Central Bank of Kenya

Twenty Fourth Bi-Annual Report of the Monetary Policy Committee

April 2020

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 24^{th} 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 2020.

Dr. Patrick Njoroge

Governor

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EXECUTIVE SUMMARY

The twenty fourth bi-annual Report of the Monetary Policy Committee (MPC) reviews monetary policy formulation and other developments in the economy during the six months to April 2020. Consistent with the price stability objective of the Central Bank of Kenya (CBK), monetary policy during the period aimed at maintaining inflation within the target range of 2.5 percent on either side of the 5 percent medium-term target. Monetary policy was conducted in the context of strong domestic growth in 2019 and a challenging environment from March 2020, due to the impact of the COVID-19 (coronavirus) pandemic which severely disrupted economic activity globally. Authorities across the world implemented a wide range of policies to mitigate the health, social, economic and financial impact of the pandemic.

The MPC held four meetings during the period to review the outcome of its previous policy decisions and economic developments, and to put in place appropriate measures to maintain price stability. During its meeting in November 2019, the MPC adopted an accommodative monetary policy and lowered the Central Bank Rate (CBR) to 8.50 percent from 9.00 percent. The MPC augmented the accomodative stance by lowering the CBR further to 8.25 percent in its January 2020 meeting to support economic activity. The onset of COVID-19 pandemic in Kenya in mid-March created unprecedented uncertainty for the economy. The MPC moved quickly to put in place measures to prevent the pandemic from becomming a severe economic and financial crisis. The Committee lowered the CBR to 7.25 percent in March and further to 7.00 percent in April in order to support economic activity. Additionally, the MPC reduced the Cash Reserve Ratio (CRR) to 4.25 percent from 5.25 percent releasing an additional liquidity of Ksh 35.2 billion used to directly support distressed borrowers as a result of COVID-19. Additionally, the MPC extended the maximum tenor of Reverse Repurchase Agreements (REPOs) from 28 to 91 days. This provided flexibility on liquidity management facilities provided to banks by CBK by enabling banks access longer term liquidity secured on their holdings of government securities without having to discount them. The MPC also held monthly meetings in March and April to ensure closer monitoring of the impact of these policy measures on the economy, as well as the evolution of the pandemic. These measures augmented other emergency measures announced by CBK and the Government to contain the spread of the pandemic and to cushion the economy, households and businesses against its effects.

Inflation remained anchored within the target range during the period, supported by lower food and fuel prices, and muted demand pressures in the economy. Overall inflation stood at 6.0 percent in April 2020 compared to 6.3 percent in October 2019. Non-food-non-fuel (NFNF) inflation remained low and stable. The CBK continued to monitor the overall liquidity in the economy as well as any threats which could fuel demand driven inflationary pressures. In March 2020, the Kenya National Bureau of Statistics (KNBS) released a rebased Consumer Price Index (CPI), which was aimed at enhancing the measurement of inflation.

The foreign exchange market remained relatively stable during the period supported by balanced flows and a narrowing current account deficit. Global financial markets experienced significant volatility in March and April, largely due to uncertainties created by the pandemic and strengthening of the US Dollar. The current account deficit narrowed to 5.6 percent of GDP in the 12- months to April 2020 from 5.8 percent of GDP in 2019, largely due to lower imports of oil and SGR-related equipment, strong receipts from tea exports and resilient diaspora remittances. The CBK foreign exchange reserves that stood at USD 7,744.20 million (4.64 months of import cover) in April 2020, 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 period, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans to gross loans increased slightly in April, mainly due to low business activity for some sectors as a result of COVID-19 disruptions. Following the announcement of the first case of COVID-19 in Kenya in March 2020, the CBK announced a number of banking sector emergency measures to mitigate the impact of COVID-19 pandemic. These measures aimed at promoting the use of digital platforms to facilitate increased use of mobile money transactions instead of cash, and facilitate lending by banks to borrowers adversely impacted by the pandemic as well as smooth loan repayments. Additionally, CBK issued a Guidance Note instructing commercial banks to activate their precautionary measures to ensure continuity of the sector's operations. CBK closely monitored the implementation of these measures, while ensuring that the interbank market and liquidity management across the sector continued to function smoothly. 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.

Private sector credit growth improved in the six months to April, particularly to the manufacturing, trade and consumer durables sectors. Growth in credit to the private sector in the 12- months to April 2020 stood at 9.0 percent compared to 7.3 percent in November 2019, supported by accommodative monetary policy stance that resulted in a decline in bank lending rates. The repeal of the interest rate caps on commercial bank loans in November 2019 was a key development in the period. This reform restored the clarity of monetary policy decisions and was expected to strengthen the transmission of monetary policy. The caps had led to signficant rationing of credit, particularly to the vulnerable Micro, Small and Medium sized Enterprises (MSMEs), and perverse outcomes of monetary policy decisions.

The MPC held regular meetings with stakeholders in the period to discuss the basis for its decisions. Particularly, the Governor held media briefings after every MPC meeting to explain the basis of policy decisions as well as to highlight other market developments. Stakeholder meetings with banks after every MPC meeting also provided a platform for obtaining feedback, and improved the understanding of the conduct of monetary policy. The Bank remained vigilant to the risks posed by developments in the domestic and global environments, particularly the evoution of COVID-19 pandemic, on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The global economic environment during the six months to April 2020 was highly uncertain due to the effects of the COVID-19 pandemic. In October 2019, the IMF had projected global growth at 3.0 percent and 3.4 percent in 2019 and 2020, respectively, with concerns of reduced industrial output in advanced economies due to the expiry of tax incentives in China, concerns over emission standards in Germany, weak business confidence due to trade tariffs and the impact of U.S-China trade tensions. Growth for Emerging Markets and Developing Economies (EMDEs) was also revised downwards mainly due to disruptions of mining activities in Brazil, weak investment and private consumption in Mexico, and persistent labour issues and weak agricultural production in South Africa.

In January, projected global growth was revised downwards by 0.1 percentage points in what signalled a tentative stabilization that reflected a sluggish economic recovery. Uncertainties remained elevated mainly due to geopolitical and trade tensions between the US and China. However, market sentiments had improved due to the progress made with regard to the trade agreements between the US and China, and the resolution of Brexit, together with the positive impact on growth of accommodative monetary policy in the major advanced economies.

However, the outlook for global growth in 2020 was downgraded significantly in April following the onset of COVID-19, which resulted in unprecedented disruptions with significant human, economic and social costs. The IMF projected global output to contract by 3.0 percent in 2020, compared to the previous projection of a growth of 3.3 percent in January. The severe containment measures and restrictions on movement of people resulted in the collapse of global travel, sharp increase in unemployment levels, constrained supply chains and reduced production across the world. These resulted in sharp contractions in the advanced economies in the first quarter of 2020. In addition, global growth was expected to worsen in the second quarter, with the imposition of more stringent containment measures across many countries. For Sub-Saharan Africa (SSA), GDP was projected to contract by 1.6 percent in 2020 from an expansion of 3.1 percent in 2019, reflecting the adverse effects of the pandemic on global demand. Global financial markets were volatile with a significant decline in asset and commodity prices.

Authorities across the world implemented a wide range of accommodative policies to mitigate the health, social, economic and financial impact of the pandemic. Several countries had, however, commenced limited and cautious reopening of their economies by the second quarter, but risks remained elevated on a possible resurgence of the pandemic. The pace of global recovery was expected to depend on the intensity and duration of the pandemic. The re-emergence of US-China trade tensions continued to pose a significant risk to the recovery of the global economy.

2. DEVELOPMENTS IN THE KENYAN ECONOMY

2.1 Overall economy

The domestic economic environment during the six months to April 2020 was characterised by sustained macroeconomic stability. This was despite the uncertainty caused by the COVID-19 pandemic. The foreign exchange market remained largely stable, inflation was within the target range and there was a gradual pickup in private sector credit growth particularly following the repeal of the interest rate capping law in November 2019.

The economy posted strong performance in 2019, growing by 5.4 percent compared to 6.3 percent in 2018. Growth moderated slightly in 2019, largely due to depressed agricultural activity following the delayed onset and below average rainfall experienced in the first half of the year. However, the service-oriented sectors remained robust growing by an average of 6.7 percent compared to 7.0 percent in 2018, supported by strong growth in accommodation and restaurant, information and communication, finance and insurance, and transport and storage activities.

