FIFTEENTH
BI-ANNUAL REPORT OF THE MONETARY POLICY COMMITTEE

Central Bank of Kenya

Issued under the Central Bank of Kenya Act, Cap 491

OCTOBER 2015

The Bi-Annual Report is prepared by the
Members of the Monetary Policy Committee.

Enquiries concerning the Report should be addressed to:
Monetary Policy Committee Secretariat,
Central Bank of Kenya,
P.O. Box 60000-00200 Nairobi, KENYA

also available on http://www.centralbank.go.ke

LETTER OF TRANSMITTAL TO THE CABINET SECRETARY FOR THE NATIONAL TREASURY

Honourable Cabinet Secretary,

I have the pleasure of forwarding to you the fifteenth bi-annual Monetary Policy Committee (MPC) Report in accordance with section 4D (6) of the Central Bank of Kenya Act. The Report outlines monetary policy formulation, developments in key interest rates, inflation, and exchange rates together with other activities of the Committee in the six months to October 2015. Copies of MPC Press Statements and the Minutes of all the Meetings of the MPC between May and October 2015 are attached to the Report for your information.

Patrick Njoroge

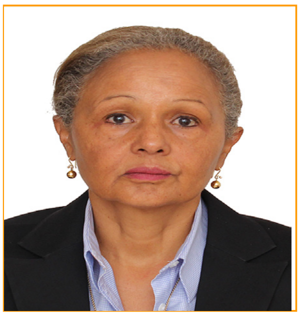
Dr. Patrick Njoroge
Governor, Central Bank of Kenya

TABLE OF CONTENTS

MEMBERS OF THE MONETARY POLICY COMMITTEE

Dr. Patrick Njoroge
Governor, Chairman

Dr. Haron Sirima (OGW)
Deputy Governor



Mrs. Sheila M'Mbijjewe
Deputy Governor

Dr.Kamau Thugge (EBS)
PS, National Treasury
Treasury Representative

Mr. Charles G. Koori
Member

Mrs. Farida Abdul
Member

Prof. Francis Mwega
Member

Mr. John Birech
Member

LEGAL STATUS OF THE MONETARY POLICY COMMITTEE

(1) Section 4D of the Central Bank of Kenya Act states that there shall be a Committee of the Bank, to be known as the Monetary Policy Committee of the Central Bank of Kenya, which shall have the responsibility within the Bank for formulating monetary policy.

(2) The Committee shall consist of the following members:-

(a) the Governor, who shall be the chairman;

(b) the Deputy Governor, who shall be the deputy chairman;

(c) two members appointed by the Governor from among the staff;

(d) four other members who have knowledge, experience and expertise in matters relating to finance, banking and fiscal and monetary policy, appointed by the Cabinet Secretary for the National Treasury. Gazette Notice No. 6309 re-appointed the two eligible external members effective 1st May 2014; and,

(e) the Principal Secretary to the National Treasury, or his representative, who shall be non-voting member.

(2A) Of the two members appointed under subsection (2) (c).

(a) one shall be a person with executive responsibility within the Bank for monetary policy analysis; and

(b) one shall be a person with responsibility within the Bank for monetary policy operations.

(3) At least two of the members appointed under subsection (2)(d) shall be women.

(4) Each member appointed under subsection (2)(d) shall hold office for a term of three years and shall be eligible to be appointed for one additional term.

(5) The chairman of the Committee shall convene a meeting of the Committee at least once every two months and shall convene an additional meeting if requested by at least four members in writing.

(6) At least once every six months the Committee shall submit a report to the Cabinet Secretary with respect to its activities and the Cabinet Secretary for the National Treasury shall lay a copy of each report before the National Assembly.

(7) The quorum of the Committee shall be five members, one of who must be the chairman or vice chairman.

(8) The Bank shall provide staff to assist the Committee.

EXECUTIVE SUMMARY

The fifteenth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and economic developments during the six months to October 2015. The monetary policy stance 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. This is consistent with the price stability objective of the Central Bank of Kenya (CBK).

The MPC adopted a tight policy stance in June 2015 in order to anchor inflationary expectations, and to moderate demand pressures in the economy that were attributed largely to exchange rate movements. The Committee held monthly meetings from May to September 2015 to ensure closer monitoring of developments in the domestic and international markets. The Central Bank Rate (CBR) was raised from 8.5 percent to 10.0 percent in June, and further to 11.5 percent in July 2015. The Kenya Banks' Reference Rate (KBRR) was raised to 9.87 percent in July, from 8.54 percent. Liquidity management was enhanced to withdraw excess liquidity. The effectiveness of liquidity management instruments were enhanced through the introduction of a 3-day Repo, and by raising the maximum acceptable rate on the Term Auction Deposits (TAD) instrument to 250 basis points above the CBR. The money market was turbulent in September and October 2015 following pressures on the Government borrowing programme and the placement of Imperial Bank Limited into receivership. The CBK used Reverse Repos to address the temporary liquidity shortages in segments of the market arising from these stresses.

The monetary policy measures adopted by the CBK in the six months to October 2015 ensured stability in the market and maintained inflation within the target range. Overall month-on-month inflation eased to 6.7 percent in October 2015 from 7.1 percent in April 2015 mainly due to moderating demand pressures which partially offset the pass-through effects of exchange rate depreciation. However, increases in the prices of some food items exerted pressure on overall inflation in September and October. The 12-month non-food-non-fuel inflation, which measures the impact of the monetary policy stance, remained below 5 percent during the period, indicating the impact of the tight policy stance.

The Kenya Shilling stabilised against the U.S. dollar in September and October 2015, after witnessing notable volatility between May and August. Most international and regional currencies were volatile against the U.S. dollar largely due to the global strengthening of the U.S. dollar following the recovery in the U.S. economy, and the anticipated increase in the U.S. interest rates. The foreign exchange market was volatile in August 2015 mainly due to the impact of the devaluation of the Chinese Yuan. The stability of the Kenya Shilling was supported by the CBK monetary policy operations, regular forums between CBK and stakeholders in the foreign exchange market which promoted transparency and market discipline, and the narrowing of the current account deficit due to a lower oil import bill, and a slowdown in consumer imports. The tight liquidity conditions in the interbank money market curtailed arbitrage activities between the interbank and foreign exchange markets, while CBK interventions in the foreign exchange market dampened short-term volatility.

