



Central Bank of Kenya

Twenty Second Bi-Annual Report of the Monetary Policy Committee

April 2019





LETTER OF TRANSMITTAL

In accordance with Section 4D of the Central Bank of Kenya Act, it is my pleasure to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the 22nd 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 2019.

Dr. Patrick Njoroge

Governor

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EXECUTIVE SUMMARY

This bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments that affected the economy during the six months to April 2019. Consistent with the price stability objective of the Central Bank of Kenya (CBK), the conduct of 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 a resilient domestic economy in 2018 with global uncertainties arising from the trade tensions between the US and China and the prolonged Brexit negotiations.

The MPC held three meetings in the six months to April 2019, to review the outcome of its previous policy decisions and economic developments. These meetings were held in November 2018, January and March 2019. The MPC retained the Central Bank Rate (CBR) at 9.00 percent during the meetings, noting that inflation remained anchored within the target range. The monetary policy stance adopted during the period, together with the CBK liquidity management ensured price stability.

Overall inflation remained within the target range during the period. The inflation rate stood at 6.6 percent in April 2019 compared to 5.5 percent in October 2018, mainly reflecting higher food prices following the delayed onset of long rains that resulted in depressed supply of fast growing food items particularly vegetables. Food inflation rose to 7.7 percent in April from 0.9 percent in October 2018. However, fuel inflation declined to 7.5 percent from 8.8 percent in the period under review, largely due to lower international oil and electricity prices. Non-food non-fuel (NFnF) inflation remained low and stable below 5 percent, indicating muted demand pressures in the economy. The CBK continued to monitor the overall liquidity in the economy as well as any threats to exchange rate stability which could fuel demand driven inflationary pressures.

The foreign exchange market remained stable supported by balanced flows and a narrowing current account deficit. The current account deficit narrowed to 5.0 percent of GDP in the 12 months to April 2019 from 6.4 percent in April 2018 and 5.8 percent in December 2018. This narrowing reflected lower imports of food and SGR-related equipment, resilient diaspora remittances, strong receipts from tourism services, and improved receipts from coffee and horticulture exports. The CBK foreign exchange reserves which stood at USD8,090.2 million (5.1 months of import cover) in April 2019, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient in the period, with strong liquidity and capital adequacy ratios. The average commercial banks liquidity and capital adequacy ratios stood at 51.0 percent and 18.3 percent in April 2019. The ratio of gross non-performing loans (NPLs) to gross loans rose slightly to 12.9 percent in April 2019 from 12.3 percent in October 2018, largely due to delayed payments by both public and private sector entities, and slow uptake of commercial and residential housing units. Private sector credit growth picked up during the period

particularly to the key sectors of the economy, growing by 4.9 percent in the 12 months to April 2019 compared to 4.4 percent in October 2018. CBK closely monitored the banking sector and ensured that the interbank market continued to function smoothly. The CBK also continued to implement measures aimed at strengthening the sector to ensure greater transparency and stronger governance, and to promote effective business models and innovation.

The MPC held bi-monthly meetings with stakeholders in the financial and real sectors to discuss the basis for its previous decisions. The Governor held media briefings to discuss the basis of monetary policy decisions and other market developments. These stakeholder meetings provided a platform for obtaining feedback and improved stakeholders' understanding of the conduct of monetary policy.

1. GLOBAL ECONOMY

The global economic environment during the six months to April 2019 was characterized by increased uncertainties in the global financial markets arising from escalation of trade tensions between the US and China, increased uncertainties over the nature of Brexit, and the pace of normalization of monetary policy in the advanced economies.

In January 2019 the IMF estimated global growth for 2018 at 3.7 percent, which was similar to the October 2018 forecast, despite weaker performance in some countries. The global economy was projected to grow by 3.5 percent in 2019 and 3.6 in 2020. The 2019 growth was 0.2 percentage points lower than the October projections partly because of the negative effects of tariff increases imposed by the US and China. In addition, the introduction of new automobile fuel emission standards in Germany, and concerns about sovereign and financial risks in Italy weighed down the domestic demand while the contraction in Turkey was deeper than previously anticipated.

Growth in advanced economies was projected to slowdown from 2.3 percent in 2018 to 2.0 percent in 2019, mainly due to slow growth in the Euro area. In the UK, despite the positive impact from fiscal stimulus announced in the 2019 budget, the prolonged uncertainty about the Brexit outcome continued to reduce growth prospects. On the other hand, Japan was projected to grow by 1.1 percent in 2019 on account of additional fiscal support to the economy.

Emerging markets and developing economies are projected to grow by 4.5 percent in 2019. China is projected to slow down due to the combined influence of needed financial regulatory tightening and trade tensions with the United States. While the financial conditions have tightened in emerging markets, the concerns of possible inflationary pressures from the earlier rise in oil prices led commercial banks in many emerging markets to raise policy rates while others like India acted to ease domestic funding conditions. For Sub-Saharan Africa (SSA) economies, growth was projected to pick up from 2.9 percent in 2018 to 3.5 percent in 2019. This was despite the downward revision of growth in Angola and Nigeria due to a decline in oil prices.

Uncertainties in the global economy remained elevated mainly due to geopolitical and trade tensions between the US and China resulting in tightening of financial conditions. These developments would require prioritization of resolutions to the trade disagreements instead of rising harmful barriers that would further destabilize an already slowing global economy. Other potential factors that could trigger further deterioration of risks included a “no-deal” withdrawal of the United Kingdom from the European Union and a greater-than-envisaged slowdown in China.

2. KENYAN ECONOMY

2.1 Overall economy

The domestic economic environment during the six months to April 2019 was characterized by sustained macroeconomic stability. The foreign exchange market remained largely stable, inflation was within the target range, and there was a gradual pickup in the growth of credit to the private sector.

The economy recovered strongly in 2018, with real GDP growth increasing to 6.3 percent from 4.9 percent in 2017. This performance reflected a strong recovery in agriculture, manufacturing, and a buoyant services sector, particularly trade, information and communication, accommodation and restaurants, transport and storage, and finance and insurance. Leading indicators of economic activity show that growth remained resilient in the first quarter of 2019, despite the delayed onset of the long rains. Growth in 2019 was expected to be supported by agricultural production, robust growth of MSMEs and the service sector, increased foreign direct investment and a stable macroeconomic environment. Additionally, the continued alignment of Government spending to the Big 4 priority sectors is expected to boost economic activity in manufacturing, agriculture, construction, real estate and health sectors.