The economy remained resilient in the first quarter of 2020, despite the onset of the effects of the COVID-19 pandemic, growing by 4.9 percent. This growth was supported mainly by improved agricultural production, and resilient performance of the services sector. In particular, the agriculture sector grew by 4.9 percent compared to 4.7 percent in the first quarter of 2019, and contributed 1.3 percentage points to real GDP growth in the first quarter of 2020. The performance of the sector was attributed to favourable weather conditions across the country that largely supported tea and sugarcane production. However, production of cut flowers declined during the period, reflecting the initial impact of COVID-19 on global transportation. The services sector, whose growth moderated to 5.5 percent from 6.1 percent in the first quarter of 2019, reflected a contraction in the accommodation and restaurants sector due to the impact of COVID-19 pandemic on global travel and hotels. Other sectors that reported subdued activity included real estate, and transport and storage services. Activity in the information and communication sector remained strong, partly reflecting the waiver of mobile-money transaction charges by commercial banks and mobile network operators to promote the use of non-cash payments and minimise the spread of COVID-19.

Overall, there were both upside and down side risks to the domestic economy in the period under review. On the upside, coordinated domestic and international interventions to contain and mitigate the negative impact of COVID-19, as well as implementation by Government of measures to mitigate the spread and effects of the pandemic was expected to cushion the economy and households against its effects. On the downside, a more protracted spread and impact of the pandemic and possibility of a second wave of infections, together with widespread and prolonged lockdown of major economies would imply a slower-than anticipated growth of Kenya's trading partners.

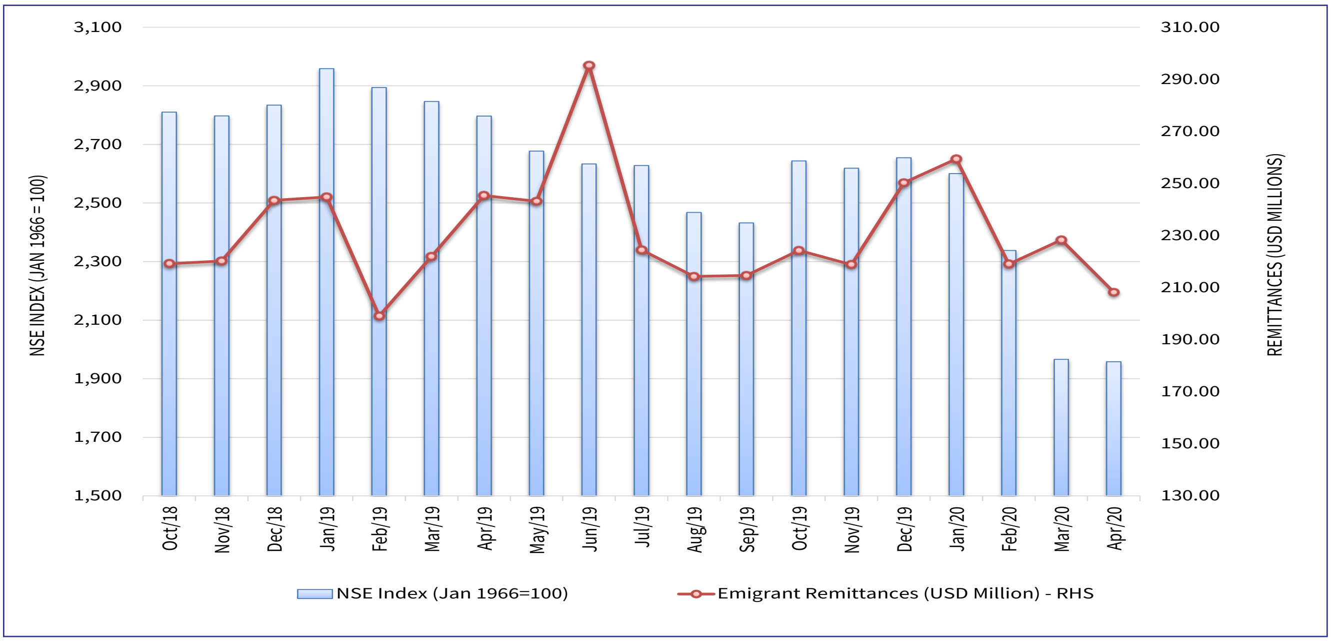
2.2 Financial Market Developments

The global financial markets experienced volatility associated with the COVID-19 pandemic uncertainties, and a significant strengthening of the US dollar. The volatility increased in April, with significant declines recorded in asset and commodity prices. To mitigate the economic and financial impact of the pandemic, authorities across the world implemented a wide range of accommodative policies.

The domestic foreign exchange market remained relatively stable in the six months to April 2020, supported by balanced flows and a narrowing current account deficit. Diaspora remittances remained resilient during the period, averaging USD 230.7 million per month in the six months to April 2020 compared to USD 236.0 million per month in the six months to October 2019 **(Chart 1a)**. The current account deficit narrowed to 5.6 percent of GDP in the 12 months to April 2020, compared to 5.8 percent of GDP in 2019. Temporary volatility was witnessed in the foreign exchange market in March due to the significant strengthening of the US Dollar in the global markets, and increased uncertainties with regard to the impact of COVID-19 pandemic.

Like in other emerging market economies, activity at the Nairobi Securities Exchange (NSE) declined following the announcement of the first case of COVID-19 in the country. The NSE 20-Share index fell from 2,643.4 in October 2019 to 1,958.1 in April 2020 **(Chart 1a)**.

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

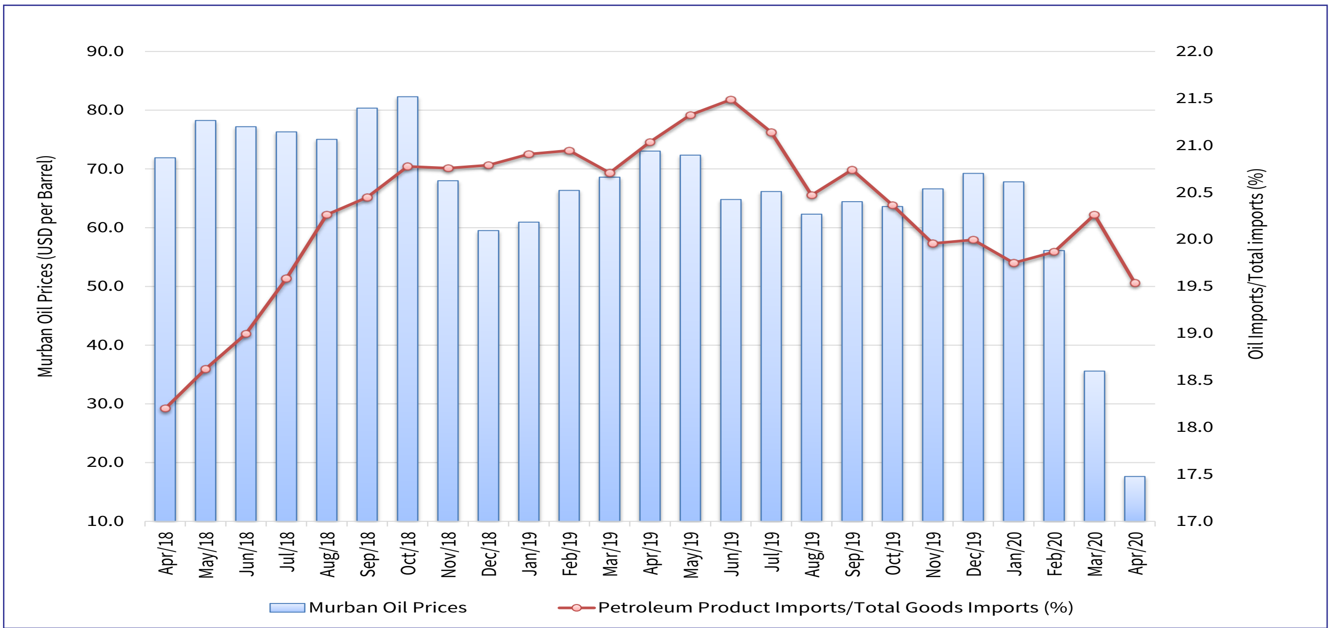


Source: Central Bank of Kenya and Nairobi Securities Exchange

The decline in international oil prices had implications on balance of payments position given that the proportion of petroleum products in total imports is high. Murban crude oil price fell steadily from USD 73.1 in April 2019 to USD 63.6 in October 2019 and further to USD 17.6 per barrel in April 2020. This reflected a decline in demand as economic activity slowed down due to the restrictions imposed to contain the spread of the pandemic.