The CBK level of usable foreign exchange reserves stood at USD 6,551 million (equivalent to 4.2 months of import cover) at the end of October 2015. This level of reserves, together with the Precautionary Arrangements with the International Monetary Fund (IMF) provided an adequate buffer against short term shocks. The IMF's Executive Board completed the first review of Kenya's performance under the programme in September 2015, and made available an additional SDR 54.28 million, bringing the cumulative amount available under the arrangements to SDR 434.24 million (about USD 610.7 million). This has boosted the Bank's capacity to respond to short term volatility in the foreign exchange market.

Although Dubai Bank and Imperial Bank were placed under receivership in August and October 2015, respectively, these actions had no systemic impact on the sector. The CBK held regular interactions with stakeholders in the financial sector, and ensured timely release of relevant data during the period. The CBK is also working with stakeholders to strengthen the Kenya Banks' Reference Rate framework which will enhance transmission of monetary policy signals through commercial banks' lending rates.

The CBK remains vigilant to risks posed by developments in the domestic and global economies on its overall price stability objective. The monetary policy measures in place, and increased food production support a stable outlook for inflation. However, the El Niño rains are a threat to stability of food prices if it disrupts the food supply chains, while the planned implementation of the new Excise Duty Act will also exert pressure on prices of some key items. In addition, any turbulence in the financial markets attributed to the anticipated rise in U.S. interest rates is a risk to the inflation outlook through its impact on the exchange rate.

1. INTRODUCTION

The fifteenth bi-annual Report of the MPC covers the period May to October 2015. It reviews outcomes of the monetary policy stance adopted by the MPC in pursuit of its price stability objective, as well as other economic developments during the period.

The monetary policy stance adopted by the MPC, coupled with moderate prices for foodstuffs and energy products supported stability in the inflation rate during the six months to October 2015. Both the 12-month overall inflation and the non-food-non-fuel (NFNF) inflation remained within the Government target range. The exchange rate of the Kenya Shilling against the U.S. dollar was volatile between May and August 2015 reflecting the impact of the strong U.S. dollar in the global financial markets. However, the Kenya Shilling stabilised in September and October 2015 supported by CBK monetary policy operations and foreign exchange market transactions. In addition, lower international oil prices provided some relief with respect to demand for foreign exchange to finance petroleum product imports during the period. Imports continued to be dominated by capital goods such as machinery and transport equipment. Data from Kenya National Bureau of Statistics (KNBS) showed that overall real GDP growth remained resilient in the first two quarters of 2015, largely supported by improved agricultural activities and the financial and insurance sector.

On the international scene, global economic growth remained moderate, but indications are for a gradual pickup in 2016, driven mainly by the U.S. economy. However, the prospects for slower growth in China could lower growth in emerging and frontier market economies. In addition, the financial markets remained uncertain in respect of the timing of the increase in U.S. interest rates and the easing of monetary policy in the Euro Area.

The remainder of this Report is structured as follows. Section 2 provides highlights of the monetary policy formulation in response to threats to price stability during the period while Section 3 provides a discussion of the impact on key economic indicators. Other activities of the MPC with relevance to monetary policy formulation and implementation are discussed in Section 4 while Section 5 concludes.

2. MONETARY POLICY FORMULATION

2.1 Attainment of Monetary Policy Objectives and Targets

During the six months to October 2015, the MPC formulated monetary policy to achieve and maintain overall inflation within the government target range as provided by the Cabinet Secretary for the National Treasury. The Government medium-term overall inflation target was 5 percent for the Fiscal Year 2015/16 with an allowable margin of 2.5 percent on either side.

The Central Bank Rate (CBR) is the base for monetary policy operations. The change in both the direction and magnitude of the CBR signals the monetary policy stance. The monetary policy stance is operationalised through various instruments including: Open Market Operations (OMO), changes in cash reserve requirements at CBK, foreign exchange market operations, and the CBK Standing Facility (CBK 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), Reverse Repos, and Term Auction Deposits (TAD).

Monetary policy implementation was guided by CBK targets on the Net International Reserves (NIR) and Net Domestic Assets (NDA) as the operational parameters. These targets were consistent with the performance measures under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) negotiated between the Kenyan Government and the IMF to protect against exogenous shocks that might lead to balance of payments needs. The CBK met its NDA and NIR targets for June and September 2015. The NDA averaged Ksh. -121 billion by end September, 2015 compared to the target ceiling of Ksh. -111 billion while the NIR averaged USD 5,545 million against a target floor of USD 5,308 million.

The annual growth rates of broad money supply (M3) and private sector credit were consistent with the respective projected growth paths in the period. The 12-month growth in M3 slowed down from 17.3 percent in April 2015 to 13.6 percent in October 2015 reflecting the impact of the monetary policy stance. Similarly, the 12-month private sector credit growth declined from 19.9 percent to 19.5 percent in the period.

