

Central Bank of Kenya

Twenty Eighth Bi-Annual Report of the Monetary Policy Committee

April 2022



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 28th 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 April 2022.

Dr. Patrick Njoroge

Governor

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EXECUTIVE SUMMARY

The twenty eighth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments that affected the economy in the six months to April 2022. 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, which is consistent with the price stability objective of the Central Bank of Kenya (CBK).

Monetary policy in the period was conducted against the backdrop of increased global uncertainties, particularly regarding the Russia-Ukraine conflict, uncertainty about the pace of policy responses in the advanced economies, and resurgence of COVID-19 cases especially in China. Prices of key commodities particularly crude oil, wheat, edible oils, and fertilizers rose sharply due to supply disruptions exacerbated by the war in Ukraine, further adding to the elevated global inflationary pressures. Financial markets volatility increased significantly, amid adjustments in monetary policy in the U.S. and other advanced economies.

The MPC held three meetings between November 2021 and April 2022, 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 maintained an accommodative monetary policy stance in the period. The Committee retained the Central Bank Rate (CBR) at 7.00 percent during the period, noting that inflation expectations remained anchored within the target range supported by Government's policy interventions, and leading economic indicators indicated improved economic performance. The MPC continued to closely monitor the elevated global risks and their potential impact on the domestic economy. The monetary policy stance together with CBK liquidity management ensured both price and market stability.

Overall inflation remained within the target range during the period. The inflation rate increased to 6.5 percent in April 2022 from 5.8 percent in November

2021, mainly driven by higher food and fuel prices. Food inflation increased during the period mainly on account of higher vegetable prices due to seasonal factors, and the impact of global supply chain disruptions on prices of wheat and cooking oil. Fuel inflation was moderated by Government measures to stabilise fuel prices and lower electricity tariffs but remained elevated due to higher international oil prices. Non-food-non-fuel (NFF) inflation remained low, indicating muted demand pressures in the economy. The CBK continued to monitor the overall liquidity in the economy as well as any threats that could fuel demand driven inflationary pressures.

The economy rebounded strongly in 2021, supported by recovery in non-agriculture activity following easing of COVID-19 restrictions and impact of Government measures. Real GDP grew by 7.5 percent in 2021 from a contraction of 0.3 percent in 2020. The strong growth was supported by recovery in manufacturing, wholesale and retail trade, education, accommodation and food services, real estate, transport and storage, and financial and insurance sectors. Leading indicators pointed to continued strong performance of the economy in the first quarter of 2022, supported by robust activity in construction, information and communication, wholesale and retail trade, transport and storage, and manufacturing sectors.

The foreign exchange market remained stable during the six months to April 2022, supported by improvement in receipts from exports and strong remittances flows. The current account deficit widened to 5.1 percent of GDP in the 12 months to April 2022 compared to a deficit of 4.8 percent of GDP over a similar period in 2021, mainly reflecting increased imports of oil and other intermediate goods which more than offset the increase in exports. The CBK foreign exchange reserves, which stood at USD8,427 million (5.01 months of import cover) at the end of April 2022, continued to provide adequate cover and buffer against short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans stood at 14.1 percent in April 2022, a marginal increase from 13.6 percent in October 2021, mainly due to delayed payments. The 12-month growth in private sector credit increased to 11.5 percent in April 2022, with strong growth recorded in the manufacturing, trade, building and construction, transport and communication, and consumer durables sectors. Private sector credit growth was supported by recovery in economic activities, the accommodative monetary policy stance and the implementation of the Credit Guarantee Scheme targeting Micro, Small and Medium-sized Enterprises (MSMEs).

The CBK continued to implement reforms outlined in the White Paper on *Modernization of the Monetary Policy Framework and Operations*, that was published in July 2021. These reforms are aimed at enhancing the effectiveness of monetary policy formulation and implementation.

The MPC held virtual meetings with CEOs of banks and members of the private sector after every meeting, to provide the 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 enhanced the understanding of monetary policy formulation and implementation.

The Bank continued to monitor and remained vigilant to the risks posed by developments in the domestic and global environments, particularly the Russia–Ukraine war and the evolving COVID-19 pandemic, on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The Russian - Ukraine conflict and related sanctions on Russia and global spillovers, have adversely affected the global growth outlook for 2022. According to the IMF World Economic Outlook (WEO) April 2022 report, global growth is expected to slowdown from an estimated 6.1 percent in 2021 to 3.6 percent in 2022, which is lower by 0.8 percentage points compared to the outlook envisaged in the January 2022 WEO Update.

Growth in the advanced economies is projected at 3.3 percent in 2022, a reduction of 0.6 percentage points compared to the January 2022 WEO update. This reduction is mainly on account of a negative terms-of-trade shock as a result of the war in Ukraine, continued supply chain disruptions and tighter financial conditions affecting the advanced economies. Euro area and UK growth rates for 2022 were revised down by 1.1 percentage points and 1.0 percentage points, respectively. Growth in most advanced economies was forecast to slowdown in 2022, including the U.S. (3.7 percent), Japan (2.4 percent), UK (3.7 percent), Germany (2.1 percent), France (2.9 percent), Italy (2.3 percent), and Spain (4.8 percent). Rising inflationary pressures remained a major concern in the advanced economies.

In the emerging market and developing economies, growth is expected at 3.8 percent in 2022. Growth in emerging and developing Europe including Russia, is projected to contract by 2.9 percent in 2022. Growth in Russian output is expected to contract by 8.5 percent in 2022 due to the tightening in trade and financial sanctions. In Asia, China's growth is expected to slow down due to a combination of the more transmissible COVID-19 variants and zero-COVID strategy. Nevertheless, the pace of growth across the region underscores the vulnerabilities, and the size of the policy response to combat the fallout. In Sub-Saharan Africa (SSA), economic growth is projected at 3.8 percent in 2022, an upward revision of 0.1 percentage points in 2022 attributed to the increase in oil prices. Nigeria and South African economies

are expected to grow by 3.1 percent and 1.9 percent, respectively, in 2022.

Global commodity prices have risen sharply and are expected to remain elevated in 2022, reflecting war-related interruptions to production, and sanctions. In particular, the Murban crude oil prices rose by 27.1 percent from USD84.48 per barrel at the end of October 2021 to USD107.39 per barrel at the end of April 2022. The UN Food Price Index increased by 18.8 percent between October 2021 and April 2022, mainly reflecting significant increases of 28.5 percent and 23.7 percent in the price indices of edible oils and cereals, respectively. Additionally, wheat prices rose sharply following an export ban by India, partly due to reduced production in Ukraine attributed to the war. Prices of edible oils rose sharply following Indonesia's export ban on palm oil, and a surge in the price of sunflower oil due to war induced supply chain disruptions.

Inflation in the U.S., UK, and Eurozone rose sharply from 6.2 percent, 4.2 percent, and 4.1 percent respectively in October 2021, to 8.3 percent, 9.1 percent, and 7.5 percent respectively in April 2022. Inflation is expected to remain elevated in 2022, driven by the war-induced commodity price increases. In 2022, inflation is projected at 5.7 percent in advanced economies and 8.7 percent in emerging market and developing economies, which is 1.8 and 2.8 percentage points higher than projected in January. Global trade volumes are expected to increase by 5.0 percent in 2022 and could moderate due to impaired access to cross-border payment systems and worsening supply chain dynamics.

Looking ahead, the outlook for global growth could worsen further due to the elevated inflationary pressures, escalating geopolitical tensions and evolution of the COVID-19 pandemic particularly in China. Further, there is increased probability of wider social tensions because of higher food and energy prices, which would further weigh on the outlook.

2. DEVELOPMENTS IN THE KENYAN ECONOMY

2.1 Overall Economy

The Economic Survey 2022 indicates that the economy rebounded strongly in 2021, supported by recovery in economic activity following easing of COVID-19 restrictions (Table 1). The economy grew by 7.5 percent compared to a contraction of 0.3 percent in 2020. The strong performance was supported by recovery in services and industry sectors, particularly manufacturing (6.9 percent), wholesale and retail trade (7.9 percent), real estate (6.7 percent), transport and storage (7.2 percent), information and communication (8.8 percent), and financial and insurance (12.5 percent). Except agriculture which was adversely affected by unfavorable weather conditions in most parts of the country, the rest of the sectors in the economy recorded positive growth rates in 2022. The agriculture sector contracted by 0.2 percent in 2021 compared to a growth of 4.8 percent in 2020.