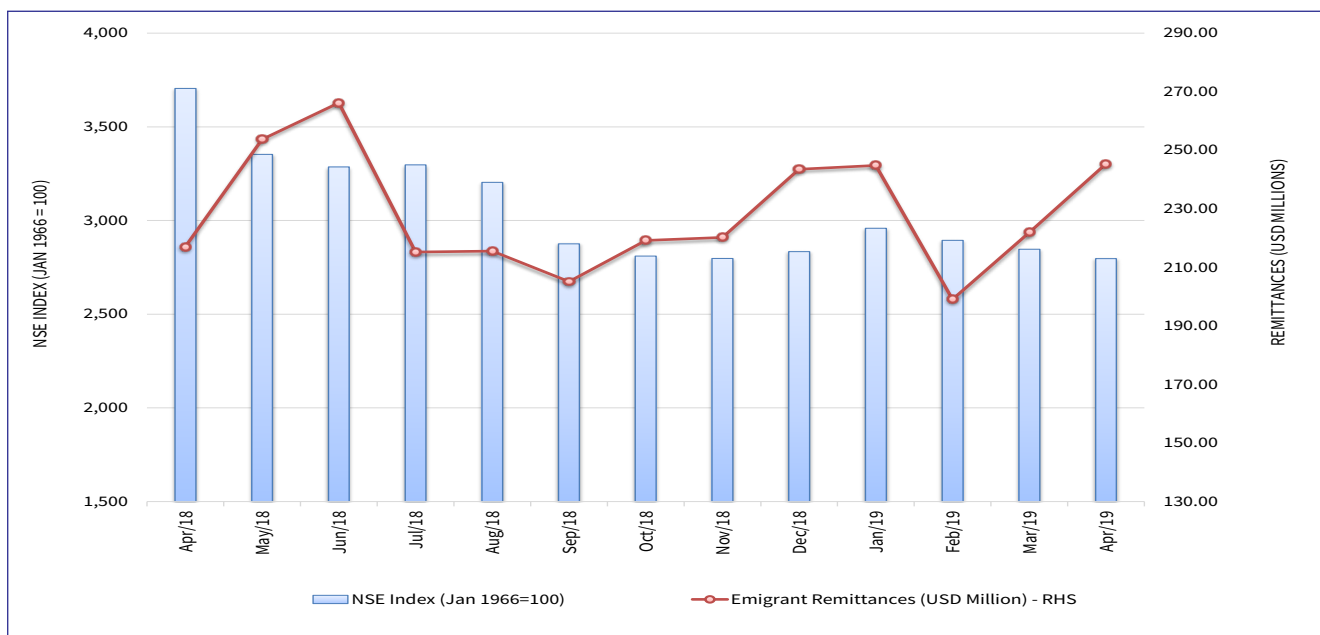
Overall, the main risks to strong domestic growth in 2019 included the slower growth of the global economy mainly due to trade tensions between China and the US, possibility of inadequate rainfall and rising international oil prices.

2.2 Financial Market Conditions

The domestic foreign exchange market largely remained stable supported by balanced flows and a narrowing current account deficit. Diaspora remittances remained resilient over the period, averaging USD229.1 million per month in the six months to April 2019 compared to USD229.2 in the six months to October 2018 (**Chart 1a**). The current account deficit narrowed to an estimated 5.8 percent of GDP in 2018 from 7.2 percent in 2017. This was mainly due to lower imports of SGR-related equipment, resilient diaspora remittances, strong receipts from tourism services, and improved receipts from coffee and horticulture. Uncertainties remained in the global financial markets due to the protracted Brexit negotiations, and escalating trade wars. The CBK foreign exchange reserves which stood at USD8,090.2 million (5.1 months of import cover) in April 2019, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

Activity at the Nairobi Securities Exchange (NSE) remained strong during the period. The NSE 20-Share index stood at 2,796.8 in April 2019 compared to 2,810.3 in October 2018, representing a 0.5 percent change (**Chart 1a**).

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

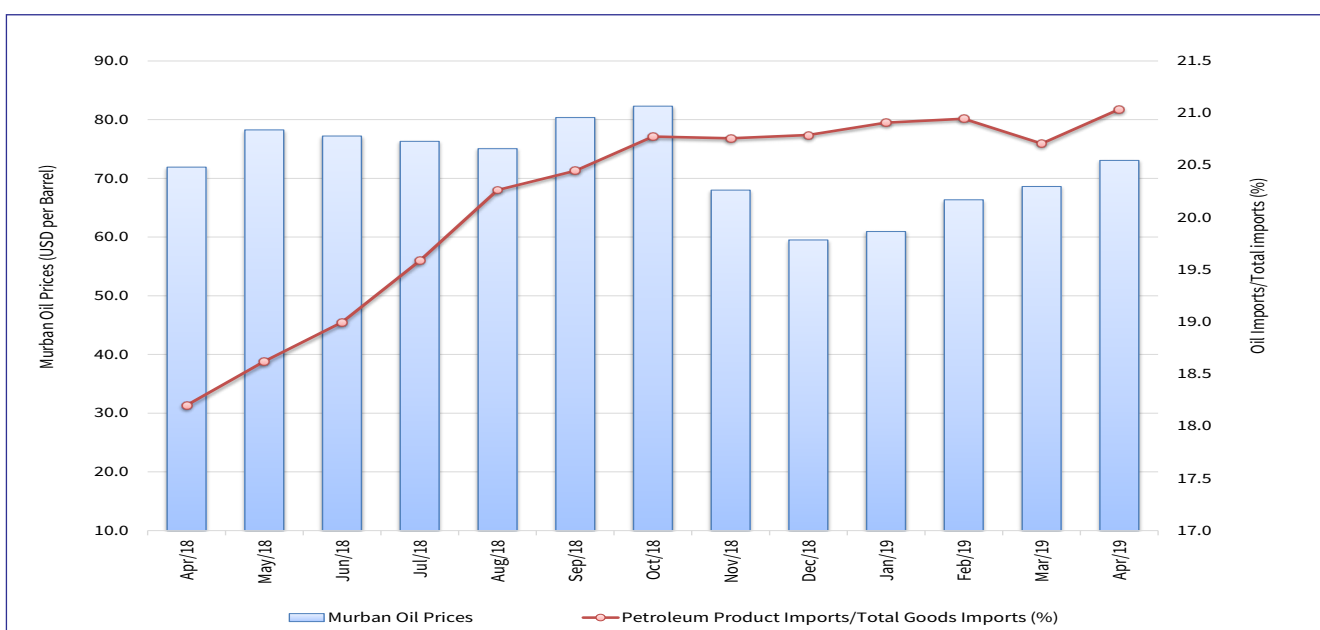


Source: Central Bank of Kenya and Nairobi Securities Exchange

Changes in international oil prices particularly when the proportion of imports of petroleum products in total imports is high has implications on the balance of payments position and the stability of the exchange rate. Murban crude oil prices fell from USD82.3 per barrel in October 2018 to USD 59.5 per

barrel in December 2018, but rose steadily thereafter to USD73.05 per barrel in April 2019. Consequently, the proportion of imports of petroleum products in total imports of goods remained relatively stable, rising marginally to 21.0 percent from 20.8 percent over the period (**Chart 1b**).