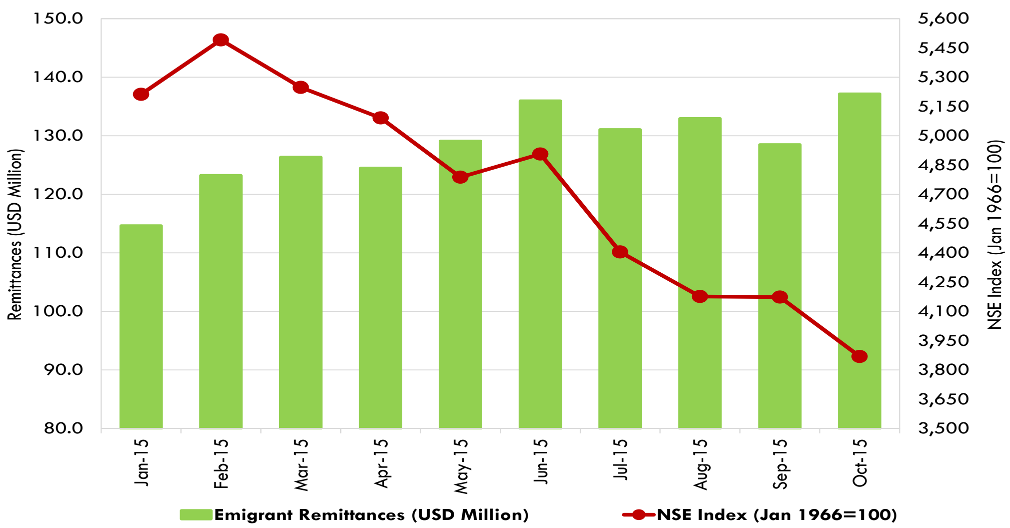
2.2 Economic Environment

The economic environment was characterised by turbulent market conditions in September and October 2015 due to pressures on the Government borrowing programme and placement of Imperial Bank Limited into receivership. The prudent monetary policy stance supported a non-inflationary growth in private sector credit, and general stability of exchange rate. Overall inflation rate remained within the prescribed target range in the period, and the NFNF inflation remained stable below 5 percent.

The foreign exchange market was volatile in May through August 2015, following the strengthening of the U.S. dollar, and uncertainty on the timing of commencement of U.S. monetary policy normalisation. However, the Kenya Shilling was stable in September and October 2015, supported by monetary policy measures, foreign exchange operations and resilient foreign exchange inflows through diaspora remittances. The diaspora remittances increased to an average of USD 132.5 million per month in the six months to October 2015, from an average of USD 122.1 million per month in the six months to April 2015 (Chart 1a). The improved diaspora remittances was partly due to the strengthening of the U.S. economy. However, the Nairobi Securities Exchange (NSE) was weighed down by the uncertainty on the timing of the increase in U.S. interest rates, and the fall in equity prices in China which led to increased instability in the financial markets and capital outflows from emerging and frontier market economies (Chart 1a).

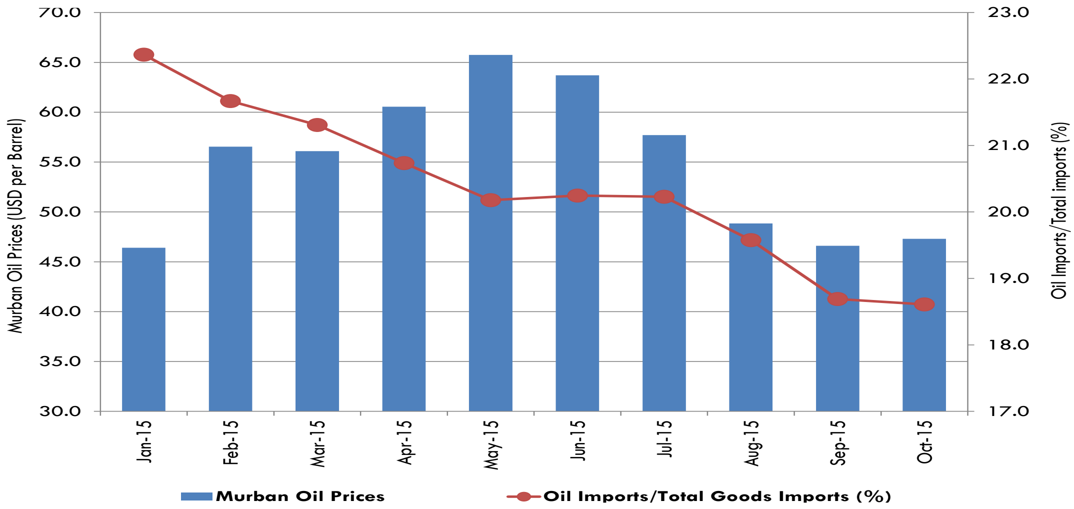
International crude oil prices remained low in the six months to October 2015 reflecting increased production from the United States and Libya, reduced demand particularly from China, a stronger U.S. dollar in the global markets, and sustained production by the Organization of Petroleum Exporting Countries. Consequently, Murban crude oil prices declined from a peak of USD 65.8 per barrel in May 2015 to USD 47.3 per barrel in October 2015 (Chart 1b). In addition, the proportion of oil imports to total imports of goods and services declined from an average of 21.9 percent in the six months to April 2015 to 19.6 percent in the six months to October 2015 (Chart 1b). The lower oil imports bill dampened the demand for foreign exchange, and improved the current account balance.

Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE Index



***Source**: Central Bank of Kenya and Nairobi Securities Exchange*

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



***Source**: Central Bank of Kenya and Adnoc website*

2.3 Monetary Policy Committee Meetings and Decisions

The MPC held monthly meetings between May and September 2015 to ensure closer monitoring of developments in the domestic and international markets, and to take appropriate measures to maintain price stability. The MPC embarked on tightening the policy stance in June 2015 to anchor inflation expectations attributed mainly to exchange rate movements. The MPC raised the CBR to 10.0 percent on 9th June 2015 from 8.50 percent. The tight policy stance was augmented on 7th July 2015 during which the CBR was raised to 11.5 percent, and the Kenya Banks' Reference Rate (KBRR) to 9.87 percent from 8.54 percent. The CBR was retained at 11.5 percent during the MPC meetings on 5th August and 22nd September in order to maintain market stability and anchor inflation expectations. The MPC augmented the instruments for liquidity management by raising the maximum applicable interest rates on Term Auction Deposits to 250 basis points above the CBR in May 2015, and introducing a 3-day Repo in July. These measures enhanced the effectiveness of open market operations.