The outlook for economic growth in 2022 remains positive, despite heightened global uncertainty. The economy is expected to remain strong, mainly supported by continued strong performance of activity in industry and services sector. In addition, continued Government investment in infrastructure projects is expected to support growth. Nevertheless, the downside risks to growth have increased since onset of the Russia-Ukraine conflict. Worsening of supply chain disruptions and higher international oil prices caused by the conflict may have spillover effects on domestic growth. Additionally, continued uncertainties arising from new COVID-19 strains and waves could lead to further lockdowns, slowing the momentum of global recovery.

Table 1: Real GDP growth (percent)

	2018	2019	2020	2021				
				Q1	Q2	Q3	Q4	Annual
1. Agriculture	5.7	2.6	4.8	0.4	-0.5	0.6	-1.2	-0.2
2. Non-Agriculture (o/w)	5.6	5.8	-0.7	3.2	14.4	11.1	9.2	9.4
2.1 Industry	3.8	3.4	4.0	4.3	9.2	8.8	6.6	7.2
Mining & Quarrying	-4.7	4.3	6.7	10.7	10.9	16.4	34.5	18.0
Manufacturing	3.6	2.5	-0.1	2.1	11.3	10.2	4.9	6.9
Electricity & water supply	3.6	1.7	0.1	3.6	7.2	6.4	2.8	5.0
Construction	6.1	5.6	11.8	6.8	6.8	6.7	6.0	6.6
2.2 Services	6.1	6.5	-2.2	3.1	15.6	11.7	9.2	9.8
Wholesale & Retail Trade	5.9	5.3	-0.4	7.5	9.2	6.4	8.4	7.9
Accommodation & food services	15.6	14.3	-47.7	-33.0	90.1	127.5	118.6	52.5
Transport & Storage	6.0	6.3	-7.8	-7.9	18.6	14.2	6.5	7.2
Information & Communication	7.9	7.5	4.8	10.1	17.1	4.1	5.3	8.8
Financial & Insurance	2.7	6.9	5.6	11.8	17.3	11.8	9.9	12.5
Public administration	7.9	9.9	5.3	6.8	7.6	4.8	3.3	5.6
Professional, Admin & Support Services	6.9	6.9	-15.0	-13.0	18.3	13.4	8.1	5.7
Real estate	6.5	6.7	4.1	6.7	7.4	7.1	5.7	6.7
Education	6.4	4.7	-10.8	11.5	31.6	28.3	18.0	21.4
Health	5.4	6.2	6.7	5.8	6.2	4.1	7.8	6.0
Other services	3.3	4.4	-14.2	-8.4	28.8	17.7	16.8	12.6
FISIM	3.7	9.5	-2.0	4.9	2.8	5.1	8.7	5.5
2.3 Taxes on products	5.9	3.7	-7.9	1.8	18.5	12.5	15.7	11.9
Real GDP Growth	5.6	5.0	-0.3	2.7	11.0	9.3	7.4	7.5

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

2.2 Financial Market Developments

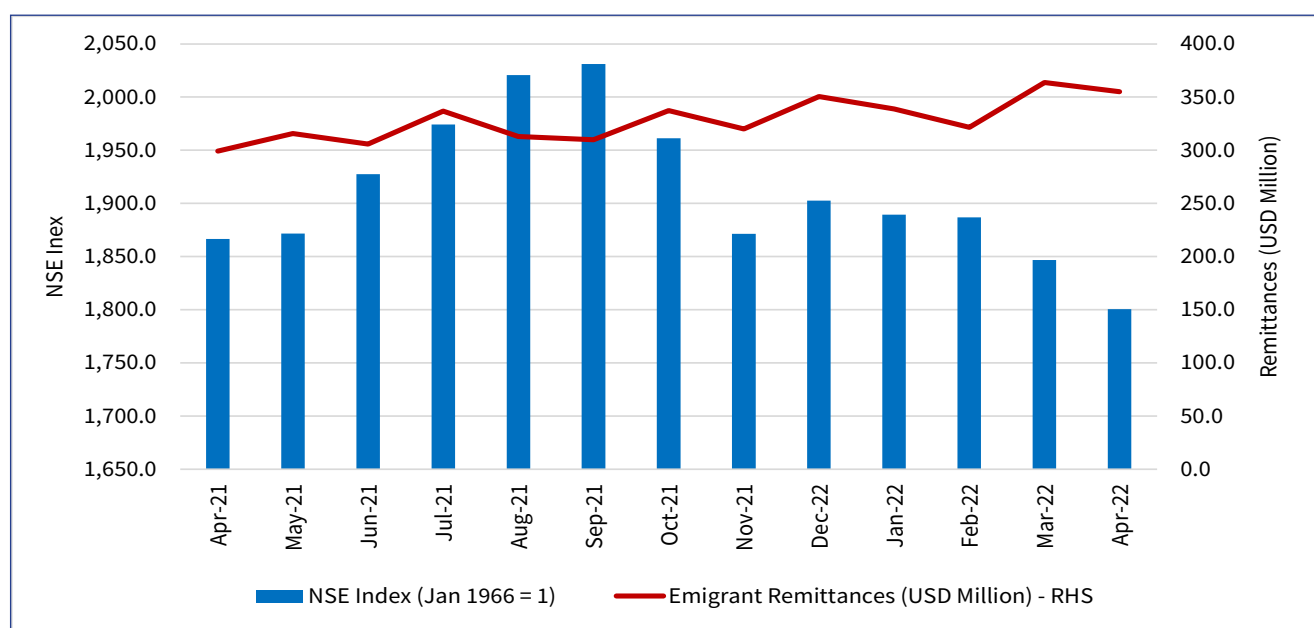
Volatility in global financial markets increased during the six months to April 2022, mainly reflecting the impact of monetary policy tightening in the advanced economies to contain inflationary pressures and concerns about the war in Ukraine. Prior to the war in Ukraine, inflation had risen significantly prompting many central banks to tighten monetary policy, resulting in a rapid increase in nominal interest rates across advanced economies. According to the April 2022 Global Financial Stability Report, policy rates are expected to rise further, mostly in advanced economies. In emerging market and developing economies, several central banks also tightened policy during the period. However, in China, the central bank cut policy rates in January 2022 to support the recovery with inflation remaining low.

The war in Ukraine and related sanctions have tightened global financial conditions, lowered risk appetite, and induced flight-to-quality flows. In

Russia, the sanctions and the impairment of domestic financial intermediation led to large increases in its sovereign and credit default swap spreads. Emerging market economies, Central Asia, and North Africa have also witnessed widening in their sovereign spreads. Emerging markets capital outflows in early March 2022, were as large as those witnessed at the start of the pandemic and was concentrated in fewer economies. Most currencies depreciated against the U.S. dollar in the six months to April, following tightening of monetary policy by the U.S. Fed, and flight-to-safety flows.

In the domestic economy, diaspora remittances remained strong over the period (**Chart 1a**). Activity at the Nairobi Securities Exchange (NSE) recovered with the pickup in economic activity up to mid-2021. Nevertheless, the NSE-20 Share Price Index was relatively volatile in the six months to April 2022, following increased uncertainties in the global financial markets. The index fell from 1,961.3 index points in October 2021 to 1,800.6 index points in April 2022.

Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE-20 Share Price Index (Jan 1966=100)