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



Source: Abu Dhabi National Oil Company and Kenya Revenue Authority

2.3 Developments in Key Economic Indicators

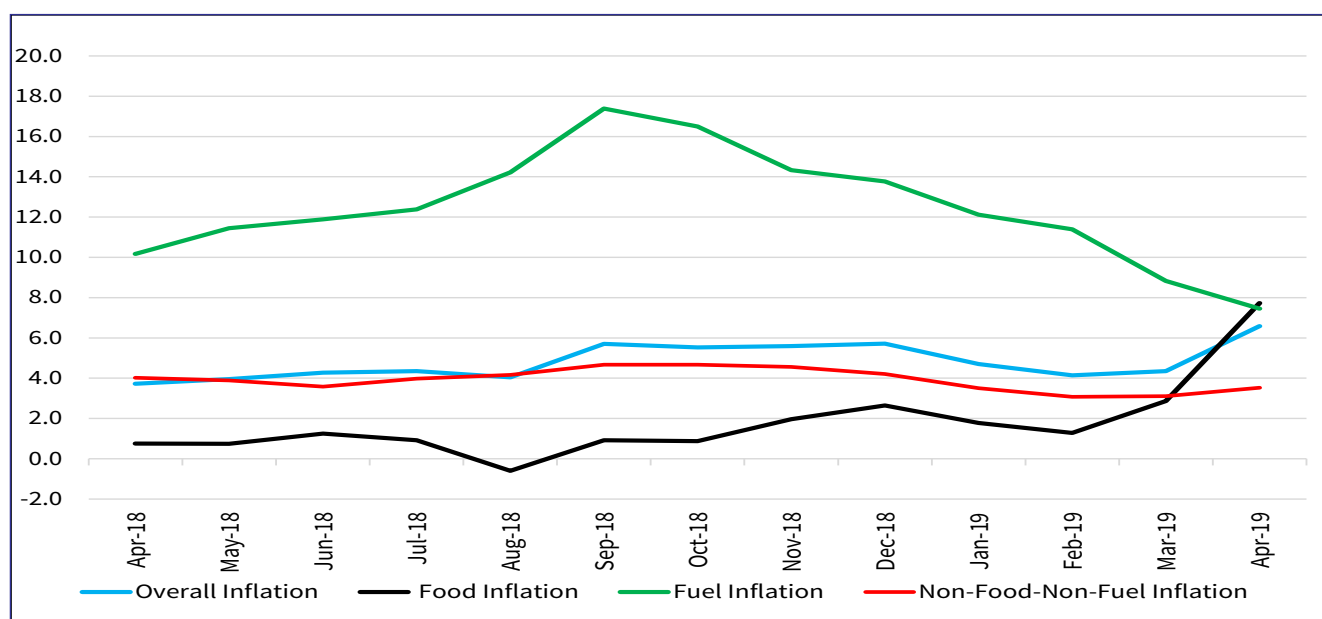
2.3.1 Inflation

The 12-month overall inflation remained within the target range during the six months to April 2019. It stood at 6.6 percent in April 2019 compared to 5.5 percent in October 2018 and 3.7 percent in April 2018. The rise in the inflation rate was attributed to higher food prices following the delayed onset of long rains that resulted in depressed supply of fast growing food items such as vegetables. Particularly, food inflation rose to 7.7 percent in April from 0.9 percent in October 2018. However, fuel inflation declined to 7.5 percent

from 16.5 percent, largely due to lower electricity and international oil prices.

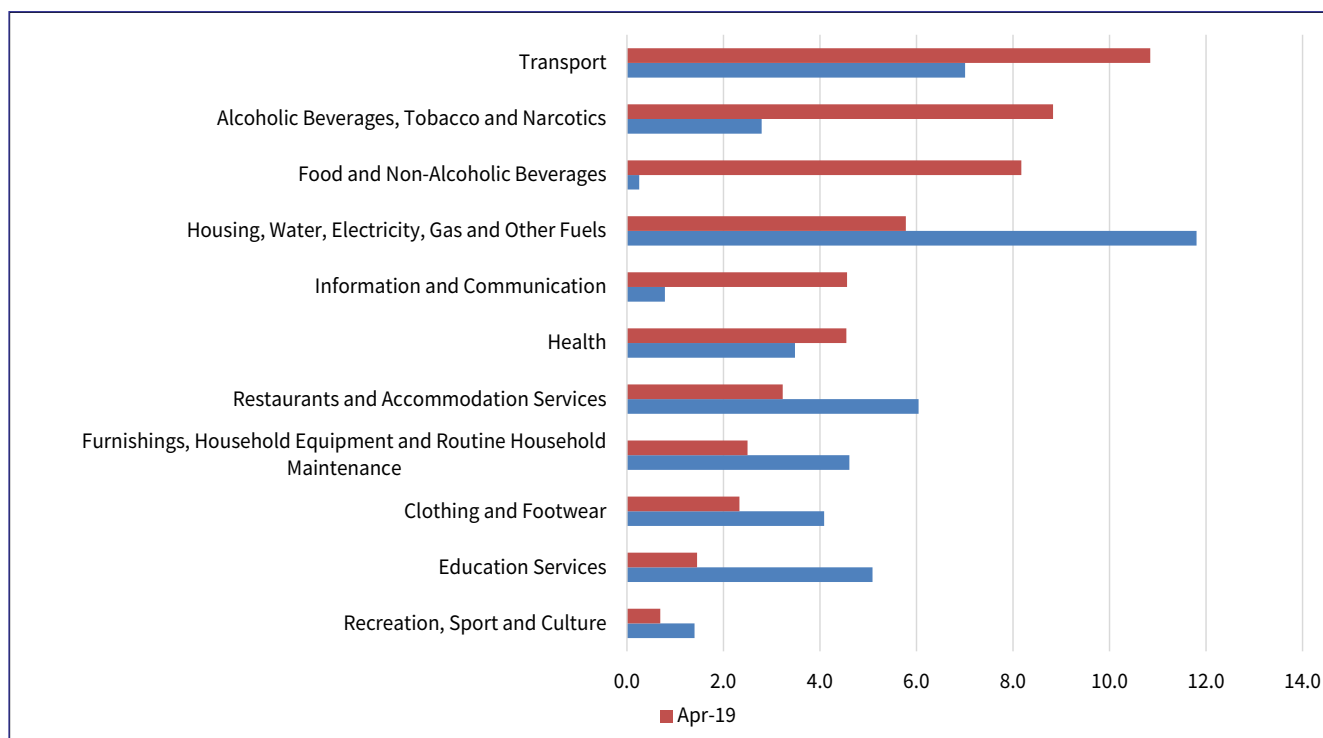
The NFNF inflation stood at 3.5 percent in April compared to 4.7 percent in October suggesting that demand pressures in the economy were muted **(Charts 2a)**. Overall, all consumer good categories except Transport, Food and Non-alcoholic beverages, Alcoholic beverages, Tobacco and Narcotics, reflected inflation levels within the target range in April 2019 **(Chart 2b)**. The trend in the overall inflation rates across the East African Community (EAC) countries, displayed similar patterns over the period **(Chart 2c)**.