Consistent with the tight monetary policy stance adopted, liquidity management operations were aimed at withdrawing excess liquidity from the market. Consequently, other short-term interest rates increased during the period. The monetary policy stance adopted by the MPC supported a non-inflationary growth in credit to the private sector. The CBK also continued to work closely with the National Treasury to strengthen coordination of monetary and fiscal policies for overall macroeconomic stability.

Foreign exchange market operations undertaken by the CBK through direct sale, and purchase of foreign exchange from banks complemented other liquidity management measures in stabilising the exchange rate and managing expectations over the period covered by this Report. The official usable foreign exchange reserves buffer held by the CBK was augmented by the Precautionary Arrangements with the International Monetary Fund to protect the country against potential balance of payments shocks. This bolstered the Bank's capacity to respond to shocks in the market.

3. IMPACT ON KEY ECONOMIC INDICATORS

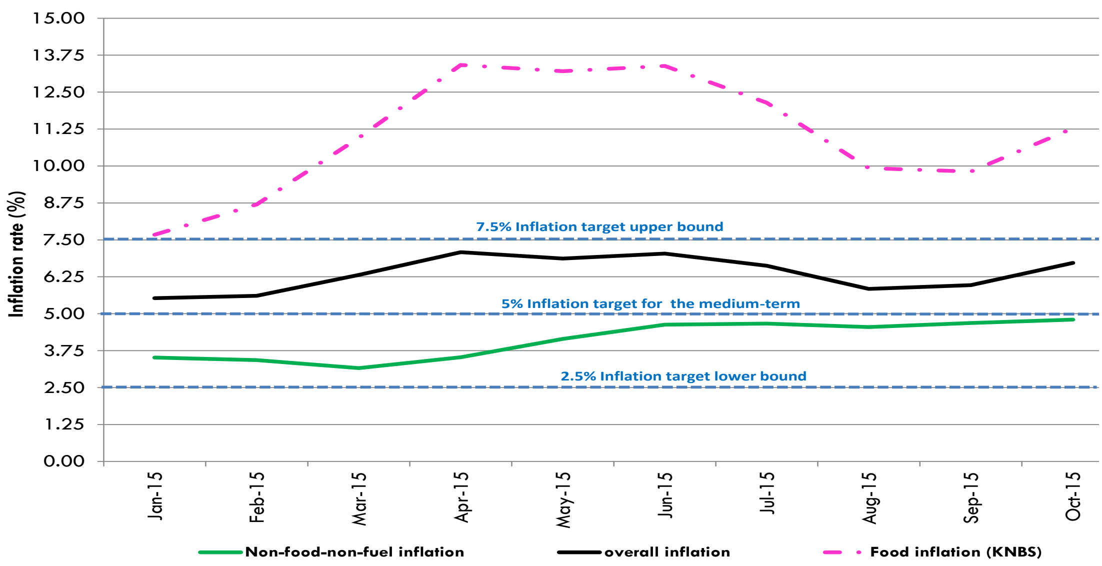
3.1 Inflation

The 12-month overall inflation remained within the Government range during the six months to October 2015. Overall month-on-month inflation decreased to 6.7 percent in October from 7.1 percent in April 2015 largely due to moderating demand pressures, partially offsetting the impact of exchange rate movements on inflation (Chart 2a). However, increases in the prices of some food items exerted pressure on overall inflation between September and October. The 12-month non-food-non-fuel (NFNF) inflation, which measures the impact of the monetary policy stance, remained stable below 5 percent during the period. Nevertheless, it rose gradually from 3.5 percent in April 2015 to 4.8 percent in October suggesting some adverse demand pressure.

Although the monetary policy measures in place, and lower international oil prices support a stable outlook for inflation, the El Niño rains expected in most parts of the country are a threat to stability of food prices if they disrupt the food supply chains. The planned implementation of the new Excise Act will also exert pressure on the prices of some key items. In addition, any instability in the financial markets attributed to the uncertainty in respect of the normalisation of U.S. monetary policy could exert pressure on inflation through its impact on the exchange rate.

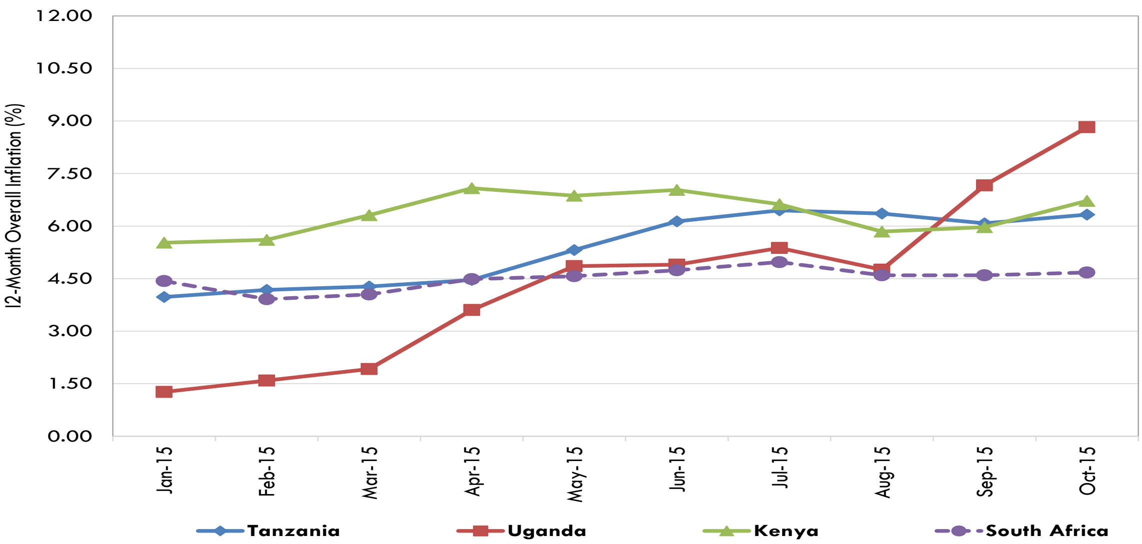
Although most advanced countries have been implementing an accommodative monetary policy stance to support growth, global inflation remained low in the six months to October 2015. This was due to the slowdown in global demand, and the lower international oil and food prices. The three major economies in the East African Community (EAC) region displayed similar trends in their inflation rates (Chart 2b). These trends largely reflected a similar composition of the Consumer Price Index (CPI) basket, which is largely affected by the movements in food and energy prices. A similar but comparably gradual trend was depicted in the inflation trend for South Africa.