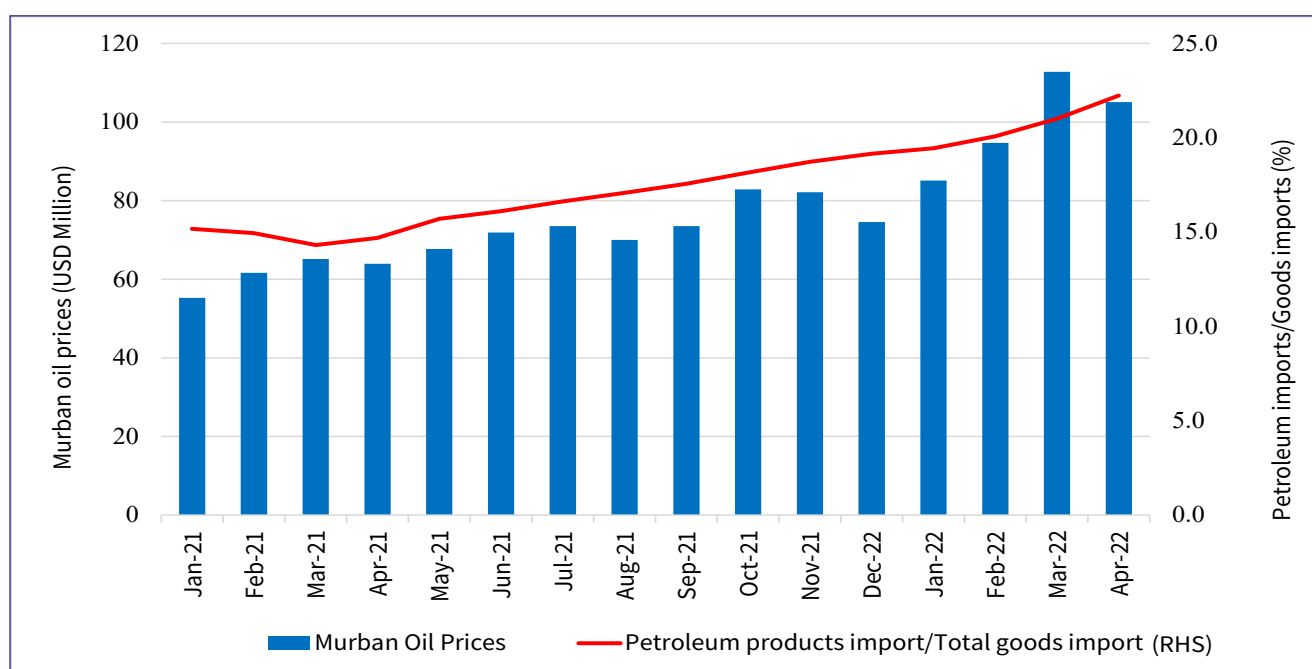


Source: Central Bank of Kenya and Nairobi Securities Exchange

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. International oil prices continued to rise in the six

months to April 2022, reflecting supply disruptions exacerbated by the war in Ukraine, and increased demand as economies reopened from the COVID-19 related containment measures (**Chart 1b**).

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



Source: Oil price.com and Kenya Revenue Authority

2.3 Developments in Key Economic Indicators

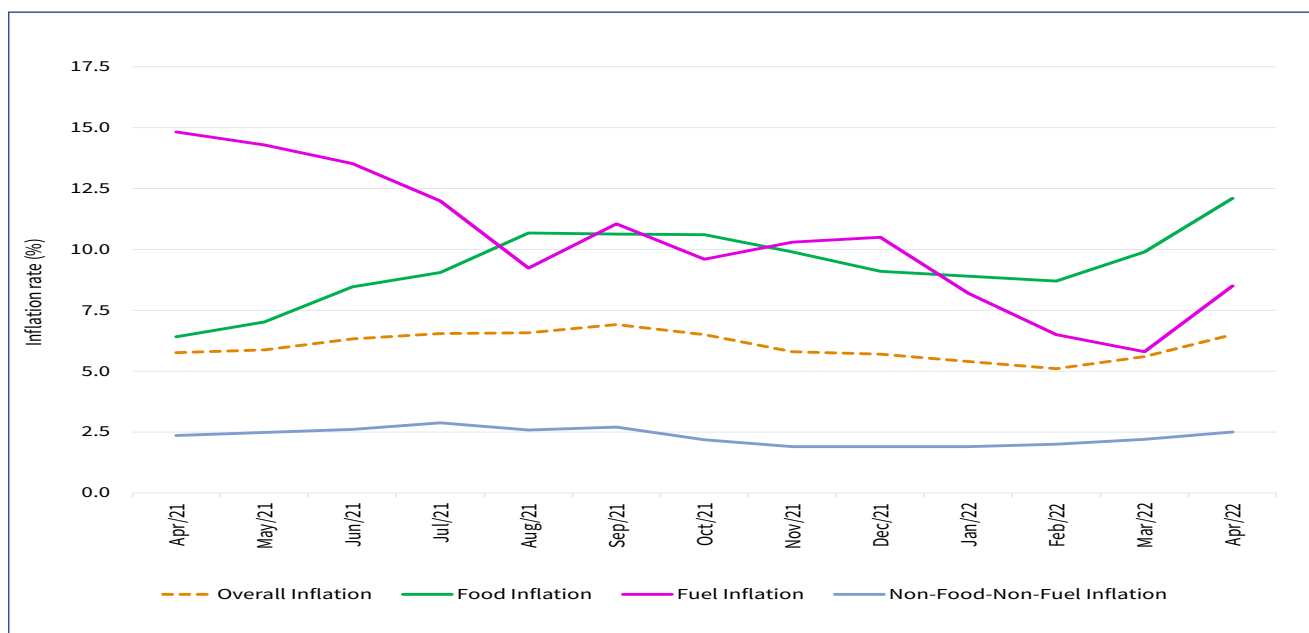
2.3.1 Inflation

Overall inflation remained within the target range during the six months to April 2022. However, the inflation rate increased to 6.5 percent in April 2022 from 5.8 percent in November 2021, mainly driven by higher food and fuel prices. Food inflation increased to 12.1 percent from 9.9 percent in November 2021. The increase was mainly on account of seasonal factors which affected supply of some vegetable food items, as well as international supply chain disruptions arising from the Russia-Ukraine conflict which affected prices

of wheat and cooking oil. Fuel inflation remained elevated during the period, reflecting increased international oil prices. The fuel inflation rate declined to 8.5 percent from 10.3 percent in November 2021.

Non-food-non-fuel (NFNF) inflation remained low, reflective of muted demand pressures in the economy. The NFNF inflation rate increased to 2.5 percent in April 2022 from 1.9 percent in November 2021 (**Charts 2a**).

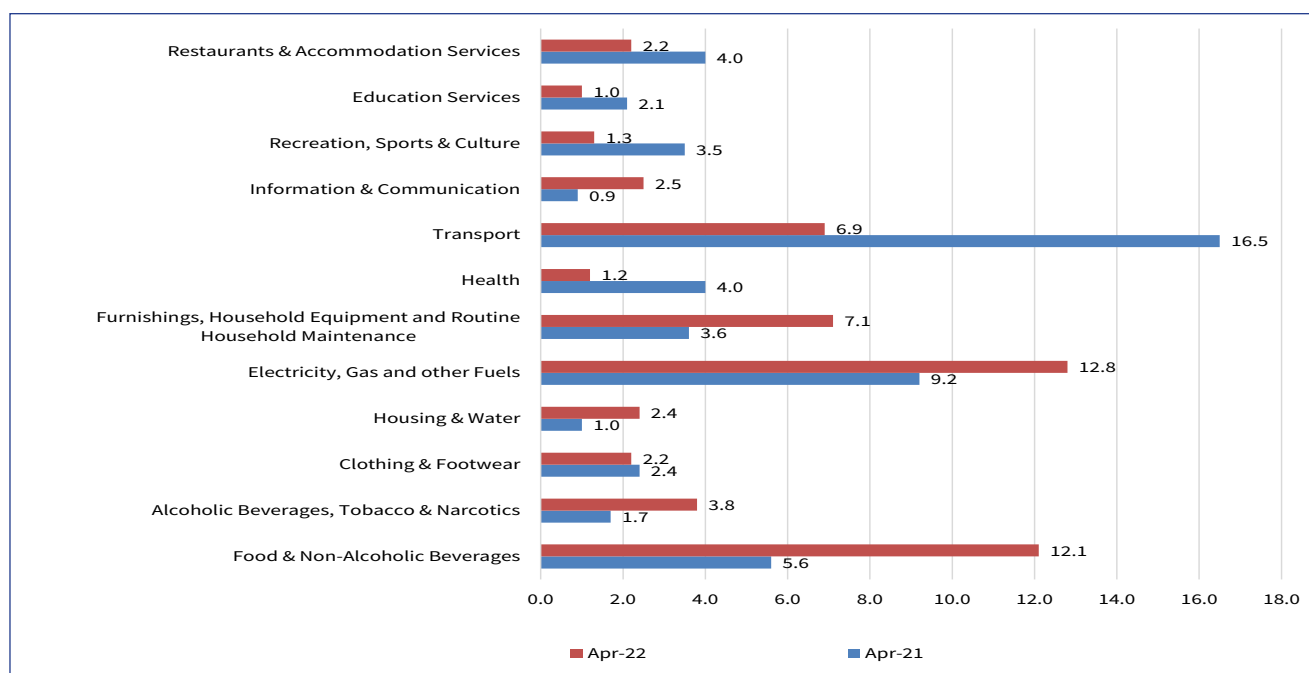
Chart 2a: Overall and Non-Food-Non-Fuel Inflation (percent)



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

Inflation rates of all consumer-goods categories except Food and Non-Alcoholic Beverages, and Electricity, Gas and other Fuels were within the target range in April 2022 (**Chart 2b**).