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



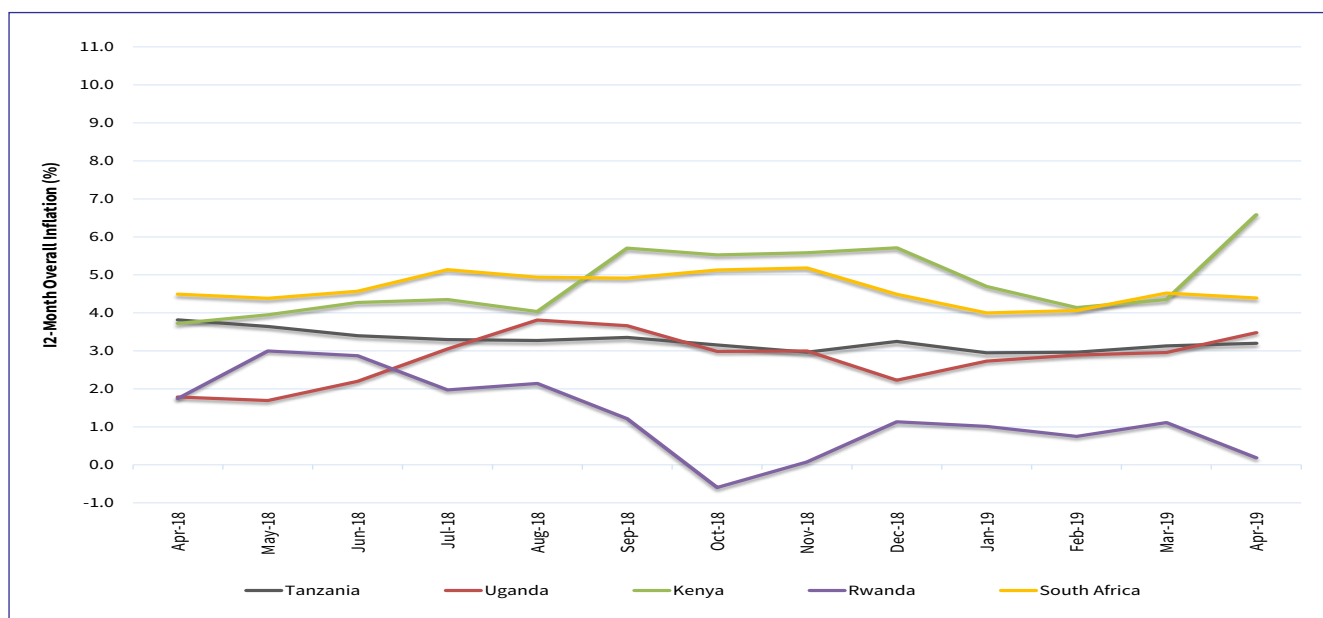
Source: Kenya National Bureau of Statistics and Central Bank of Kenya

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



Source: Kenya National Bureau of Statistics

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



Source: Respective country central bank websites

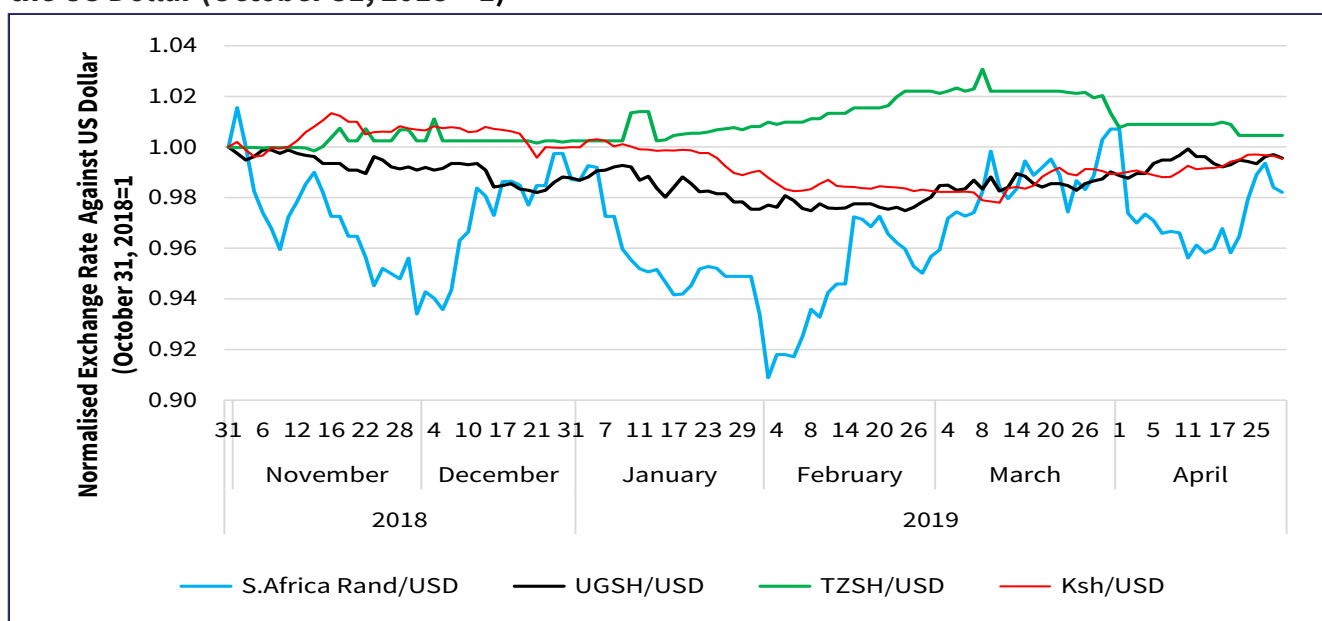
2.3.2 Foreign Exchange Market Developments

The foreign exchange market in the six months to April 2019 remained stable supported mainly by a narrowing current account deficit. The current account deficit narrowed to 5.0 percent of GDP in the 12 months to April 2019 from 6.4 percent in April 2018 and 5.8 percent in December 2018. This narrowing reflected lower imports of food and SGR-related equipment, resilient diaspora remittances, strong receipts from tourism services, and improved receipts from coffee and horticulture exports. Diaspora remittances remained resilient over the period, averaging USD 229.1 million per month in the six months to April 2019 compared to USD 229.2 million per month in the six months to October 2018. The current account deficit was expected to narrow to 4.8 percent of GDP in 2019 due to continued resilience in agricultural exports, service receipts, remittance inflows, and moderate growth in imports of key products including food.