Chart 2a: 12-Month Inflation in Broad Categories (%)



***Source**: Kenya National Bureau of Statistics and CBK*

Chart 2b: 12-Month Inflation in the Selected EAC Countries and South Africa(%)



***Source**: Websites of Respective Central Banks*

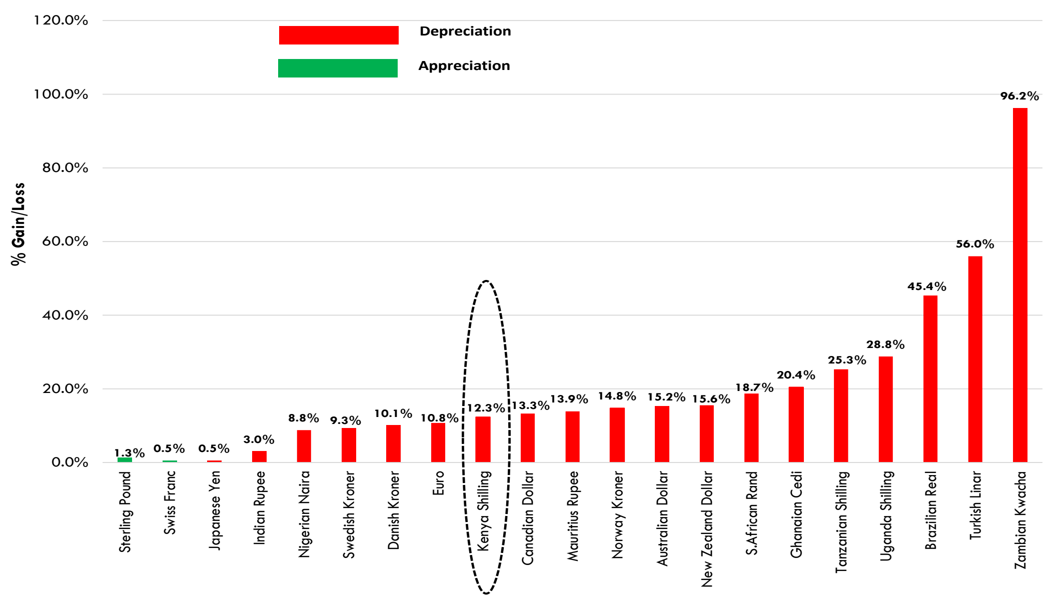
3.2 Exchange Rates

The exchange rate of the Kenya Shilling against the U.S. dollar was volatile between May and August 2015 largely due to the stronger U.S. dollar in the global currency market, the widening current account deficit attributed to imports of capital goods towards infrastructure development, and associated high demand for foreign exchange. The global strengthening of the U.S. dollar reflected the strong recovery in the US economy, and uncertainty in the financial markets attributed to the timing of the increase in U.S. interest rates. Consequently, the major international and regional currencies depreciated against the U.S. dollar between January and October 2015 (Charts 3a). The foreign exchange market was volatile in August 2015 largely reflecting international developments, in particular the impact of the devaluation of the Chinese Yuan. The Kenya Shilling was, however, less volatile against the U.S. dollar compared with the other currencies in the region (Chart 3b).

The foreign exchange market stabilised in September supported by the CBK monetary policy operations, regular forums between CBK and stakeholders in the foreign exchange market which promoted transparency and market discipline and the narrowing of the current account deficit due to a lower oil import bill, and a slowdown in consumer imports. The tight liquidity conditions in the interbank money market curtailed arbitrage activities between the interbank and foreign exchange markets. In addition, interventions by the CBK dampened short-term volatility in the foreign exchange market during the period.

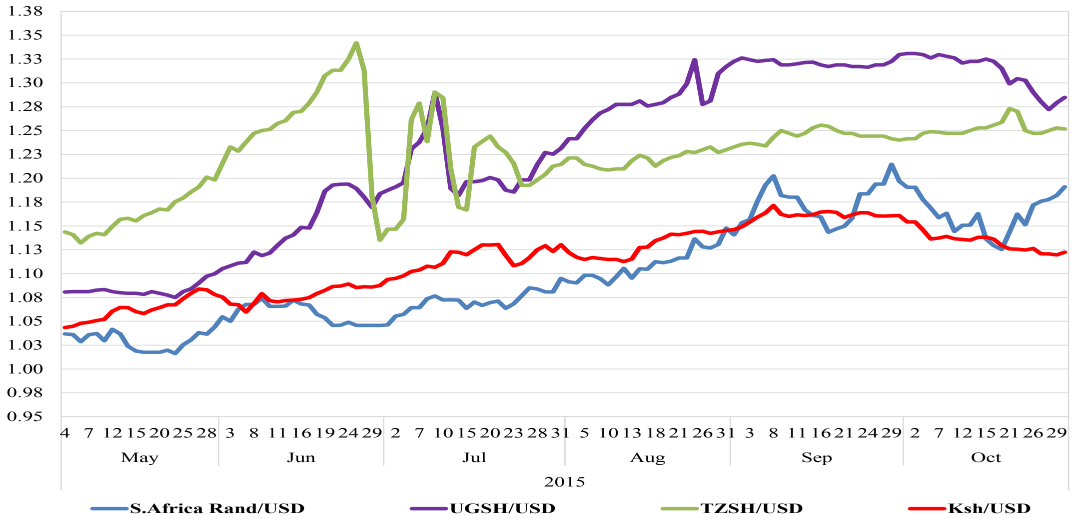
The CBK level of usable foreign exchange reserves stood at USD 6,551 million (equivalent to 4.2 months of import cover) at the end of October 2015. This, together with the Precautionary Arrangements with the IMF provided an adequate buffer against short term shocks. The IMF's Executive Board completed the first review of Kenya's performance under the programme in September 2015, and made available an additional SDR 54.28 million, bringing the cumulative amount available under the arrangements to SDR 434.24 million (about USD 610.7 million). This boosted the Bank's capacity to respond to short-term volatility in the foreign exchange market.