Consequently, the proportion of imports of petroleum products in total imports of goods declined to 19.5 percent from 21.0 percent over the period **(Chart 1b)**. This decline supported the 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

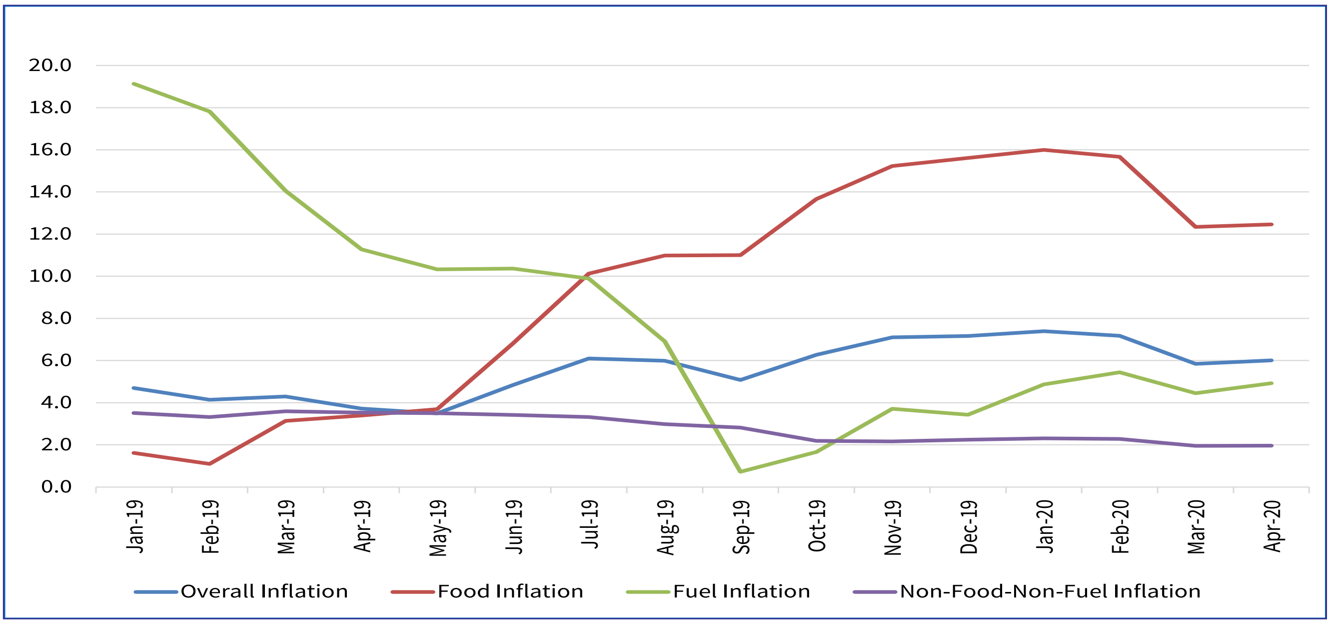
2.3.1 Inflation

Overall inflation remained within the target range during the six months to April 2020. The inflation rate declined to 6.0 percent in April 2020 from 6.3 percent in October 2019, supported by lower food and fuel prices. Food inflation declined to 12.5 percent in April 2020 from 13.7 percent in October 2019, largely reflecting the impact of favourable weather conditions on the prices of key short-term food items such as *sukuma wiki* (kales) and carrots. Fuel inflation stood at 4.9 percent in April, representing a decline from the 5.4 percent in February 2020 and 11.3 percent in April 2019 following a decline in international oil prices. Non-food-non-fuel inflation remained low between 1.9 percent and 3.5 percent during the period, suggesting that demand pressures in the economy were muted **(Charts 2a)**. Inflation rates of all consumer good categories except Food and Non-alcoholic beverages, Alcoholic beverages, Tobacco and Narcotics, were within the target range in April 2020 **(Chart 2b)**.

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

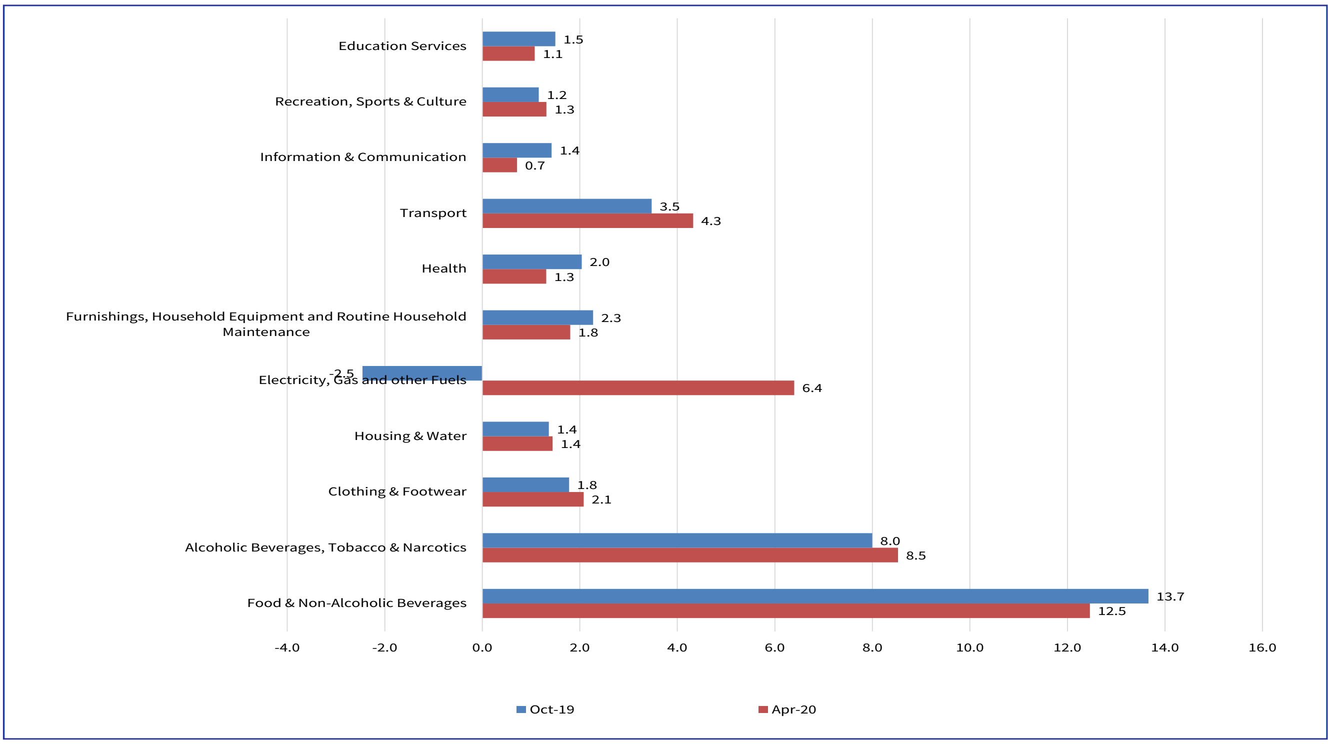
In March 2020, the Kenya National Bureau of Statistics (KNBS) released a rebased Consumer Price Index (CPI), a rebased Producer Price Index (PPI) and four Quarterly Labour Reports. These three products aimed at enhancing the quality of statistics, including the measurement of inflation, upon which policymakers base their decisions. These revisions were guided by internationally accepted best practices as well as the Common Market for East and Southern Africa (COMESA) and the East African Community Harmonized Consumer Price Index regulations. The new release of CPI data involved an announcement of a revised CPI basket comprising 330 items, compared to the previous basket of 234 items. Obsolete items in the old basket were dropped, while new and more relevant items were included. The weights in the rebased CPI were updated and the Expenditure Groups were recalculated, based on the 2015/16 Kenya Integrated Household Budget Survey. The review of the PPI reflected changes in production patterns and a new industrial structure. The Quarterly Labour Force Survey will more accurately measure key labour statistics, including labor force participation, employment and utilization.