The CBK foreign exchange reserves remained above the statutory minimum equivalent to 4 months of import cover over the period. The reserves stood at USD 8,090.2 million (5.1 months of import cover) in April 2019. These reserves continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

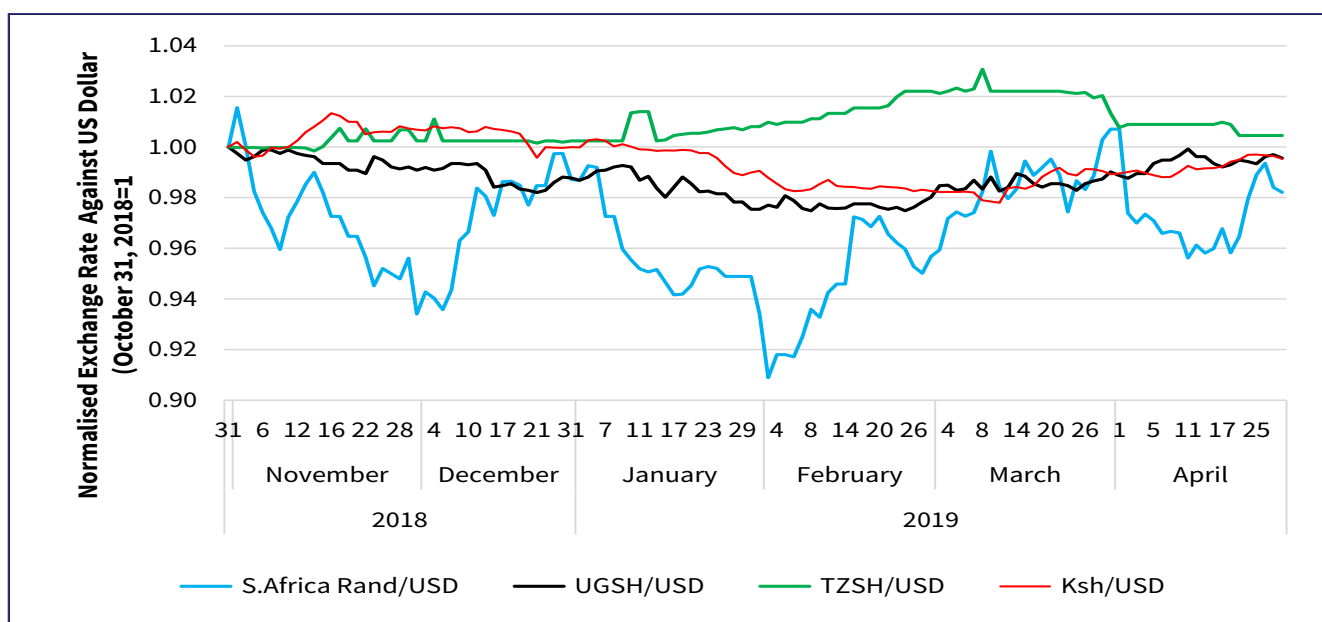
Exchange rates of major international and regional currencies against the US dollar in the six months to April 2019 were comparably volatile than the Kenya shilling / US dollar exchange rate (**Charts 3a and 3b**). The volatilities were mainly as a result of the trade tensions between the US and China, US economic and trade policies, resolution of Brexit, and the pace of normalisation of monetary policies in the advanced economies.

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (October 31, 2018 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (October 31, 2018 = 1)



Source: Central Bank of Kenya

2.3.3 Balance of Payments Developments

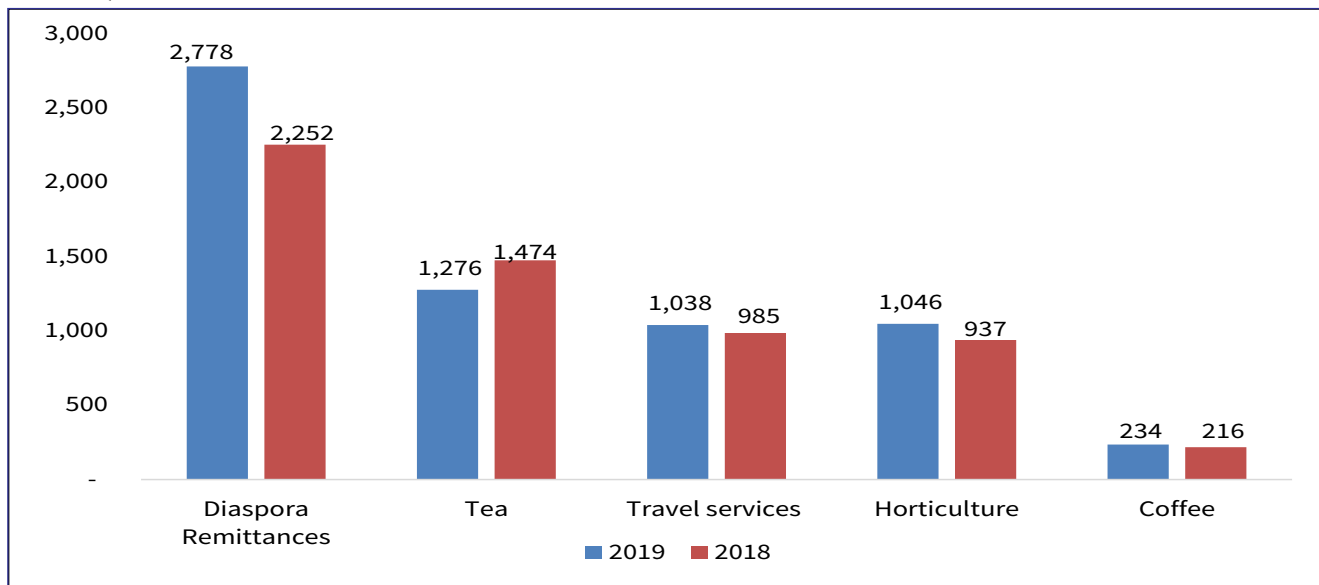
The overall cumulative current account deficit narrowed to USD 4,755.0 million in the 12 months to April 2019 (5.0 percent of GDP) from USD 5,656.7 million (6.4 percent of GDP) over a similar period in 2018. The narrower deficit mainly reflected an improvement in service exports by 15.9 percent over the period, particularly transportation and travel services that increased by 20.1 percent and 5.4 percent, respectively. In addition, goods exports increased by 1.3 percent, compared to a decline of 0.4 percent in goods imports, reflecting improved exports of horticulture and a slowdown in imports of machinery and transport equipment.