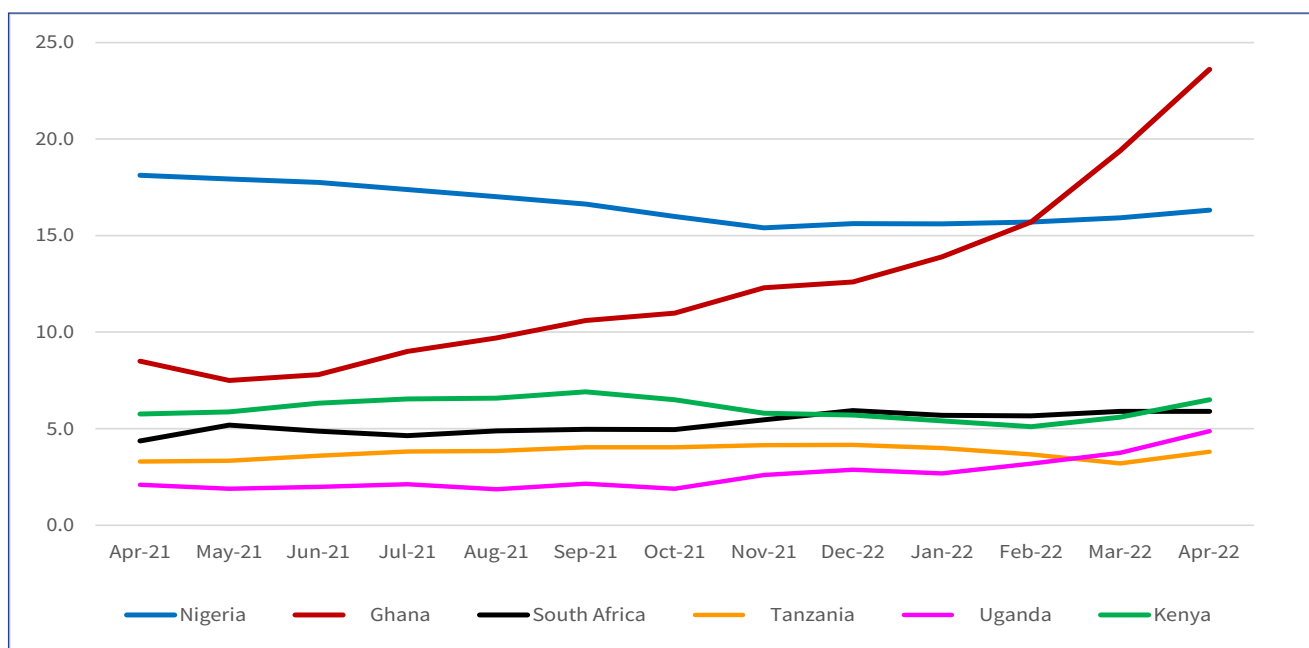
Chart 2b: 12-Month Inflation by Broad CPI Category (Percent)



Source: Kenya National Bureau of Statistics

The trend in the overall inflation rates in the major African economies displayed similar patterns over the period **(Chart 2c)**. Food and energy prices were the main drivers of inflationary pressures in these countries.

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



Source: Respective country central bank websites

2.3.2 Foreign Exchange Market Developments

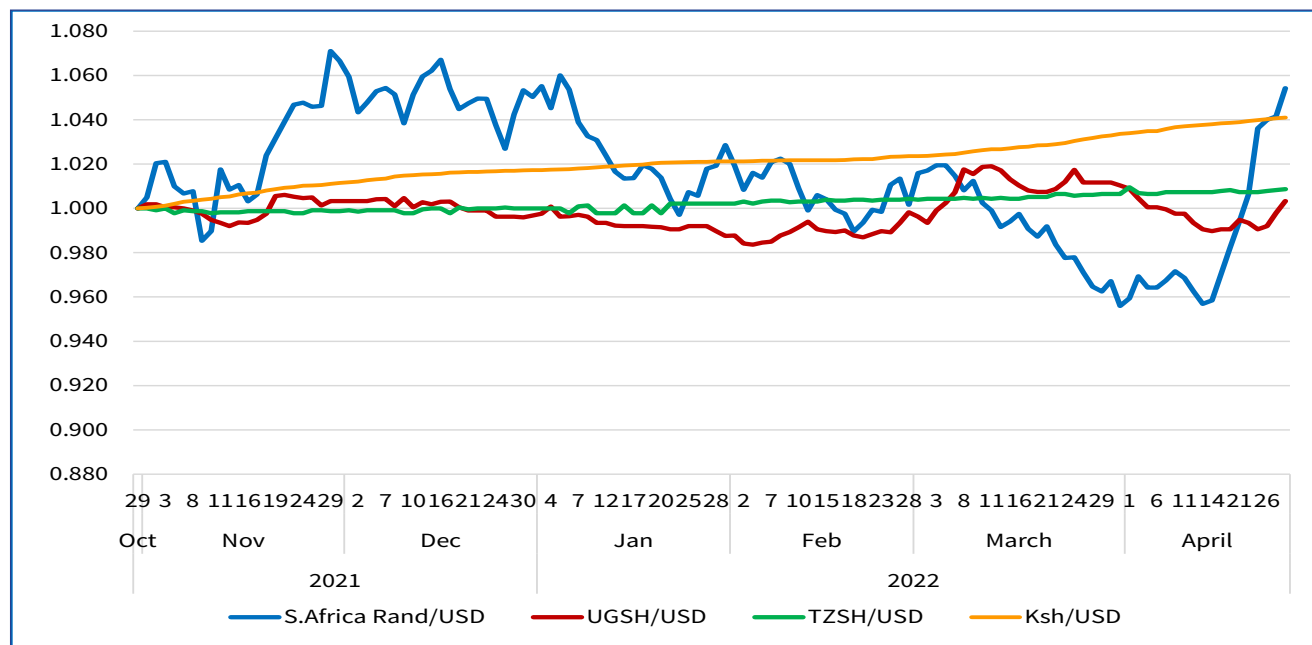
Global financial markets experienced significant volatility during the six months to April following increased uncertainties with the breakout of the Russia-Ukraine conflict. Majority of advanced and emerging market currencies weakened against the U.S. dollar driven by the pace of monetary policy tightening in the U.S., slowdown in China's growth due to lockdowns, and spillover effects of the war in Ukraine on Europe **(Charts 3a and 3b)**.

The foreign exchange market in Kenya remained relatively stable in the six months to April 2022, supported mainly by improvement in receipts from exports as well as strong diaspora remittances. Nevertheless, the rising import bill with regard to

oil and other intermediate goods exerted moderate pressure. International oil prices rose sharply during the period mainly due to supply chain disruptions attributed to the war in Ukraine and increased oil demand. Diaspora remittances averaged USD341.6 million per month in the six months to April 2022 compared to USD319.8 million per month in the six months to October 2021.

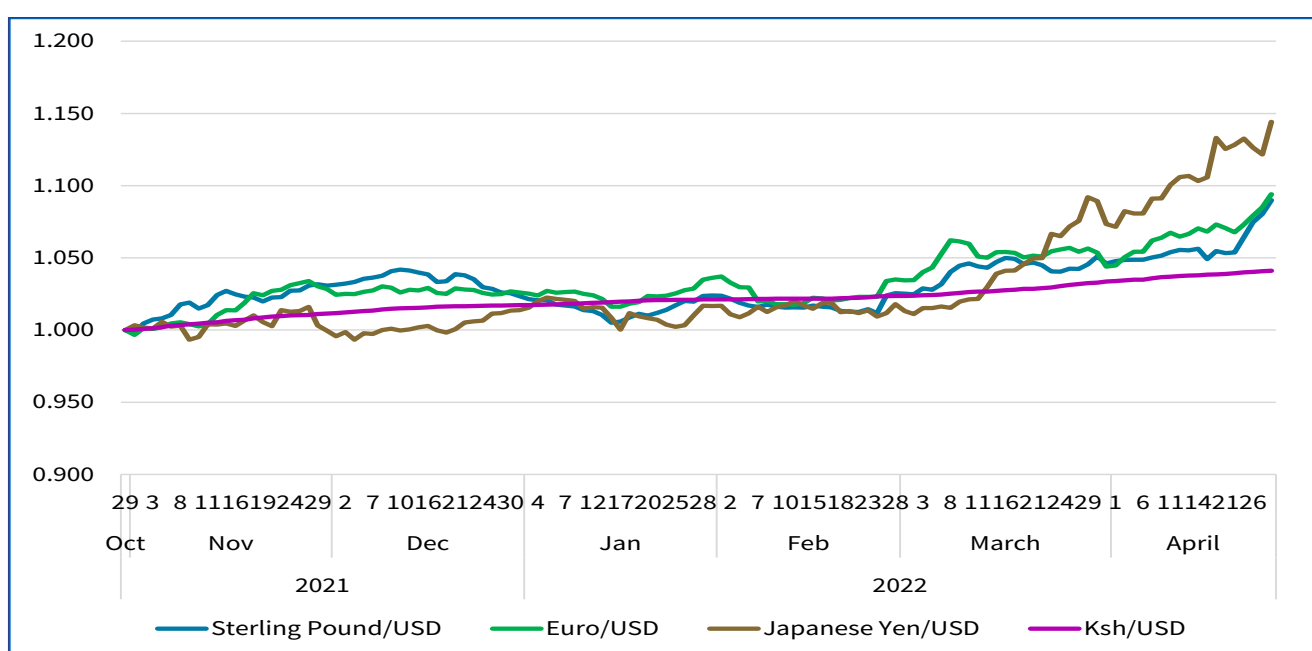
The CBK foreign exchange reserves, which stood at USD8,427 million (5.01 months of import cover) in April 2022, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (October 29, 2021 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (October 29, 2021 = 1)



