainly on account of reduced net lending to government. Recovery in private sector credit supported growth in M3 during the period.

The demonetisation of the old KSh 1,000 notes (equivalent to 80.3 percent of total currency in circulation) from June to September 2019 had a minimal impact on broad money supply, M3. At the end of the exercise KSh 7.4 billion (equivalent to 0.2 percent of M3 and 3.6 percent of total currency in circulation at the end of September 2019) were not exchanged due to the robust AML/CFT checks in place. However, the demonetisation resulted in a portfolio shift in the composition of M3 during the period towards deposits. The exercise resulted in a contraction in currency outside banks from KSh 222 billion at the end of May 2019 to KSh 158 billion at the end of September 2019, mainly due to reduced demand for physical cash by businesses and people as they exchanged the old 1,000 Shilling notes with new ones. The reduced demand for cash was partly mirrored in increased commercial banks deposits, which grew from KSh 3,174 billion to KSh 3,285 billion over the same period. In addition, increased usage of cashless payment platforms, such as mobile payments, partly reduced the demand for cash for transaction. Cash outside banks started to normalise immediately after the conclusion of the demonetisation exercise, rising from KSh 158 billion in September to KSh 177 billion in October.

3.2 Monetary Policy Committee Meetings and Decisions

Over the six months to October 2019, the MPC held bi-monthly meetings on May 27, July 24 and September 23, 2019. These meetings were held against a backdrop of domestic macroeconomic stability, sustained optimism on the economic growth prospects, and increased uncertainties in the global financial markets, largely due to escalation of trade tensions between US and increased concern with regard to the resolution of

Brexit. The meetings reviewed the impact of previous MPC decisions and recent economic developments.

In the May meeting, the MPC noted that inflation expectations remained well anchored within the target range as demand pressures and the spillovers of the rise in food and fuel prices were muted. In addition, the foreign exchange market remained relatively stable, supported by the narrowing current account deficit. The MPC also noted the rollout of innovative credit products, particularly targeting Micro Small and Medium Enterprises (MSMEs), and was expected to support lending to this sector. The MPC concluded that the current accommodative monetary policy stance remains appropriate, and continue to monitor any perverse response to its previous decisions, and therefore decided to retain the Central Bank Rate (CBR) at 9.00 percent.

The July MPC meeting noted that inflation expectations remained within the target range, supported by lower fuel prices and muted demand pressures. The MPC noted that the economy remained strong in the first quarter of 2019, despite the effects of the delayed long rains on agricultural production. The MPC noted that the banking sector remains stable and resilient, and the rollout of innovative, bank-initiated credit products mainly targeting MSMEs was expected to support growth in private sector credit. The MPC also noted that the gradual demonetisation (withdrawal of the older KSh 1,000 notes) and the close monitoring by CBK ensured that the process was not disruptive to the economy. The MPC concluded that the current policy stance remains appropriate, and therefore decided to retain the CBR at 9.00 percent.

In the September meeting, the MPC noted that inflation expectations remained well anchored within the target range, supported by decreases in the prices of both vegetable and non-vegetable food crops due to improved supply, and muted demand pressures and spillover effects of the excise tax indexation in July. The MPC also noted that the prospective tightening of fiscal policy would provide scope for accommodative monetary policy in the near term. The MPC noted the need to remain vigilant on the possible effects of the increased uncertainties in the external environment and the slowdown in the global growth in 2019, largely due to heightened uncertainties with regard to escalation of trade tensions between the U.S. and China and Brexit resolution. The MPC concluded that the current policy stance remains appropriate, and therefore decided to retain the CBR at 9.00 percent.

4. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC Market Perceptions Surveys carried out during the period as well as regular communication with the key stakeholders facilitated the MPC in its market information gathering process for effective conduct of forward-looking monetary policy. The MPC also continued to simplify its Press Releases to enhance the clarity of information communicated to the public, media, financial sector and other stakeholders.

Over the period, the Chairman held meetings with the Chief Executives of commercial and microfinance banks after every MPC Meeting in order to apprise them on the background to its decisions and to obtain feedback. In addition, the Chairman of the MPC held press conferences after each MPC meeting to brief the media on the background to MPC decisions and measures undertaken by the CBK to support macroeconomic stability.