Chart 3a: Performance of Selected Currencies against the U.S. dollar (January to October 2015)



***Source**: Central Bank of Kenya*

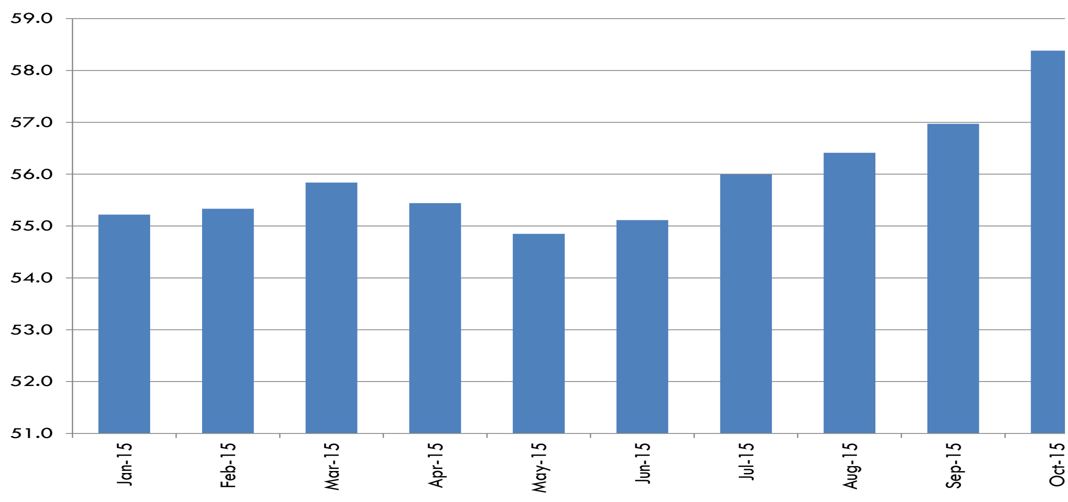
Chart 3b: Normalised Exchange Rates of Major Currencies in the Region against the U.S. dollar (2nd January 2015 = 1)



***Source**: Central Bank of Kenya*

The lower international oil prices eased pressure on demand for foreign exchange to finance imports of petroleum products during the period. The 12-month cumulative proportion of imports of goods and services financed by exports of goods and services increased from 55.4 percent in April 2015 to 58.4 percent in October (Chart 4). However, foreign exchange earnings from traditional sources such as tea, tourism and horticulture remained subdued mainly due to weak global demand, and adverse travel advisories in the period. Imports of machinery and equipment averaged 30.8 percent of total imports per month in the six months to October 2015, up from an average of 27.6 percent per month in the six months to April 2015. These imports were mainly towards infrastructure development which is essential for enhancing the future productive capacity of the economy.

Chart 4: 12-Month Exports/Imports of Goods and Services (%)



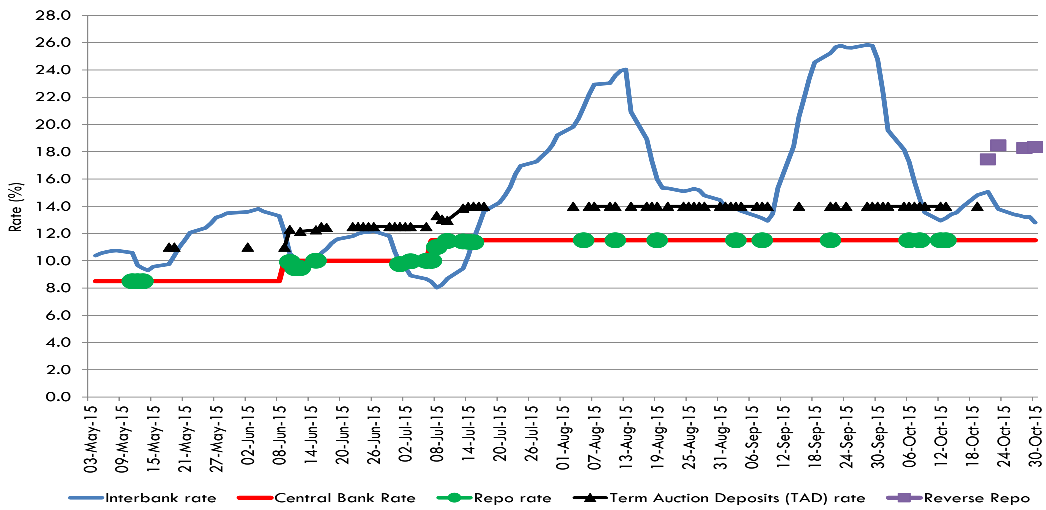
***Source**: Kenya National Bureau of Statistics*

3.3 Interest Rates

The short-term interest rates remained generally above the CBR during the six months to October 2015 consistent with the tight monetary policy stance adopted by the MPC. The CBK liquidity management through Open Market Operations (OMO) was used to operationalise the tight monetary policy stance (Chart 5a). The money market was turbulent in September and October 2015 following pressures on the Government borrowing programme and the placement of Imperial Bank Limited under receivership. These developments tightened further the liquidity conditions and exerted upward pressure on short-term interest rates, partly due to skewed distribution of liquidity. Pressure on the Government domestic borrowing programme contributed to the sharp increase in Treasury bill rates in September (Chart 5b). The rise in Treasury bill rates led to higher subscription rates for Government securities.