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



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

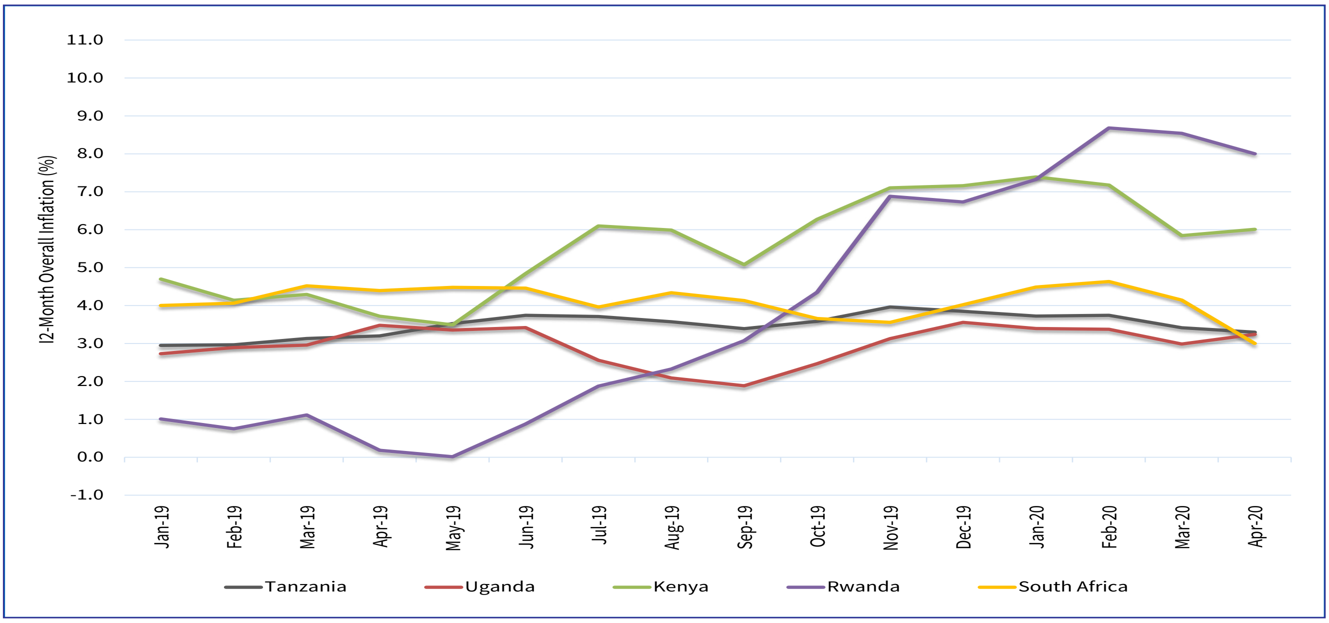
Chart 2b: 12-Month Inflation by Broad CPI Category (%)



Source: Kenya National Bureau of Statistics

Note: New CPI data released in March 2020 reflected a revised basket based on February 2019 prices.

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



Source: Respective country central bank websites

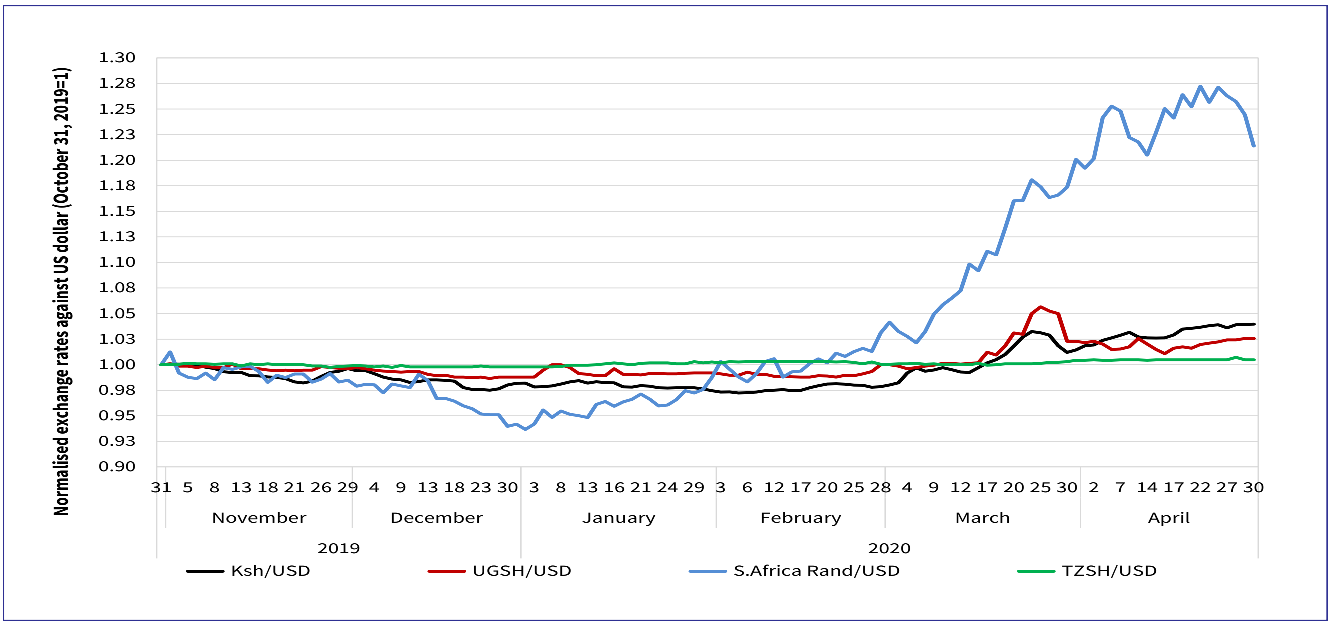
2.3.2 Foreign Exchange Market Developments

The foreign exchange market in the six months to April 2020 remained stable supported by balanced flows and a narrowing current account deficit. However, temporary volatility was experienced in the market in March largely due to significant strengthening of the US Dollar in the global markets and uncertainities regarding the impact of COVID-19 pandemic. The markets in April experienced higher volatility impacting asset and commodity prices. Authorities across the world implemented a wide range of accommodative policies to mitigate the health, social, economic and financial impact of the pandemic.

Diaspora remittances remained resilient and the CBK foreign exchange reserves remained above the statutory minimum of 4 months of import cover. The reserves stood at USD 7,744.2 million (4.64 months of import cover) in April 2020. These reserves continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

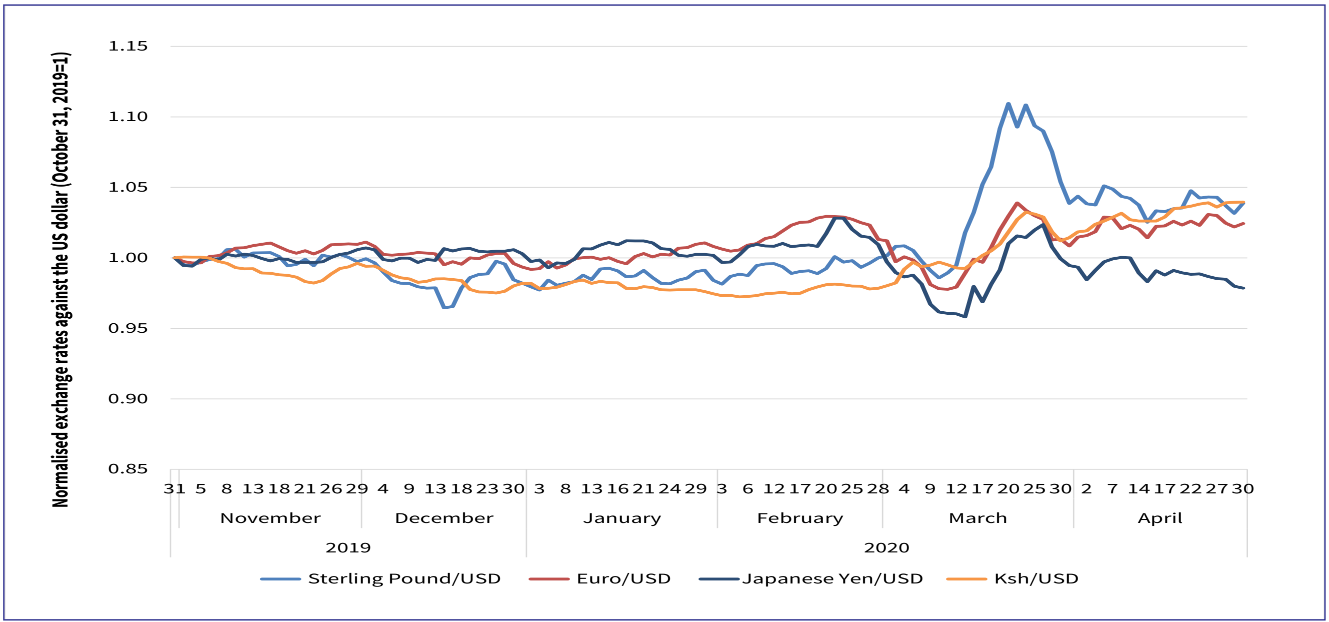
In the six months to April 2020, the major international and regional currencies' exchange rates against the US Dollar remained relatively more volatile than the Kenya shilling / US dollar exchange rate **(Charts 3a and 3b)**. This reflected the shilling's relative resilience against shocks and uncertainties in the global financial markets, associated with the impact of COVID-19 pandemic, protracted trade tensions between the US and China, and accommodative monetary policies across the world to mitigate the adverse effects of the pandemic on economies.