The financial account deficit narrowed to USD 3,854.4 million in the 12-months to April from USD 6,581.6 million over a similar period in 2018. This largely reflected improvement in portfolio and other

investment accounts balances. The capital account, however, recorded a surplus of USD 220.0 million in the 12 months to April 2019 compared to a surplus of USD 214.7 million in the 12-months to April 2018, primarily reflecting steady inflows of government grants.

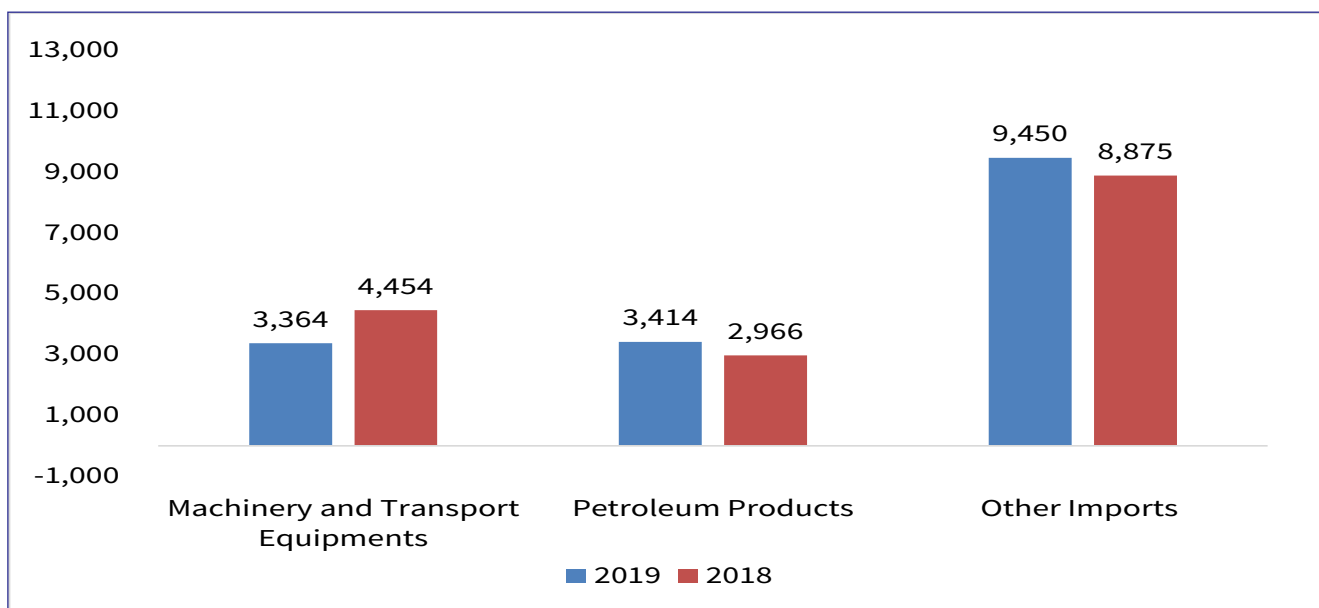
The value of merchandise exports improved to USD 10,182.9 million in the 12 months to April 2019 from USD 10,325.0 million in the 12-months to April 2018, largely reflecting an increase in coffee and horticulture exports, which rose by 8.3 percent and 11.6 percent, respectively. Earnings from tourism and travel also increased by 15.9 percent over the period, reflecting the increasing performance of the sectors (**Chart 4a**). Merchandise imports declined by 0.4 percent to USD 16,227.5 million in the 12-months to April 2019 from USD 16,294.1 million over a similar period in April 2018. The decline in imports was mainly driven by other imports that more than offset the 15.1 percent rise in imports of petroleum products (**Chart 4b**).

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

In terms of direction of trade, the UK and US accounted for an average of 7.0 percent and 8.4 percent, respectively, of Kenya's total exports over the six months to April 2019. Exports to other trading blocs such as the EAC, COMESA and the EU, accounted for

an average of 21.8 percent, 24.2 percent and 23.5 percent respectively over the period, compared to 21.0 percent, 24.7 percent and 20.2 percent of total exports in the six months to October 2019, respectively.

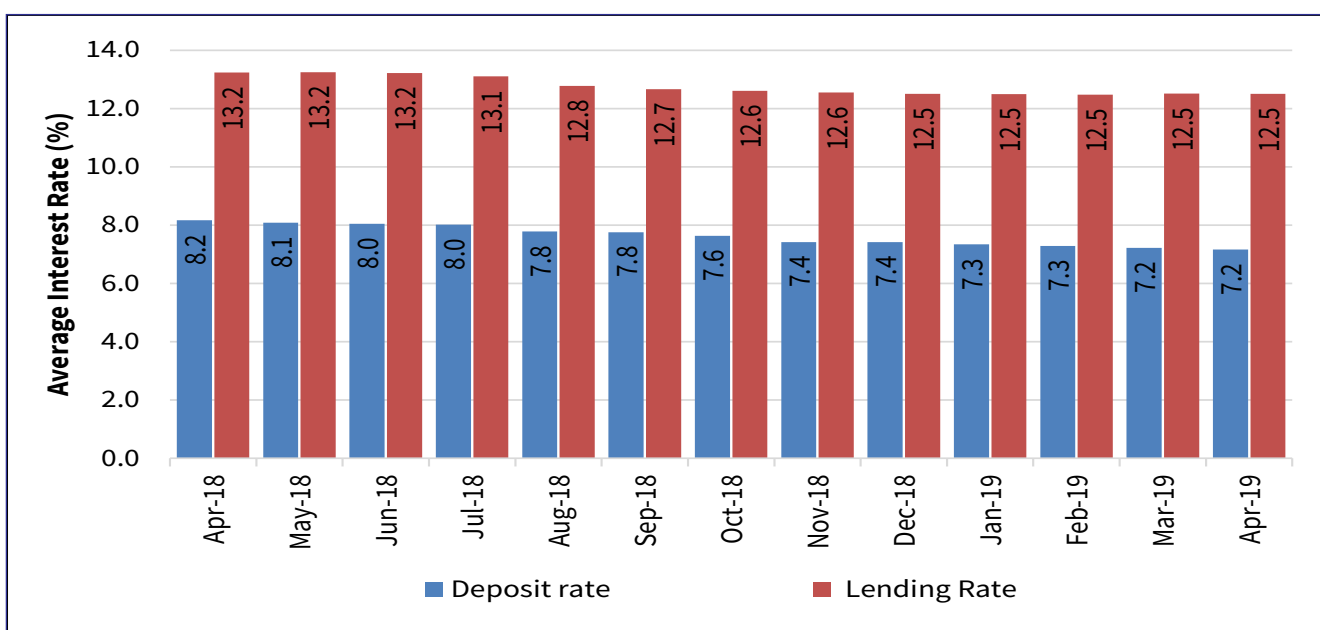
2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the six months to April 2019, with strong liquidity and capital adequacy ratios. The average commercial banks' liquidity ratio stood at 51.0 percent in April 2019 compared to 48.9 percent in October 2018, while the capital adequacy ratio remained largely unchanged at 18.3 percent in the period. The ratio of gross non-performing loans (NPLs) to gross loans was 12.9 percent in April 2019 compared to 12.3 percent in October 2018. The slight increase was due to delayed