Source: Central Bank of Kenya

2.3.3 Balance of Payments Developments

The current account balance widened to a deficit of USD5,685.1 million (5.1 percent of GDP) in the 12-months to April 2022, compared to a deficit of USD4,357.1 million (4.8 percent of GDP) in a similar period in 2021. The widening of the current account deficit was primarily due to a higher import bill, particularly for oil, which more than offset the increased receipts from agricultural and services exports, as well as diaspora remittances.

The value of merchandise exports improved to USD6,871.4 million in the 12-months to April 2022 compared with USD 6,178.4 million in the 12-months to April 2021. Exports increased by 11.1 percent in the 12 months to April 2022 compared to a similar period in 2021. With the exception of receipts from horticulture which declined by 2.2 percent, receipts from the rest of the exports registered significant increases.

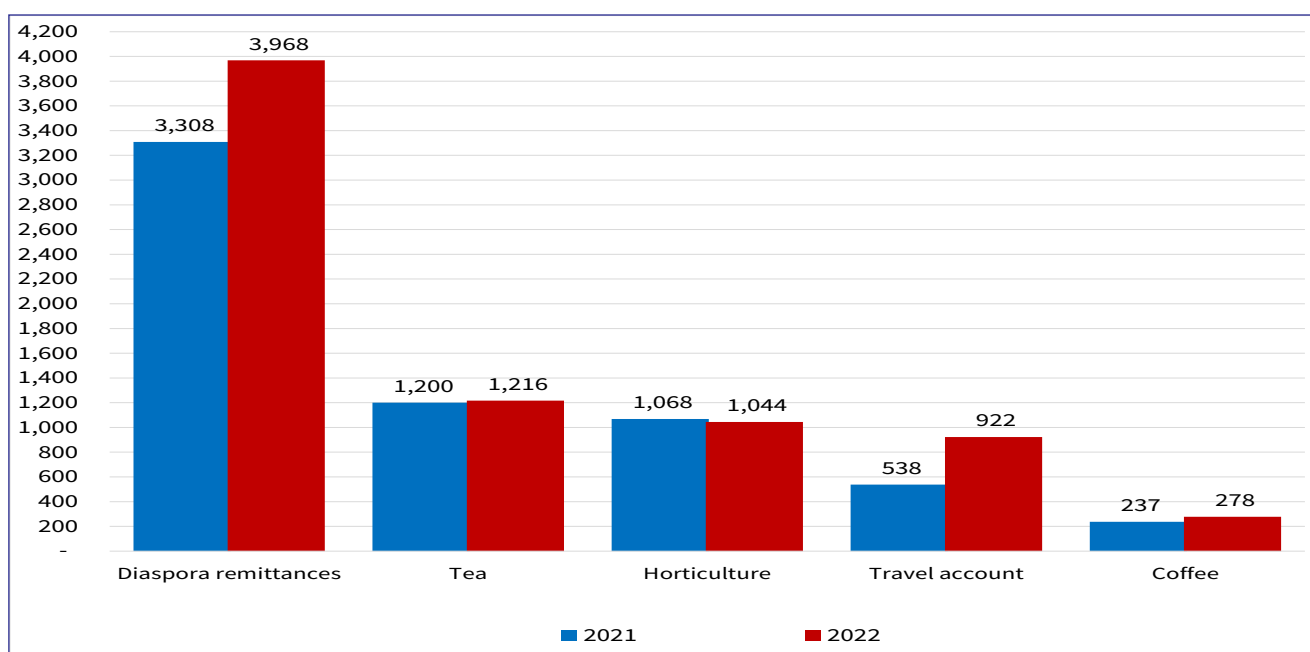
Merchandise imports increased to USD18,697.0 million in the 12 months to April 2022, from USD15,231.1 million in the previous year. The increase in imports was mainly driven by imports of petroleum products which

increased by 85.7 percent on account of high global oil prices. Services exports increased by 62.2 percent in the 12 months to April 2022 due to a pickup in travel and transport receipts, which increased by 71.4 percent and 77.6 percent respectively, in the period **(Chart 4a and Chart 4b)**.

Financial account net inflows totaled USD7,235.3 million in the 12-months to April 2022 from USD 3,732.8 million over a similar period in 2021. This largely reflected an increase in other investment inflows. The capital account on the other hand, recorded a surplus of USD178.8 million in the 12-months to April 2022, owing to consistent inflows of Government grants.

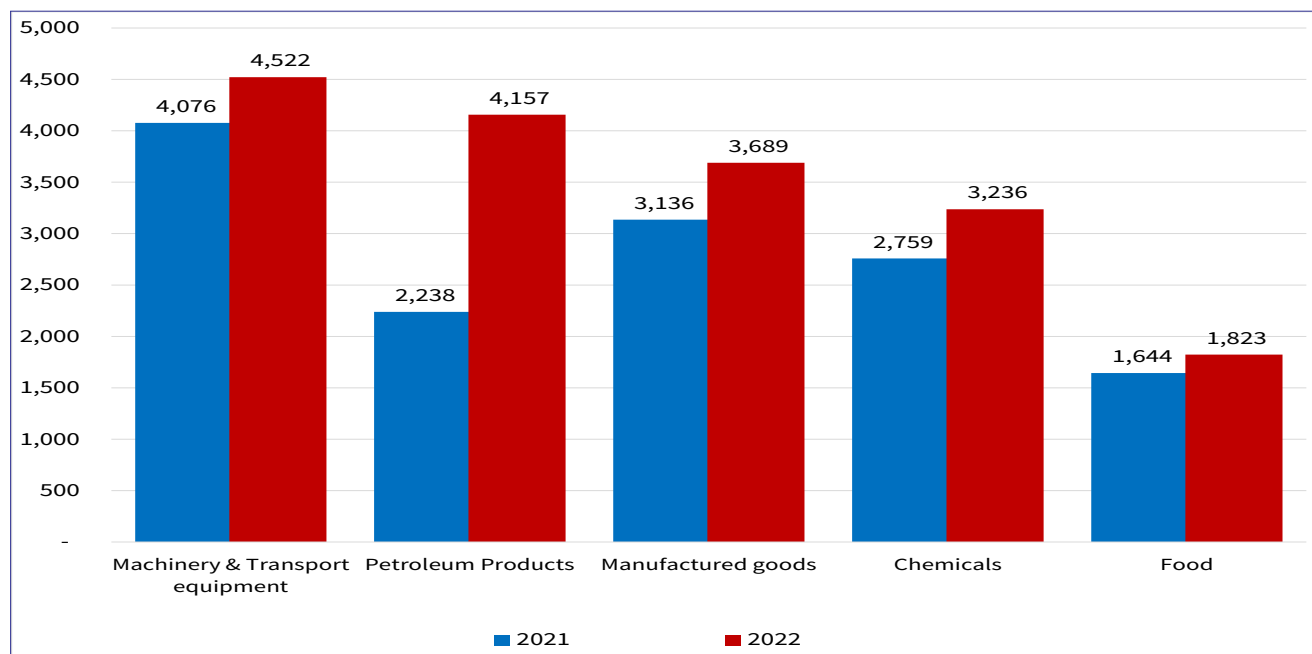
The CBK continued to monitor global developments during the period, particularly the effects of the war in Ukraine, COVID-19 pandemic, U.S. economic and trade policies, global trade and investment and inflationary concerns in major economies. The U.K. and U.S. accounted for 6.2 percent and 8.6 percent, respectively, of Kenya's total exports in the 12-months to April 2022. Exports to other trading blocs such as the EAC, COMESA and the EU accounted for 26.0 percent, 27.2 percent and 21.9 percent, respectively, of total exports over the

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



Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

period, compared to 24.6 percent, 28.0 percent and 23.4 percent of total exports in the 12-months to April 2021, respectively. Imports from China accounted for 19.7 percent of the total imports in the 12 months to April 2022, while India, the United States, and the United Kingdom accounted for 13.0 percent, 4.4 percent, and 1.6 percent, respectively

2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the period ended April 2022, with strong liquidity and capital adequacy ratios. The average commercial banks liquidity and capital adequacy ratios stood at 54.3 percent and 18.8 percent in April 2022. These were above the minimum statutory limits of 14.5 percent and 20.0 percent, respectively.