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (October 31, 2019 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (October 31, 2019 = 1)



Source: Central Bank of Kenya

2.3.3 Balance of Payments Developments

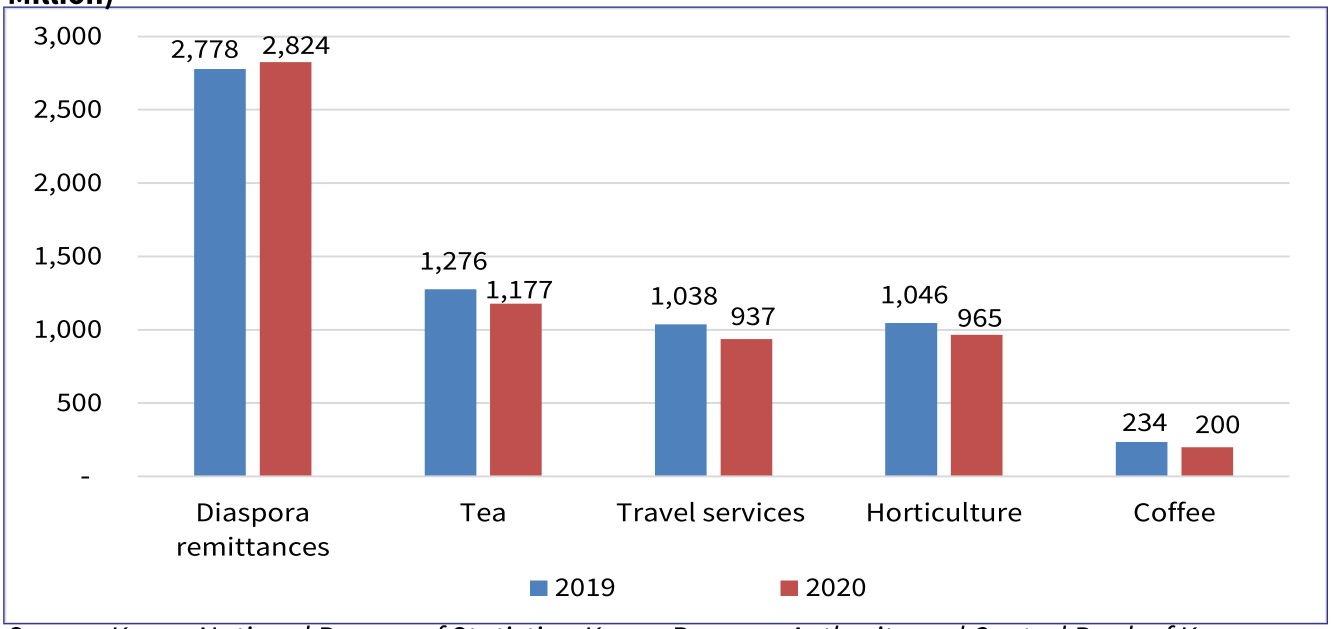
The current account balance was a deficit of USD 5,488.7 million in the 12-months to April 2020 (5.6 percent of GDP) compared to a deficit of USD 4,755.1 million (5.0 percent of GDP) over a similar period in 2019. The wider deficit mainly reflected a slowdown in services exports by 9.1 percent over the period, particularly transportation and travel services that declined by 2.6 percent and 9.7 percent, respectively. Goods exports declined by 0.9 percent, compared to a decline of 0.5 percent in goods imports, reflecting the disruptions caused by COVID-19 pandemic. However, service imports particularly transportation services grew by 3.5 percent.

The value of merchandise exports declined to USD 5,992.6 million in the 12-months to April 2020 from USD 6,044.6 million in the 12-months to April 2019, largely reflecting a slowdown in tea and horticulture exports, which fell by 7.8 percent and 7.7 percent, respectively. Earnings from tourism declined over the period, partly reflecting the impact of the pandemic on global travel **(Chart 4a).** Merchandise imports also declined, albeit at a slower pace than the exports, to USD 16,150.4 5million in the 12-months to April 2020 from USD 16,227.5 million over a similar period to April 2019. The decline in imports was mainly driven by imports of petroleum products, which fell by 7.5 percent. The value of imports of petroleum products declined on account of lower global oil prices **(Chart 4b).**

The financial account deficit widened to USD 5,726.3 million in the 12-months to April from USD 3,854.4 million over a similar period in 2019. This largely reflected a faster increase in foreign direct investment (FDI) liabilities than the increase in FDI assets, slowdown in other investment inflows and increase in government external borrowing. The capital account, however, recorded a surplus of USD 130.1 million in the 12-months to April 2020 compared to a surplus of USD 220.0 million in the 12-months to April 2019, primarily reflecting steady inflows of government grants.

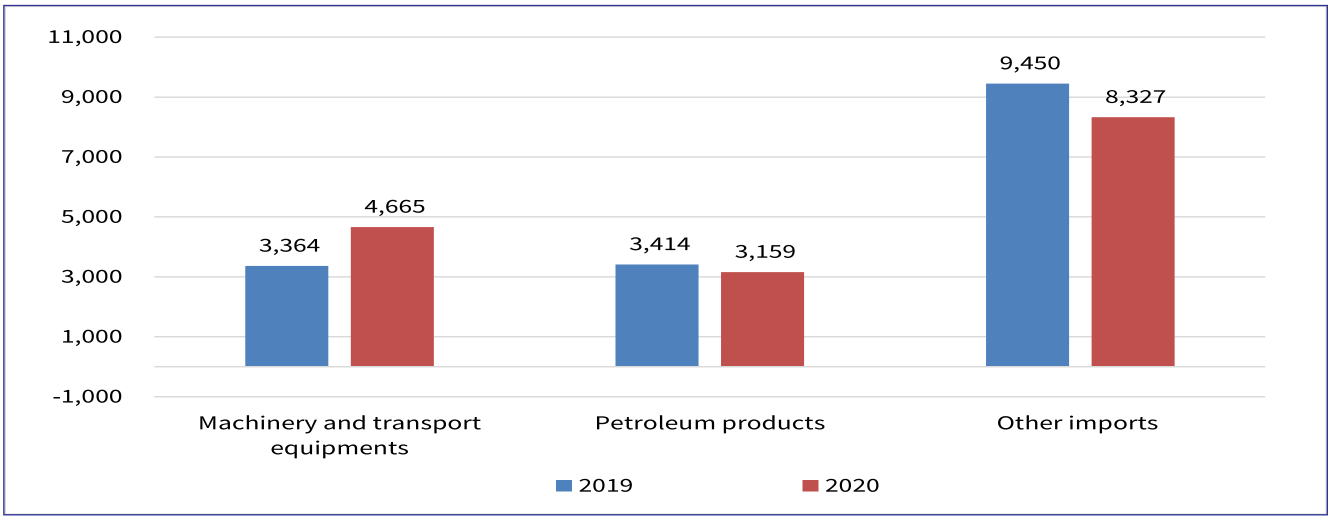
During the period under review, the CBK continued to monitor global developments, particularly the effects of COVID-19 pandemic, the post-Brexit resolution and the U.S. economic and trade policies, particularly their impact on trade and investment. The U.K. and U.S. accounted for an average of 6.4 percent and 8.5 percent, respectively, of Kenya's total exports over the six months to April 2020. Exports to other trading blocs such as the EAC, COMESA and the EU, respectively, accounted for an average of 23.7 percent, 25.2 percent and 22.1 percent over the period, compared with 22.3 percent, 24.9 percent and 22.1 percent of total exports in the six months to October 2019, respectively.