payments by both public and private sector entities, and slow uptake of commercial and residential housing units. Banks continued with mitigation measures to reduce NPLs, including recovery efforts.

The commercial banks' average deposit rate declined to 7.2 percent in April 2019 from 7.6 percent in October 2018, while the average lending rate remained stable at 12.5 percent (**Chart 5**). The evolution of commercial bank rates in the period was determined by the law on interest rates caps.

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



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Growth in credit to the private sector improved to 4.9 percent in the 12 months to April 2019 from 4.4 percent in October 2018 (**Table 1**). Strong growth in credit to the private sector was observed in manufacturing, consumer durables, trade, transport

and communication, finance and insurance and agriculture sectors. 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.

The value of loan applications and approvals increased, respectively, to KSh 169.1 billion and KSh 147.2 billion in April 2019 from KSh 161.9 billion and KSh 143.7 billion in October 2018. The increase, both in the value of loan applications and approvals, was recorded in electricity and water, transport and communication and agriculture. During the period, loan approvals to the household, services and productive sectors declined by 6.0 percent, 65.7 percent and 20.8 percent, respectively.

2.3.6 Interest rates

The short term interest rates remained below the CBR during the six months to April 2019 except for a few days in December 2018, reflecting improved liquidity conditions in the market. In particular, the average interbank rate remained

largely stable, at 4.32 percent in the period, lower than an average of 4.80 percent in the six months to October 2018. Liquidity management operations by the CBK continued to ensure stability in the market. During the period, Reverse Repos were 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 6a**).

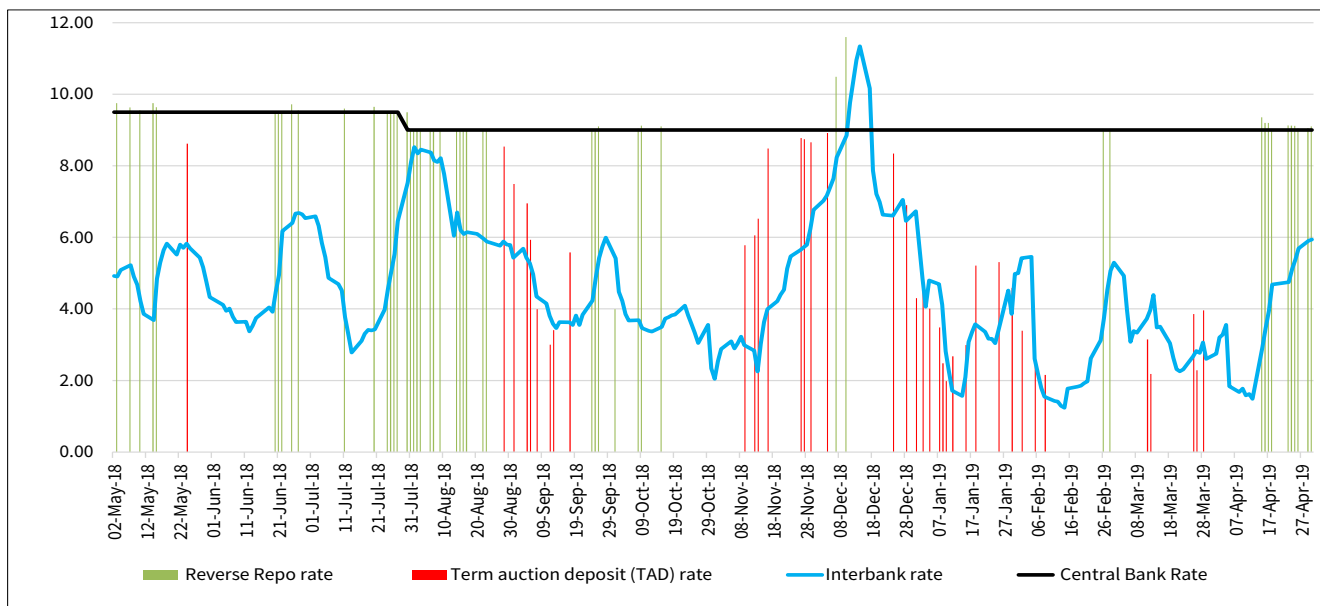
The interest rates on Government securities generally declined during the six months to April 2019, as reflected in the yield curve of Government securities (**Chart 6b and 6c**) and continued to support the implementation of the Government domestic borrowing programme at a lower cost.