Credit risk was elevated but easing, with the ratio of gross non-performing loans (NPLs) to gross loans standing at 14.1 percent in April 2022, a marginal increase from 13.6 percent in October 2021. Gross NPLs increased by 4.7 percent from Ksh 424.5 billion in October 2021, to Ksh 486.6 billion in April 2022, mainly due to delayed payments. The main sectors with increased NPLs are Tourism, Restaurants and Hotels, Building and Construction, and Manufacturing.

The total banking sector lending increased by 0.5 percent to Ksh 3,241.4 billion in April 2022, from

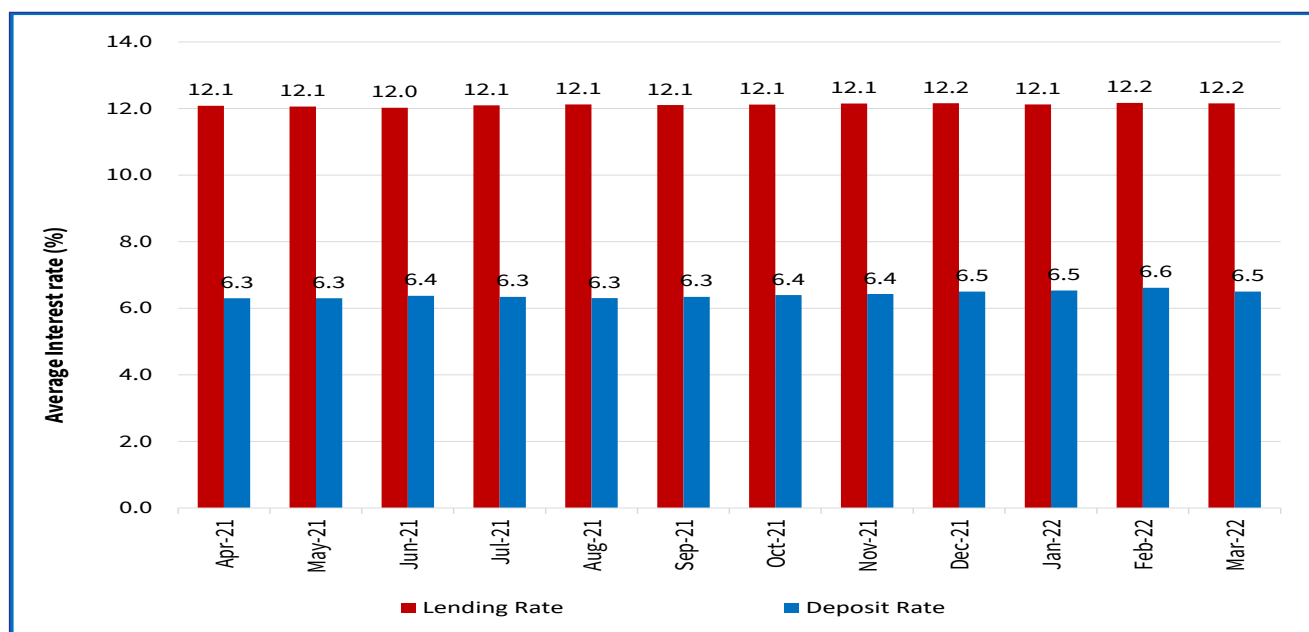
Ksh 3,226.4 billion in October 2021. This was mainly driven by increased demand for loans in the Trade, Transport and Communication, and Personal and Household sectors following resumption of economic activities after the lifting of COVID-19 containment measures.

Customer deposits remained the main source of funding to the banks accounting for 72.8 percent of the banking sector total liabilities and shareholders' funds as at April 2022. This was a slight decrease from 74.6 percent in October 2021. Customer deposits increased by 3.2 percent to Ksh.4,521.9 billion in April 2022, from Ksh 4,383.3 billion in October 2021.

Going forward, the banking sector is projected to remain resilient and stable. Credit risk and operational risk are expected to remain elevated in the short to medium term, while liquidity risk is expected to remain stable.

Commercial banks' average lending rate remained relatively stable, at about 12.1 percent during the review period. The average commercial banks' deposit rate increased slightly to 6.5 percent compared to about 6.3 percent in the previous period, partly reflecting increased competition by banks to attract deposits (**Chart 5**).

Chart 5: Commercial Banks' Average Interest rates (Percent)



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Private sector credit growth improved in the period, supported by demand arising from recovery in economic activity, and an accommodative monetary policy stance. The 12-month growth in private sector credit increased to 11.5 percent in April 2022 from

7.8 percent in October 2021. All sectors registered positive credit growth, with strong growth observed in transport and communications, manufacturing, trade, business services, and consumer durables (**Table 2**).

Table 2: 12-Month Growth in Private Sector Credit (%)

	Apr-21	Jun-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22
Total Credit to Private Sector	6.7	7.7	7.7	7.8	7.7	8.6	8.8	9.1	10.9	11.5
Agriculture	10.0	3.7	3.3	2.7	1.3	0.5	1.3	3.0	7.7	6.4
Manufacturing	4.0	8.1	9.8	10.9	11.5	13.1	9.7	7.6	9.9	12.0
Trade	0.9	1.9	4.7	5.5	6.1	8.5	9.6	8.9	10.4	10.7
Building & construction	3.4	2.0	0.5	-0.5	2.8	1.9	2.9	7.9	6.4	8.2
Transport & communication	13.3	11.8	10.9	9.6	8.3	14.3	20.7	24.1	25.0	28.9
Finance and insurance	7.6	11.5	11.7	8.9	7.1	5.8	3.5	3.6	3.6	5.8
Real estate	5.8	4.0	2.9	2.4	1.1	0.6	0.5	0.7	0.5	0.8
Mining & quarrying	-8.8	-13.0	-8.4	6.2	8.3	42.9	24.9	-10.7	-4.9	28.3
Private households	4.5	3.2	2.6	2.7	3.3	3.7	4.3	5.0	7.5	6.7
Consumer durables	19.3	23.4	17.6	16.5	15.3	15.0	14.6	14.0	15.6	16.1
Business services	7.2	5.2	7.6	8.2	10.8	9.5	8.4	11.6	14.7	12.2
Other activities	24.3	65.2	59.5	64.1	55.2	38.9	46.8	49.7	60.5	53.6