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



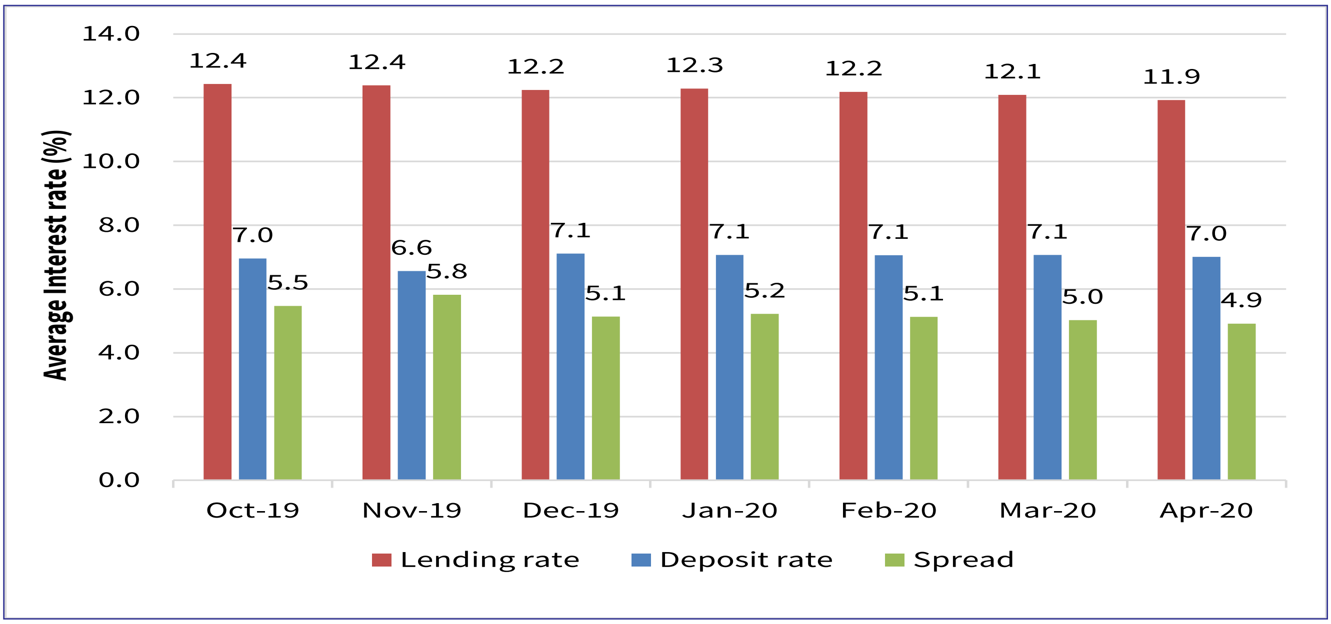
Source: Kenya National Bureau of Statistics and Kenya Revenue Authority

2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the six months to April 2020, with the average commercial banks liquidity and the capital adequacy ratios remaining largely unchanged at 51.2 percent and 18.4 percent, respectively. The ratio of gross non-performing loans (NPLs) to gross loans rose slightly to 13.1 percent in April 2020 from 12.3 percent in October 2019, due in part to a slight increase in NPLs in the real estate, trade and manufacturing sectors. While the main drivers of NPLs in the real estate sector included the slow uptake of housing units and commercial properties, trade and manufacturing sector activities were adversely affected by COVID-19 pandemic-related disruptions.

The average commercial banks' lending rate declined gradually, partly reflecting the accommodative monetary policy stance adopted during the period. This reduced the interest rate spreads in the market, even as the average deposit rate remained largely unchanged **(Chart 5a)**. The CBK continued to monitor movements in the market interest rates particularly following the repeal of the interest rate capping law in November 2019.

Chart 5a: Commercial Banks' Average Interest rates and Spreads (%)



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

The 12-month growth in credit to the private sector improved to 9.0 percent in April 2020 from 6.6 percent in October 2019. Strong growth in credit to the private sector was observed in the following sectors: manufacturing (20.1 percent), consumer durables (19.6 percent), trade (10.3 percent), transport and communication (9.1 percent), and building and construction (7.7 percent).These sectors jointly accounted for an average of 53.5 percent of total credit to the private sector during the period. Lending to the manufacturing sector, which picked up strongly during the period, was largely absorbed by large food and beverage manufacturers for working capital purposes **(Table 1).** These borrowers accounted for 33.0 percent of credit to manufacturing sector, which was the largest share in April 2020.

The value of loan applications and approvals declined, respectively, to KSh 111.2 billion and KSh 86.8 billion in April 2020 from KSh 174.1 billion and KSh 151.0 billion in October 2019. The decline in the value of loan applications and approvals, was recorded across all the sectors, but mainly in the household sector (comprising private household loans and loans to finance consumer durables) which declined by 42.9 percent in April 2020 relative to the October 2019 levels. The services sector (transport, ICT, trade and business activities) also recorded a significant decline in loan applications, at 40.9 percent over the same period. The productive sectors (agriculture, manufacturing, building and construction, real estate and mining and quarrying activities) recorded a relatively lower decline in applications, at 12.4 percent over the same period. Similarly, loan approvals to the household, services and productive sectors also declined, by 41.1 percent, 54.3 percent and 19.6 percent, respectively. The declines in loan application and approvals largely reflected reduced economic activity following the disruptions attributed to COVID-19 pandemic.

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

	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20
Total Credit to Private Sector	**6.6**	**7.3**	**7.1**	**7.3**	**7.7**	**8.9**	**9.0**
Agriculture	-5.2	-6.1	-2.4	-4.8	0.2	1.4	2.8
Manufacturing	6.4	7.5	9.2	12.7	10.4	15.3	20.1
Trade	10.2	8.8	8.9	6.0	9.5	9.4	10.3
Building & construction	-5.5	-6.1	1.6	4.0	-0.5	9.5	7.7
Transport & communication	4.8	9.8	8.1	9.9	7.4	7.1	9.1
Finance and insurance	15.1	15.8	0.4	-1.1	1.9	6.6	3.1
Real estate	0.4	1.9	1.5	3.5	3.4	2.2	4.8
Mining & quarrying	0.1	-3.2	-5.8	-9.4	-14.6	3.9	11.0
Private households	5.3	6.1	5.6	5.6	5.9	3.4	2.2
Consumer durables	28.6	25.9	26.0	21.4	20.6	24.1	19.6
Business services	-0.4	-0.3	2.4	1.5	2.4	3.3	1.2
Other activities	12.7	30.9	16.0	24.4	33.4	36.8	14.3