The Governor also held meetings with various investors to brief them on economic developments and the outlook for the economy. The MPC continued to monitor the implementation of monetary policy decisions by the CBK. The Committee also continued interaction with other government agencies such as the National Treasury and Kenya National Bureau of Statistics (KNBS) on various data issues.

5. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to October 2019 provided support to macroeconomic stability by ensuring that demand-driven inflation was maintained within the target range. The stability of the exchange rate moderated any possible distortions that imported inflation would have had on the stability of domestic prices. The continued coordination of fiscal and monetary policies during the period also supported the achievement of price and market stability.

CBK will continue to monitor developments in the domestic and global economy, the transmission of the monetary policy and other measures previously taken, and their effects on price stability. CBK will also continue to explore and implement measures aimed at promoting the efficiency of the money markets, improve the conduct of liquidity management and adopt measures to support access and affordability of credit to private sector, particularly the MSMEs.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (MAY – OCTOBER 2019)

October	Release of October 2019 World Economic Outlook by the IMF
September	• CBR retained at 9.00 percent • CBK announced successful completion of demonetisation of the old 1,000 Kenya Shillings notes
July	CBR retained at 9.00 percent
June	• CBK launched the new generation currency banknotes, and announced the gradual demonetisation of the old 1,000 Kenya Shillings notes from June 1 to September 30
May	• CBR retained at 9.00 percent

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the month-on-month movement of indices of all consumer price items of goods and services sampled by the KNBS. It is affected by commodity components in the market that may experience sudden inflationary spikes such as food or energy.

Reserve Money: These are CBK's monetary liabilities comprising currency in circulation (currency outside banks and cash held by commercial banks in their tills) and deposits of both commercial banks and non-bank financial institutions held with the CBK. It excludes Government deposits.

Money Supply: Money supply is the sum of currency outside banks and deposit liabilities of commercial banks. Deposit liabilities are defined in narrower and broader terms as follows: narrow money (M1); broad money (M2); and extended broad money (M3). These aggregates are defined as follows:

M1	Currency outside banking system + demand deposits
M2	M1 + time and savings deposits + certificates of deposits + deposit Liabilities of Non-Bank Financial Institutions (NBFIs)
M3	M2 + residents' foreign currency deposits

Central Bank Rate (CBR): This is the lowest rate of interest that the CBK charges on overnight loans to commercial banks. It is reviewed and announced by the Monetary Policy Committee at least every two months as part of its decisions. It is used by the commercial banks as a reference interest rate hence transmits to the financial sector and signals the CBK's monetary policy stance.

Cash Ratio Requirement (CRR): This is the ratio of deposits of commercial banks and non-bank financial institutions maintained with the CBK (as reserves) to commercial banks total deposit liabilities. The ratio is fixed by CBK as provided for by the law.

CBK Discount Window: The CBK Discount Window is a collateralized facility of last resort for banks. It has restrictive guidelines controlling access. The Discount Window plays a significant role in ensuring banking sector stability by offering overnight liquidity as a last resort. It is anchored on the CBR with a prescribed penalty.

Open Market Operations (OMO) : The act of buying or selling of government securities from or to commercial banks by the Central Bank in order to achieve a desired level of bank reserves. OMO is carried out in the context of an auction where commercial banks bid through the Reuters dealing system or by phone/fax.

Repurchase Agreement (Repo): Repos/reverse repos are agreements between the CBK and commercial banks to purchase/sell Government securities from/to commercial banks at agreed interest rates (REPO rate) for a specified period with an understanding that the commercial bank will repurchase/resell the security from/to the CBK at the end of the period. The period can be varied by the CBK.

Term Auction Deposits (TAD): The TAD is used in exceptional market conditions when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options. The CBK seeks to acquire deposits through a transfer agreement from commercial banks at an auction price but with no exchange of security guarantee.

Horizontal Repo: This is an interbank Repo instrument which recognises Government securities as collateral for borrowing. The instrument has a variable tenor and allows commercial banks without credit lines with other banks to access credit from the interbank market.

Interbank Market: The interbank market is a critical channel for distributing liquidity that reduces the need for banks to access the CBK Overnight Discount Window. However, since not all banks have credit lines with each other, it is not a perfectly operating market and therefore banks may come to the Window as a last resort. The interest rates charged by banks reflect an individual bank's perception of the risk of the particular bank borrower and also the tightening liquidity in the market.

Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi |Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000

www.centralbank.go.ke | www.facebook.com/CentralBankKenya | @CbkKenya