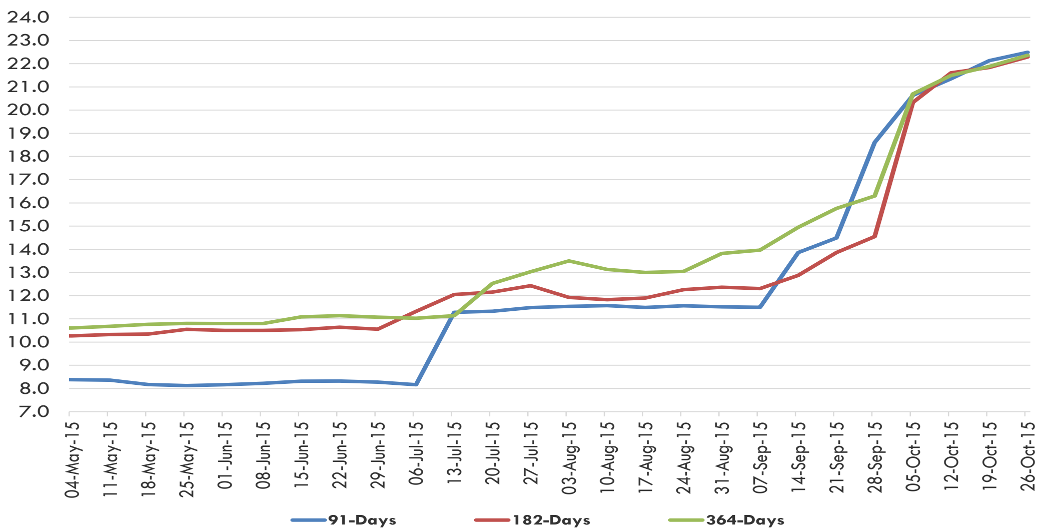
The CBK used Reverse Repos to address the temporary liquidity shortages in segments of the market. In addition, the issuance of a Syndicated Loan by the Government was expected to dampen pressure on domestic borrowing. The tight liquidity conditions eased in October with the interbank rate declining towards the CBR. The CBK continued to engage stakeholders in the banking sector to explore strategies for enhancing the use of Horizontal Repos towards redistributing liquidity in the interbank market. The value of Horizontal Repos transacted rose to Ksh. 4.5 billion in the six months to October 2015 from Ksh. 4.4 billion in the six months to April 2015, while the number of transactions increased to 25 from 6 due to the tight liquidity conditions in the market.

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



Source*: Central Bank of Kenya*

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



***Source**: Central Bank of Kenya*

3.4 Banking Sector Developments

Although the banking sector remained strong in the six months to October 2015, there were credit and liquidity risks. Dubai Bank was put under receivership on 14th August 2015 following capital and liquidity deficiencies that culminated in the bank's inability to meet its obligations. On 13th October, 2015, CBK placed Imperial Bank Limited (IBL) under receivership following fraudulent activities reported by the bank's board. The decision by CBK to put the IBL under receivership was to safeguard the credibility of the banking sector while protecting the interests of depositors, creditors and members of the public. Dubai Bank and IBL had market shares of 0.1 percent and 1.8 percent, respectively. The problems bedeviling the two banks were not systemic.

The CBK continued to work with stakeholders including the Kenya Bankers Association (KBA) to identify and implement initiatives aimed at promoting innovations and improving the efficiency of the banking sector. Such initiatives would augment the effectiveness of the measures implemented by the CBK and KBA to reduce the cost of doing business in the sector, including the opening of Currency Centres, Cheque Truncation, and operationalisation of Credit Reference Bureaus. In order to enhance the transmission of monetary policy signals through commercial banks' lending rates, the CBK is working with stakeholders to strengthen the framework for the determination and implementation of the Kenya Banks' Reference Rate.

The CBK raised the KBRR to 9.87 percent on 7th July 2015 from 8.54 percent, reflecting the tight policy stance adopted by the MPC. The average commercial banks' lending rates increased to 16.4 percent in October 2015 from 15.4 percent in April 2015 (Table 1). The increase in lending rates was reflected across all the bank tiers, but was more pronounced in the small bank category reflecting competition for funds. The average deposit rate increased from 6.6 percent to 7.5 percent during the period reflecting increased banks' competition for deposits. As a result, the spread between the average commercial banks' lending rate and deposit rate was 8.8 percent in October 2015. The spread for large banks was 9.9 percent due to lower deposit rates.

The MPC continued to engage the Chief Executive Officers of commercial banks through the KBA on various issues through the post-MPC meeting forums. This has continued to facilitate moral suasion and provided a regular feedback mechanism.

Table 1: Trends in Commercial Bank Interest Rates and Spreads by Bank Size (%)

	Average Lending rates (%)				Average Deposit rates (%)				Average Spread (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jan-15	16.40	15.57	15.79	15.93	6.73	7.67	5.31	6.65	9.66	7.90	10.47	9.28
Feb-15	16.24	15.37	15.24	15.47	6.61	7.62	5.40	6.68	9.64	7.75	9.84	8.78
Mar-15	16.12	15.43	15.22	15.46	6.56	7.54	5.47	6.63	9.56	7.89	9.75	8.82
Apr-15	16.08	15.32	15.25	15.40	6.66	7.78	5.55	6.60	9.42	7.54	9.70	8.80
May-15	16.13	15.02	15.21	15.26	6.76	7.57	5.28	6.55	9.37	7.45	9.93	8.70
Jun-15	16.21	15.52	15.42	15.48	6.81	8.01	5.14	6.64	9.40	7.51	10.28	8.85
Jul-15	16.27	16.13	15.31	15.75	7.03	7.68	5.26	6.31	9.24	8.44	10.04	9.44
Aug-15	15.89	15.69	15.40	15.68	7.52	7.73	5.69	6.91	8.37	7.96	9.71	8.77
Sep-15	17.39	16.38	15.73	16.27	7.53	7.86	6.49	7.28	9.85	8.52	9.24	8.99
Oct-15	17.31	15.90	16.43	16.37	9.06	8.04	6.52	7.54	8.25	7.86	9.91	8.83