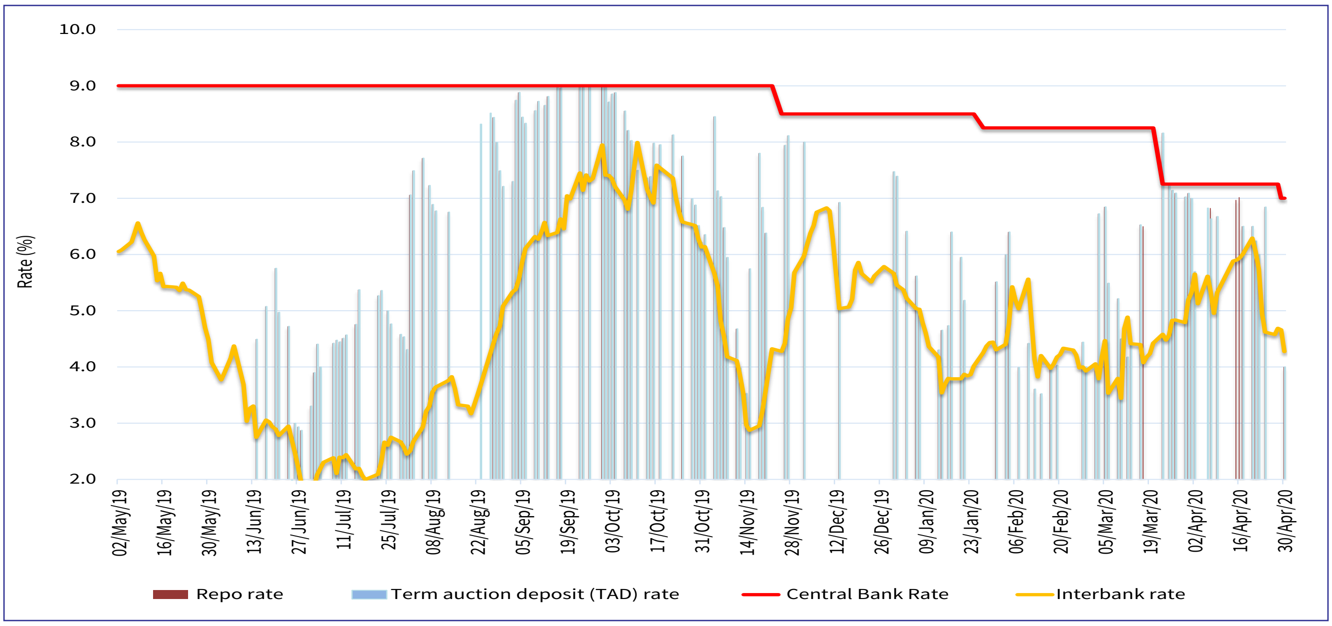
Source: Central Bank of Kenya

2.3.6 Interest rates

The short term interest rates remained below the CBR during the six months to April 2020, reflecting improved liquidity conditions in the market. The average interbank rate remained largely stable at 4.74 percent in the period, marginally higher than an average of 4.70 percent in the six months to October 2019. Liquidity management operations by the CBK continued to ensure stability in the market. During the period, Reverse Repos were not used to supply liquidity to segments of the market facing shortages, indicating ample and fair distribution of liquidity in the market. Repos and Term Auction Deposits were used to withdraw liquidity from segments of the market with surpluses **(Chart 5b).**

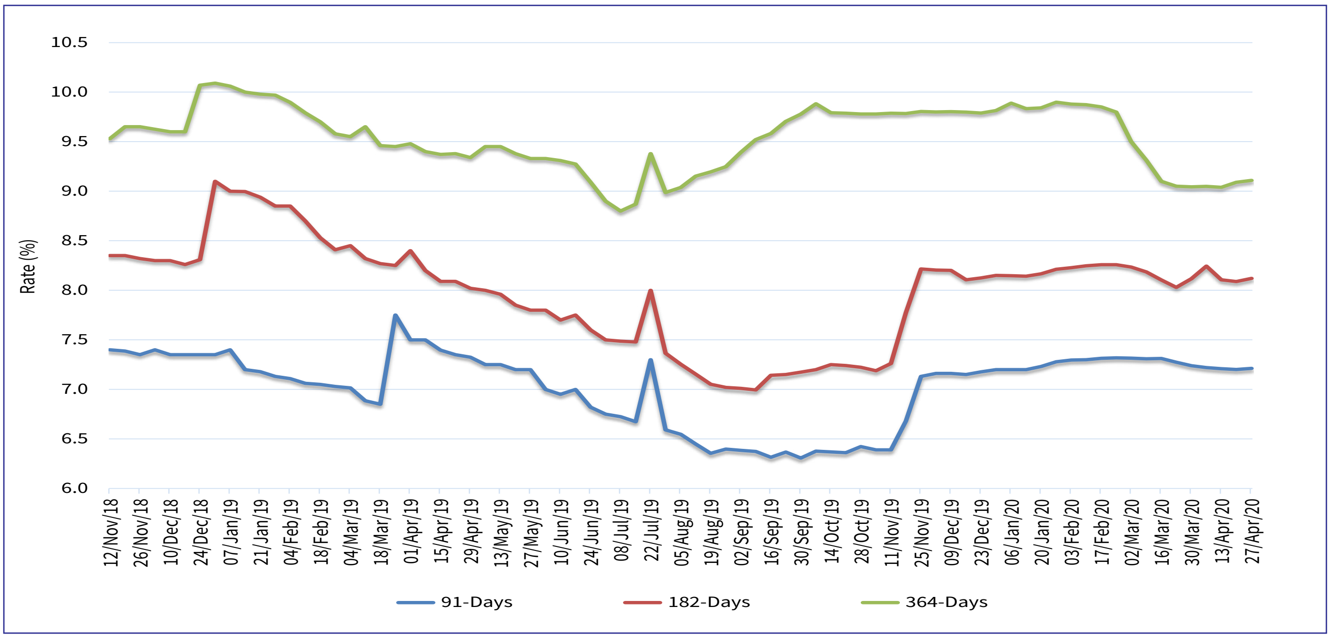
The interest rates on Government securities were largely stable during the six months to April 2020, as reflected in a stable yield curve of Government securities **(Chart 5c and 5d).** The stability in the interest rates is an indication that there was effective coordination of monetary and fiscal policies, particularly in the implementation of the Government domestic borrowing programme.

Chart 5b: Trends in Short Term Interest Rates (%)



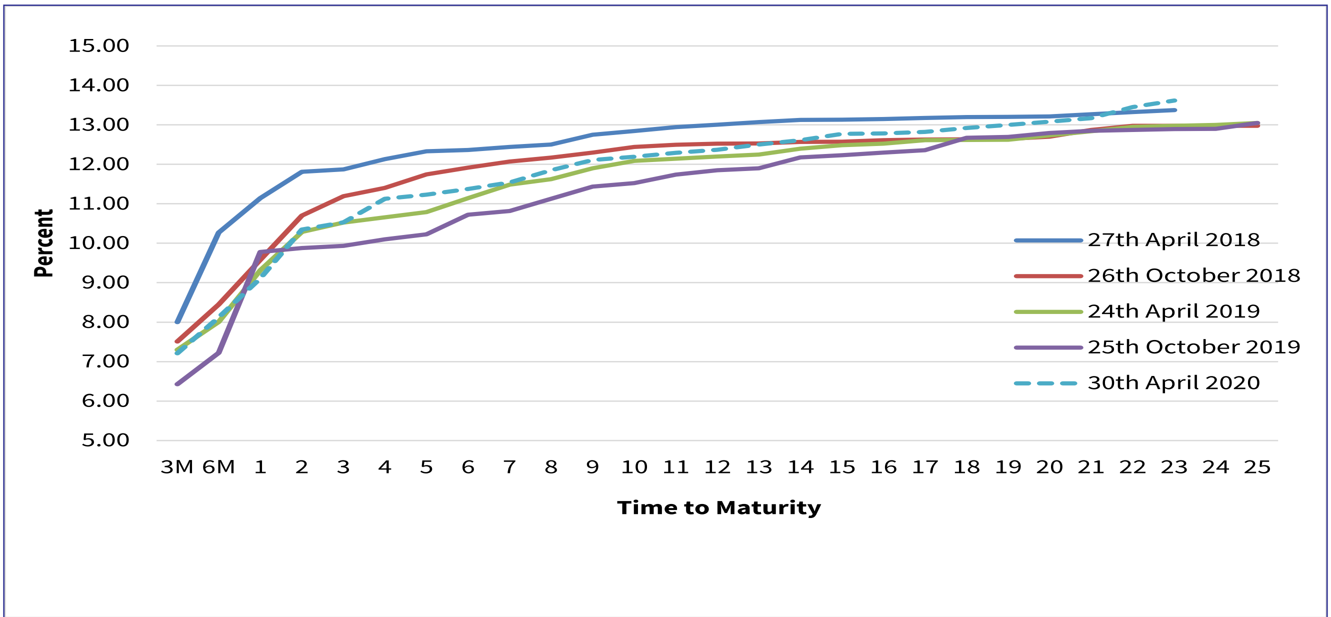
Source: Central Bank of Kenya

Chart 5c: Interest rates on Treasury Bills (%)



Source: Central Bank of Kenya

Chart 5d: Government Securities Yield Curve



Source: Central Bank of Kenya

3. MONETARY POLICY FORMULATION

3.1 Attainment of Monetary Policy Objectives and Targets

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 overall 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.

In the six months to April 2020, 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 is 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 through the period under review. In particular, the 12-month growth in M3 rose to 8.6 percent in April 2020 from 7.5 percent in October 2019 reflecting the improvement in private sector credit uptake during the period.

3.2 Monetary Policy Committee Meetings and Decisions

The MPC held its bi-monthly meetings on November 25, 2019, January 27, March 23, 2020 and a special meeting on April 29, 2020, to review market and economic developments as well as the outcome of its previous policy decisions, including the measures taken to mitigate the impact of COVID-19 pandemic on the economy.