Source: Central Bank of Kenya

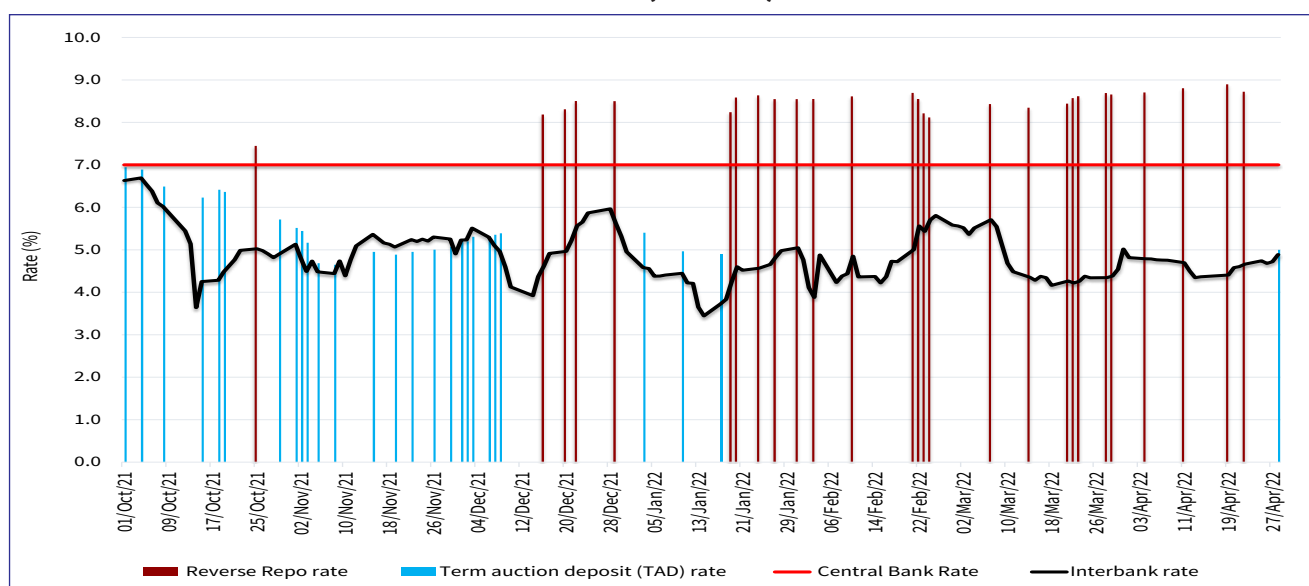
Growth of credit to the private sector is expected to remain resilient on account of continued economic recovery, and the previous policy measures, including the MSMEs Credit Guarantee Scheme.

2.3.6 Interest rates

Short-term money market interest rates remained relatively low; and below the CBR in the six months to April 2022, partly reflecting ample liquidity conditions

in the market and an accommodative monetary policy stance. The interbank interest rates, however, increased slightly in December 2021 and early March 2022, partly on account of seasonal increased demand for liquidity during the festive season, and temporary tight liquidity condition following higher government receipts relative to payments, respectively. Open market operations remained active (**Chart 6a**).

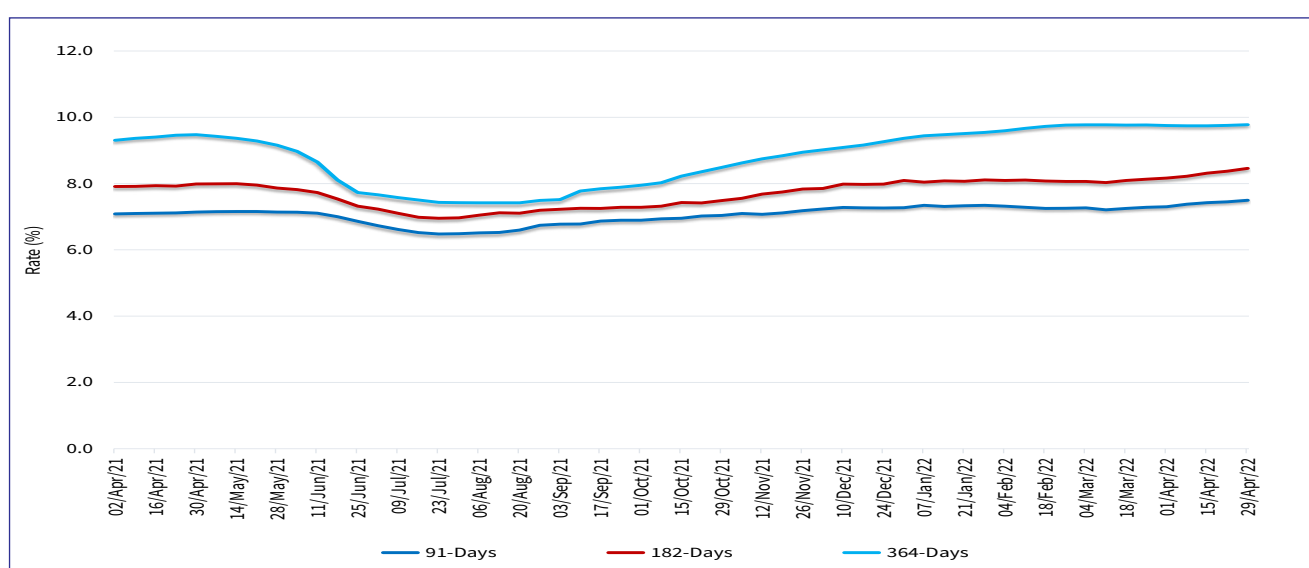
Chart 6a: Trends in Short Term Interest Rates (Percent)



Source: Central Bank of Kenya

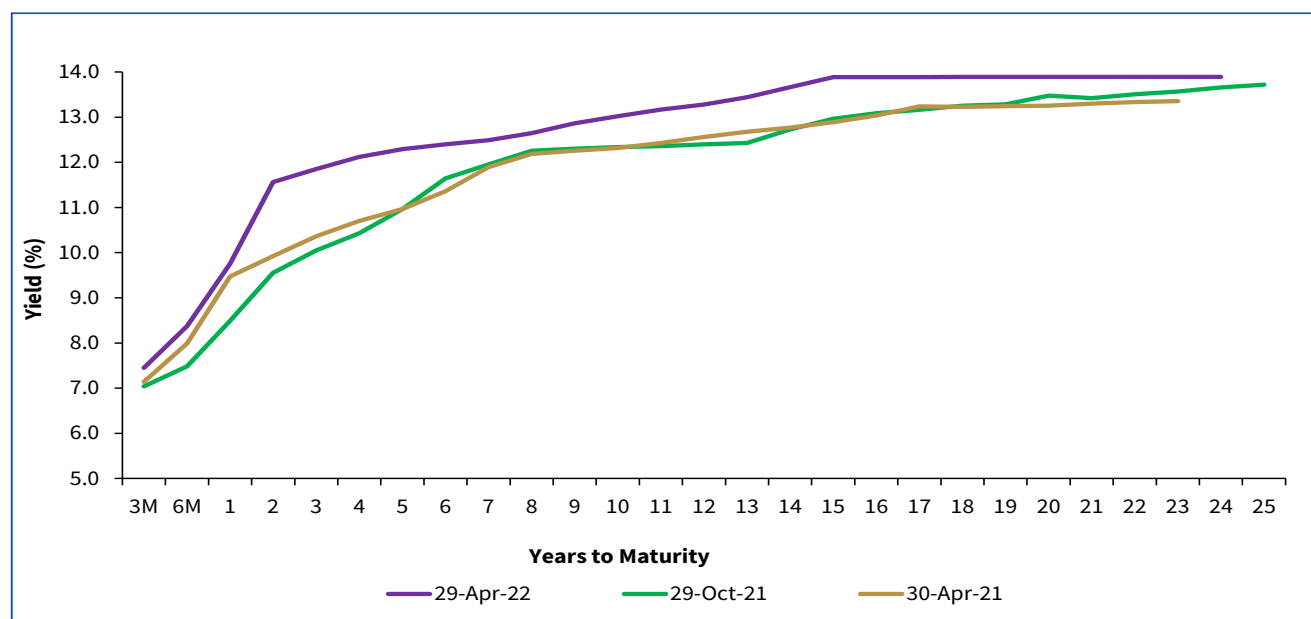
Interest rates on Government securities increased slightly, with a stable normal yield curve during the period. This reflected effective coordination of monetary and fiscal policies, particularly in the implementation of the Government domestic borrowing programme (**Chart 6b and 6c**).

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



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 April 2022, 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 FY 2020/21 and FY2021/22 was 5 percent with an allowable margin of 2.5 percent on either side.

The Central Bank Rate (CBR) remained the base for monetary policy operations and its adjustments both in direction and magnitude signaled the stance of monetary policy. The monetary policy stance was operationalised 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). Monetary policy was conducted in the context of a flexible exchange rate regime.

The annual growth in the broad money (M3) and private sector credit remained optimal during the period under review. The 12-month growth in M3 and credit to the private sector stood at 6.9 percent and 11.5 percent respectively, in April 2022. The growth in M3 was largely supported by resilient growth in private sector credit during the period.

3.2 Implementation of Monetary Policy Reforms

The CBK provided updates to the MPC regarding the status of implementation of the White Paper on *Modernization of the Monetary Policy Framework and Operations*, published in July 2021. The update was provided during the MPC Analytical Meeting held in March 2022. The reforms will enhance the

effectiveness of monetary policy and support anchoring of inflation expectations. These reforms focus on refining macroeconomic modelling and forecasting frameworks in line with changing structure of the economy, improving the functioning of the interbank market to strengthen monetary policy transmission and operations, and continued improvement of communication of monetary policy decisions.