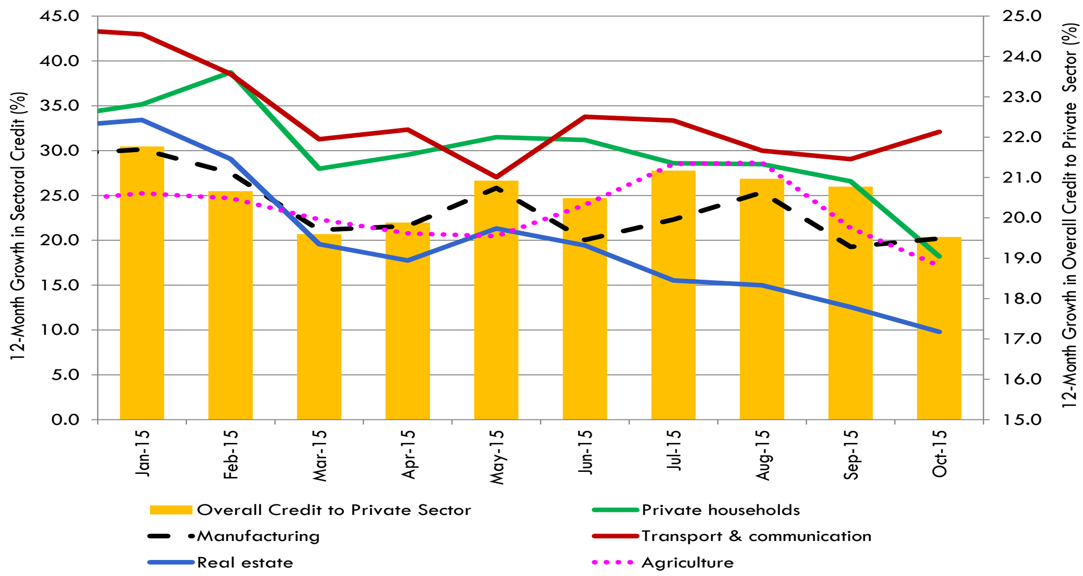
***Source**: Central Bank of Kenya*

3.5 Credit to Private Sector

Growth in bank credit to the private sector remained strong in the six months to October 2015. However, consistent with the tight policy stance adopted by the MPC, the 12-month growth in overall private sector credit slowed down slightly from 19.9 percent in April 2015 to 19.5 percent in October 2015 (Chart 6).

The growth in private sector credit in the period was channelled towards key sectors of the economy including agriculture, manufacturing, transport and communication, trade, and real estate. Growth in credit to finance imports and towards consumption related sectors such as private households slowed down during the period. The monetary policy stance adopted by the MPC is expected to continue supporting a non-inflationary credit expansion to the key sectors of the economy in the remainder of financial year 2015/16.

Chart 6: 12-Month Growth in Private Sector Credit (%)



Source: *Central Bank of Kenya*

4. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC engaged the Chief Executive Officers of commercial banks through the KBA on various issues during the post MPC meeting forums. The Committee continued to improve on the information gathering processes through the market Perception Surveys and communication with key stakeholders on the MPC decisions to obtain feedback. The MPC also continued to improve on its Press Releases by simplifying them and making them better focused to the public, media, financial sector and other stakeholders. The media and public understanding of monetary policy decisions and their expected impact on the economy continued to improve as can be noted by increased analysis and coverage in the press.

In July 2015, the Chairman of the MPC held meetings with the National Assembly Departmental Committee on Finance, Planning and Trade as well as the Senate Standing Committee on Finance, Commerce and Budget to discuss developments in exchange rates, inflation, economic growth, and interest rates. The MPC Chairman issued press releases, and also held press conferences in September and October 2015 to brief the media on measures undertaken by the CBK to support macroeconomic and financial stability.

MPC members participated in conferences locally over the period covered by this Report as part of enhancing their responsibility, and to share experiences. The members also held meetings with the IMF Review Mission in September, as well as with various investors in order to brief them on economic developments and the outlook for the economy. They also participated in forums organised by the World Bank and IMF to launch country and regional economic reports.

5. CONCLUSION

Despite volatility in the financial markets, the monetary policy stance adopted by the MPC has anchored inflation expectations, and stabilised the exchange rate. The implementation of measures to promote foreign direct investment, tourism, exports, and the consumption of locally produced goods will ensure the long-term stability of the exchange rate. Such measures would support the overall price stability objective of the CBK. The MPC will continue to monitor developments in the domestic and global economy and take appropriate measures to sustain price stability.

APPENDIX: CHRONOLOGY OF EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (MAY - OCTOBER 2015)

Date	Events
May 2015	The effectiveness of the Term Auction Deposits (TAD) instrument was enhanced by raising the maximum acceptable rate on the instrument to 250 basis points above the CBR
June 2015	a) The Central Bank Rate (CBR) was raised from 8.5 percent to 10.0 percent to anchor inflation expectations
	b) Appointment of the new CBK Governor
July 2015	a) The CBR was raised from 10.0 percent to 11.5 percent to anchor inflation expectations
	b) Introduction of a 3-day repo augmented the instruments for liquidity management
	c) The CBK revised the KBRR from 8.54 percent to 9.87 percent
August 2015	a) The CBR was retained at 11.50 percent in order to anchor inflation expectations
	b) Dubai Bank Kenya Limited was placed under receivership by the CBK
September 2015	The CBR was retained at 11.50 percent in order to anchor inflation expectations
October 2015	Imperial Bank Limited was placed under receivership by the CBK

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.

Kenya Banks' Reference Rate (KBRR): This is the base rate for all commercial banks' lending. It is currently computed as an average of the CBR and the weighted 2-month moving average of the 91-day Treasury bill rates.

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 collateralised 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.

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): 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 limited 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 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.