The November 2019 meeting was held against a backdrop of domestic macroeconomic stability, the repeal of interest rate caps in early November 2019, and heightened global uncertainties and volatility in international markets. The MPC noted that inflation expectations remained well anchored within the target range, and assessed that the economy was operating below its potential level. Furthermore, the MPC noted the tightening of fiscal policy and concluded there was room for accommodative monetary policy to support economic activity. The MPC therefore, decided to lower the Central Bank Rate (CBR) to 8.50 percent from 9.00 percent.

The January 2020 meeting was held against a backdrop of continued domestic macroeconomic stability, potential risks to food supply and increased global uncertainties. However, inflation expectations remained well anchored within the target range, while the economy continued to operate below its potential level. With tightening of fiscal policy, the Committee assessed that the effects of the lowering of the CBR in November 2019 continued to be transmitted in the economy. There was, however, room for further accommodative monetary policy to support economic activity. The MPC therefore decided to lower the CBR to 8.25 percent from 8.50 percent.

The March 2020 meeting was held in the context of COVID-19 pandemic, which continued to devastate many countries, with significant human, economic and social costs. It was noted that the global economic outlook was highly uncertain, with unprecedented turmoil in the financial markets even as policymakers in the advanced economies announced ambitious supportive packages. While the extent of the adverse effects of the pandemic on the Kenyan economy were still evolving, it was already evident that the impact may be severe. Against this backdrop, the MPC's deliberations focused on minimizing the economic and financial impact of the pandemic. In light of this adverse economic outlook, the MPC took a number of policy actions to prevent the COVID-19 health crisis from becoming a severe economic and financial crisis. The MPC lowered the CBR to 7.25 percent from 8.25 percent, and reduced the CRR to 4.25 percent from 5.25 percent. Against a backdrop of increased uncertainty, the Committee decided to reconvene within a month for an early assessment of the impact of these measures and assessment of the evolution of the COVID-19 pandemic.

The April meeting was held at a time when authorities around the world had taken measures to contain the spread and impact of the pandemic. The MPC assessed the economic impact of the pandemic, and the outcomes of its policy measures that were deployed in March to mitigate the adverse economic and financial disruptions, and noted that the effects of the measures continued to be transmitted through the economy and were having the intended effect. The MPC also noted the release of the 2019 economic growth data, and the continuing adverse impact of the pandemic-related containment measures particularly on the hotel and tourism services sectors. In this regard and due to continuing adverse economic outlook, the MPC decided to augment its accommodative monetary policy stance, by lowering the CBR to 7.00 percent from 7.25 percent.

During the six months to April 2020, the MPC analyzed the effects of its previous policy changes, monitored the impact of COVID-19 pandemic on the economy, as well as other developments in the domestic and global economy, and stood ready to take additional measures as necessary. The CBK continued to work closely with the National Treasury to ensure effective coordination of monetary and fiscal policies for overall macroeconomic stability. The Bank also continued to closely monitor the foreign exchange market in view of the risks posed by increased uncertainties in the global financial markets largely arising from the pandemic.

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

COVID-19 was declared a global pandemic in March 2020 by the World Health Organization. The pandemic precipitated an unprecedented global health and economic crisis. In Kenya, the first COVID-19 case was confirmed on March 13, 2020 and the Central Bank of Kenya (CBK) immediately took a frontline position in ensuring that the Kenyan financial sector remained resilient despite the threats posed by the pandemic. CBK immediately instituted a series of emergency measures to mitigate the health and economic effects of the pandemic. These measures can be grouped into five categories as follows:

i. Measure to encourage use of digital finance:

The first series of emergency measures were announced on March 16, 2020 by CBK in conjunction with commercial banks and Payment Service Providers. These were intended to encourage the use of digital financial platforms and mitigate the transmission risk posed by use of bank notes and coins. The measures included elimination of charges for mobile money transactions under KSh 1,000, and transfers between bank accounts and mobile e-wallets. CBK also increased daily mobile money transaction limits from KSh 70,000 to KSh 150,000.

Implementation of the measures resulted in a significant increase in the use of mobile money channels by individuals in both value and number of transactions. Most of the increase was in low-value transactions of KSh 1,000 or less—this band accounts for over 80 percent of mobile money transactions. The elimination of charges helped cushion the most vulnerable households. Moreover, more than 1.6 million additional customers are now using mobile money channels. These measures were timely and highly effective in facilitating official and personal transfers at a time of great need.

ii. Affordable credit

On March 23 and April 29 the MPC lowered the Central Bank Rate to signal the banking sector to lower lending and deposit rates. By end April, the average commercial banks' lending rates had fallen to 11.9 percent, supporting provision of affordable credit to Kenyans.

iii. Banking sector measures

The emergency measures announced by CBK on March 18, 2020 on restructuring personal/household and other loans by banks were effective. As at end April, the repayment period of personal/household loans amounting to KSh 102.5 billion or 13.1 percent of the banking sector personal/household gross loans had been extended. For other sectors, a total of KSh 170.6 billion had been restructured. The sectors that had recorded the highest levels of restructuring were Trade (43.5 Percent), Real Estate (9.8 percent) and Manufacturing (13.6 percent). These are the sectors that bore the brunt of the slowdown occasioned by the pandemic. Total loans restructured of KSh 273.1 billion accounted for 9.5 percent of the total banking sector loan book of KSh 2.8 trillion.

iv. Measures to support operations of the financial institutions

The CBK also implemented measures to support operations of the financial institutions by ensuring adequate liquidity for both banks and borrowers. These included the lowering of the Cash Reserve Ratio (CRR) from 5.25 percent to 4.25 percent on March 23 which provided additional liquidity of KSh 35 billion to support the banks as they restructured performing loans adversely impacted by COVID-19. Additionally, the maximum tenor of Reverse Repurchase Agreements (REPOs) was extended from 28 to 91 days. This provided flexibility in liquidity management facilities provided to banks by CBK by enabling banks to access longer term liquidity secured on their holdings of government securities without having to discount them.

v. Measures to support business continuity and enhance resiliency of the financial sector

The banking sector activated business continuity measures, which included: creating two alternate teams; creating redundant teams for all critical functions and ensuring that the teams were facilitated to undertake requisite functions; ensuring that alternate recovery sites were ready; updating Business Continuity Plans (BCPs); and reporting to CBK when they invoke their BCPs and any incident relating to the pandemic affecting their staff members/premises. As a result, the banking sector continued to operate smoothly during the pandemic period serving customers both from branches and digital channels. While ensuring the health and safety of customers and staff, over 90 percent of the approximately 1,500 bank branches across the country remained open. The over 30,000 bank staff were in the frontline serving Kenyans even in areas locked down to contain the pandemic.

5. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC held regular stakeholder forums with Chief Executive Officers of banks in the six months to April 2020 to provide the background to the policy decisions and obtain feedback on the Committee's previous policy decisions. The bi-monthly 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.

The MPC Chairman held press conferences after MPC Meetings to brief the public on the background information considered before each policy decision was reached, and the measures undertaken by the CBK to ensure macroeconomic and financial sector stability. This included the measures that the CBK had put in place to mitigate the effects of the pandemic on households and businesses. The media and public understanding of monetary policy decisions and their expected impact on the economy continued to improve as was noted by increased coverage, commentaries and analyses by the press. During the period covered by this report, the Chairman and MPC Members also held meetings with potential investors to discuss recent economic developments and the outlook for the economy.

6. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to April 2020 provided support to households and businesses in mitigating the impact of COVID-19 pandemic, while at the same time 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. Effective coordination of fiscal and monetary policies 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 pandemic on the economy, the transmission of the monetary policy and other measures previously taken, and their effects on price stability. The 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 sustainably increase private sector credit uptake.

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2019 – APRIL 2020)

April 2020	The MPC augmented its accommodative monetary policy stance by lowering the CBR to 7.00 percent from 7.25 percent.
March 2020	• First COVID-19 case in Kenya reported on March 13, 2020. • CBR lowered to 7.25 percent from 8.25 percent. • CRR reduced to 4.25 percent from 5.25 percent, releasing KES.35.2 billion as additional liquidity availed to banks to directly support borrowers that are distressed as a result of COVID-19.
January 2020	CBR lowered to 8.25 percent from 8.50 percent.
November 2019	• CBR lowered to 8.50 percent from 9.00 percent to support economic activity • Interest rate caps removed.

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.

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