3.3 Monetary Policy Committee Meetings and Decisions

Over the six months to April 2022, the MPC held meetings on November 29, 2021 January 26, 2022 and March 29, 2022. These meetings were preceded by technical meetings. MPC meetings were held against a backdrop of increased global uncertainties, particularly regarding the Russia-Ukraine conflict, uncertainty about the pace of policy responses in the advanced economies, and resurgence of COVID-19 cases especially in China.

The March 2022 meeting was held against a backdrop of a changed global outlook with heightened geopolitical tensions, volatile commodity prices, the COVID-19 (coronavirus) pandemic and measures taken by authorities around the world in response to these developments. The global economic outlook remained uncertain, on account of the Russia-Ukraine conflict that had started at the end of February, significant uncertainty about the policy responses in the advanced economies, and a spike in COVID-19 cases especially in China. Prices of commodities particularly oil, wheat, and fertilizer had risen sharply because of supply chain disruptions, adding to the already elevated global inflationary pressures. Financial market volatility had also increased amid adjustments in monetary policy in advanced economies. Leading indicators pointed to a strong performance of the Kenyan economy in the first quarter of 2022, supported by robust activity in construction, information and communication, wholesale and retail trade, transport and storage, and manufacturing sectors. The MPC also noted that

inflation expectations remain anchored within the target range supported by the Government's policy interventions. While noting the elevated global risks and their potential impact on the domestic economy, the MPC concluded that the current accommodative monetary policy stance remained appropriate, and therefore decided to retain the Central Bank Rate (CBR) at 7.00 percent.

The January 2022 meeting was held against a backdrop of the COVID-19 (coronavirus) pandemic, measures taken by authorities around the world to contain its spread and impact, and a projected weaker global outlook for 2022 and 2023. The MPC noted that uncertainties in the global economic outlook had increased, reflecting elevated risks from COVID-19 variants, supply chain disruptions, oil price volatility, and inflation developments. The risk of increased volatility in the global financial markets remained high because of uncertainties regarding policy actions in the advanced economies. GDP data for the third quarter together with leading indicators confirmed that the Kenyan economy had rebounded strongly in 2021, following the easing of COVID-19 restrictions and the impact of government interventions. Exports of goods had registered strong growth in 2021, particularly horticulture and manufactured goods exports. While inflation expectations remained anchored within the target range, and leading economic indicators showed continued robust performance, the MPC noted the elevated global risks, and their potential impact on the

domestic economy. Nonetheless, the MPC concluded that the prevailing accommodative monetary policy stance remained appropriate and decided to retain the CBR at 7.00 percent.

In the November 2021 meeting, the MPC considered the implications and outcomes of the measures implemented to mitigate the adverse economic effects and financial disruptions from the COVID-19 pandemic. The MPC noted that the global economy continued to strengthen, largely supported by the deployment of vaccines, improved business investment and consumer spending, and accommodative policy measures. Nevertheless, the pace of recovery remained uneven across countries, in part due to an unequal distribution of vaccines, varied supply chain constraints, and disparate policy support measures. Additionally, inflation in the advanced economies and emerging markets had risen sharply, driven in part by rising global oil prices, thereby raising concerns about the policy response. The MPC also noted the successful progress in implementation of the FY2021/22 Government Budget, particularly the rebound in revenue performance with the pick-up of economic activities and improvement of the business environment. Additionally, inflation expectations remained anchored within the target range, and leading economic indicators showed continued robust performance. The MPC concluded that the accommodative monetary policy stance remained appropriate, and therefore decided to retain the CBR at 7.00 percent.

4. IMPACT OF POLICY RESPONSES TO CORONAVIRUS (COVID-19) PANDEMIC

During the six months to April 2022, the MPC continued to monitor the outcomes of the measures deployed at the onset of the COVID-19 pandemic in March 2020, to mitigate the anticipated adverse economic effects and financial disruptions from the pandemic. These measures were intended to provide liquidity to the banking sector, mitigate the adverse impact on bank borrowers and facilitate the use of mobile money. The assessment by the MPC showed that these measures protected the economy from substantial decline and supported the most vulnerable citizens. In particular, the measures ensured continued provision of financial services and provided a buffer against a more adverse impact on the economy.

Interest rates remained low and stable supported by the accommodative monetary policy and improved

liquidity conditions. Private sector credit growth continued to strengthen, benefiting key sectors of the economy particularly transport and communications, manufacturing, trade, business services, and consumer durables. The Credit Guarantee Scheme (CGS) that was operationalized in October 2020, continued to support additional credit uptake by the vulnerable Micro Small and Medium-sized Enterprises (MSMEs).

On the fiscal front, the Government continued to implement programmes to cushion citizens and businesses from the effects of the COVID-19 under the Economic Stimulus Programme. Revenues continued to improve following reopening of the economy, reflecting enhanced tax collection efforts, and increased economic activity.

5. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC Surveys conducted 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 CBK continued to reach out to additional stakeholders and to broaden further the sample of non-bank private sector firms' size of the Surveys. 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.

The MPC Private Sector Market Perceptions Survey, CEOs Survey, and the Survey of Hotels conducted during the period revealed continued optimism about business activity and economic growth prospects. The optimism was attributed to continued post COVID-19 recovery, improving employment conditions, easing of international travel restrictions, and increased Government infrastructure spending. However, respondents were concerned about the impact of the Russia-Ukraine conflict on commodity prices, supply chain disruptions, and increased political activity. The Survey of Hotels revealed sustained strong activity in

the sector, with most hotels expecting to attain pre-pandemic levels of operations in 2022.

Over the period, the MPC Chairman held virtual stakeholder meetings with the Chief Executives of commercial and microfinance banks after every MPC Meeting to apprise them on the background to its decisions and to obtain feedback. In addition, the Chairman of the MPC held virtual 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 virtual meetings with various investors and representatives from the private sector 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 to interact with other government agencies such as the National Treasury and Kenya National Bureau of Statistics (KNBS) on various data issues.

6. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to April 2022 continued to support price stability, while also providing support to households and businesses in mitigating the adverse impact of COVID-19 pandemic and war in Ukraine. 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.

The CBK will continue to monitor developments in the domestic and global economy, the impact of the COVID-19 pandemic on the economy, the transmission of the monetary policy and other measures previously taken, and their effects on price stability. The MPC will also continue to closely monitor the implementation of the reforms in the White Paper on *Modernization of The Monetary Policy Framework and Operations*, which will enhance the effectiveness of monetary policy and support anchoring of inflation expectations.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2021 – APRIL 2022)

Date	Event of Relevance to Monetary Policy
November 2021	<p>Suspension, for a period of twelve months of the listing of negative credit information for borrowers with loans below Ksh 5 million. This applied to loans, which were performing but became non-performing from October 1, 2021. This followed the publication of Legal Notice No. 225 of November 5, 2021, by the Cabinet Secretary for the National Treasury and Planning, on the recommendation of CBK, pursuant to Regulation 18(7) of the Banking (Credit Reference Bureau) Regulations, 2020.</p> <p>CBR retained at 7.00 percent. The MPC noted that inflation expectations remained anchored within the target range, and that leading economic indicators showed continued robust performance.</p>
December 2021	The Central Bank of Kenya (Amendment) Act, 2021 became effective. The Amendment provides CBK with the powers to license and oversight the previously unregulated digital credit providers.
January 2022	<p>Release of January 2022 IMF World Economic Outlook (WEO) Report showing weaker global growth projections for 2022 and 2023 relative to the October 2021 WEO. This reflected increased mobility restrictions on account of new COVID-19 variants, financial market volatility at the end of 2021, continuing supply chain disruptions and higher global inflation, particularly in the United States.</p> <p>CBR retained at 7.00 percent. The MPC noted that inflation expectations remained anchored within the target range, and that leading economic indicators showed continued robust performance.</p>
February 2022	Russia's invasion of Ukraine
March 2022	CBR retained at 7.00 percent. The MPC noted elevated global risks and their potential impact on the domestic economy but concluded that the current accommodative monetary remained appropriate.
April 2022	Release of April 2022 IMF World Economic Outlook (WEO) Report showing worsening global economic prospects largely on account of Russia's invasion of Ukraine and the sanctions aimed at pressuring Russia to end the war. Global growth projected at 3.6 percent in 2022 and 2023, which is 0.8 and 0.2 percentage points lower for 2022 and 2023 compared to the January 2022 projections.

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the year-on-year 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 Reserves Ratio(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.



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