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

	18-Oct	18-Nov	18-Dec	19-Jan	19-Feb	19-Mar	19-Apr
Total Credit to Private Sector	4.4	3	2.4	3	3.4	4.3	4.9
Agriculture	-5.6	-0.1	-2	-0.2	-2.6	0.2	2.5
Manufacturing	14.8	10.6	6.5	6.5	7.7	7.2	7.9
Trade	4	3.2	2.9	6.6	6.4	8.7	8.4
Building & construction	8.9	1.8	1.4	2.6	-7	-6.5	7.1
Transport & communication	-10.7	-9.4	-6.5	-0.7	5.7	6.4	-7.7
Finance and insurance	5.3	17.5	15.4	13.1	10.2	13.3	9.1
Real estate	-1.1	-0.5	-2.6	-2.9	-0.1	-0.7	1.2
Mining & quarrying	-10.6	-10.7	-14.5	-13.4	-11.4	-12.5	-11.6
Private households	5.4	6.8	5.6	6.6	8	7.9	5.1
Consumer durables	8.9	11	15.4	16.1	13.9	16.4	7.6
Business services	9.5	8	0	0.3	-0.4	1.1	12.1
Other activities	-23.4	-34.8	-27.2	-33.1	-31.7	-29.6	-12.4

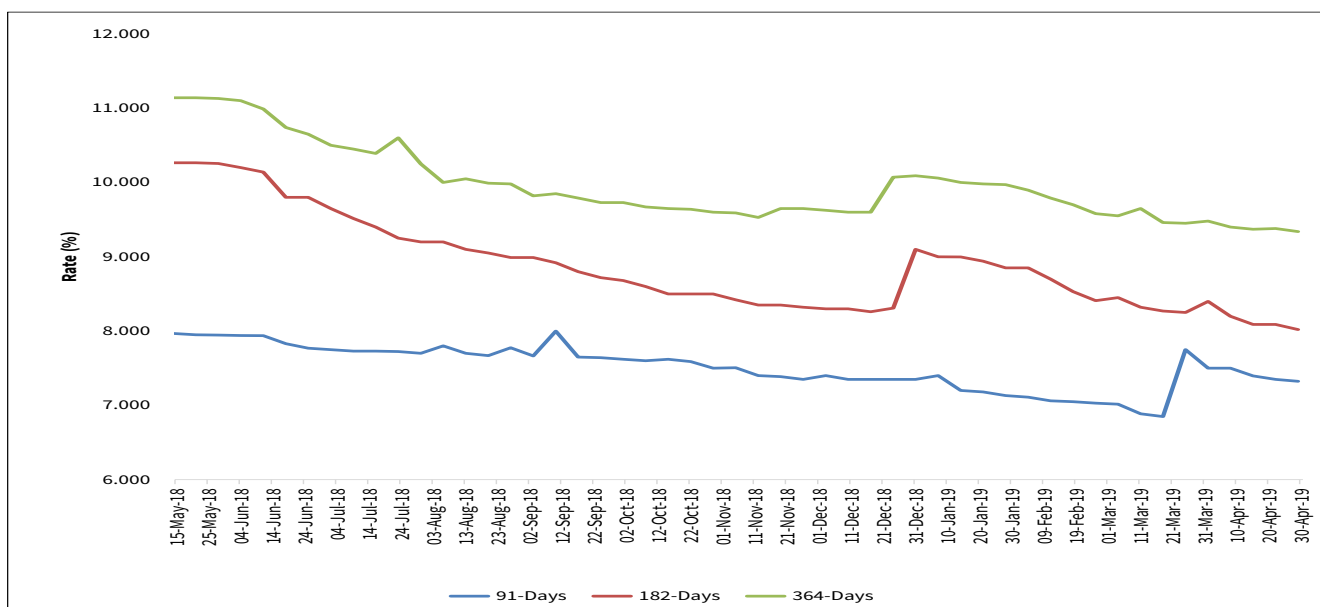
Source: Central Bank of Kenya

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



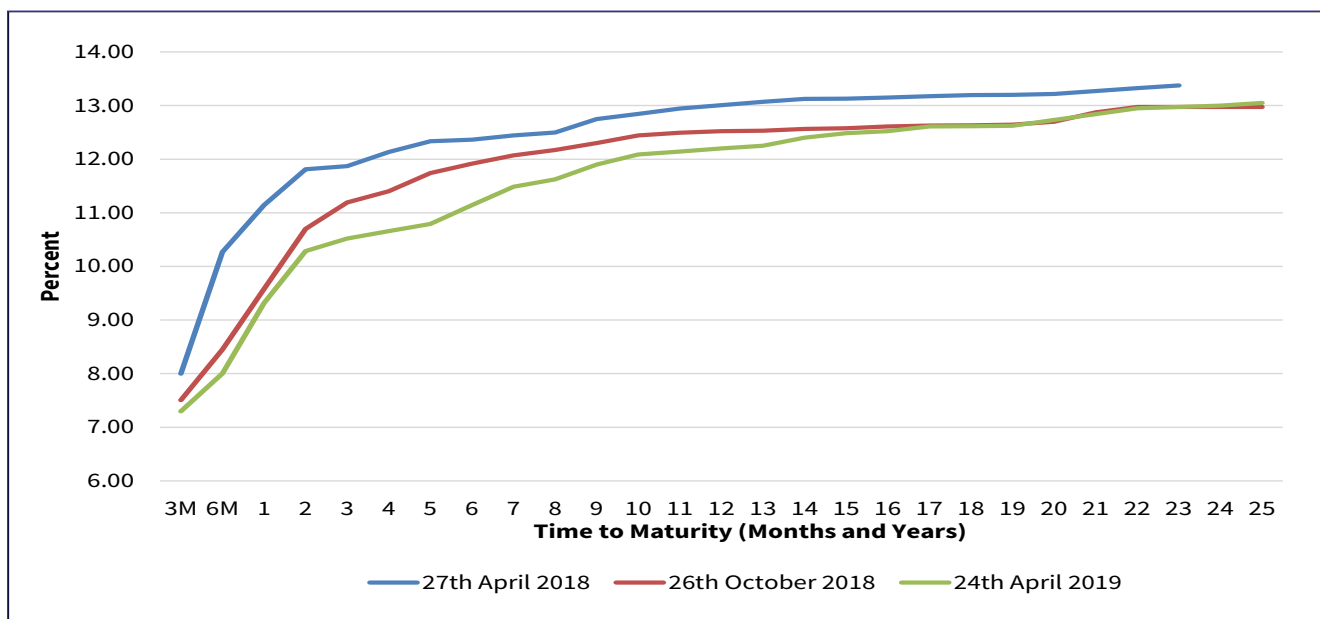
Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

Chart 6c: Government Securities Yield Curve



Source: Central Bank of Kenya

3. MONETARY POLICY COMMITTEE MEETINGS AND DECISIONS

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 Government overall inflation target provided by the Cabinet Secretary for the National Treasury at the beginning of FY2018/19 was 5 percent with an allowable margin of 2.5 percent on either side.

In the six months to April 2019, the Central Bank Rate (CBR) remained as 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 (CRR) 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), Reverse Repos and Term Auction Deposits (TAD).

The annual growth in the broad money (M3) and private sector credit remained below their projected growth paths through the period under review. In particular, the 12-month growth in M3 rose to 10.7 percent in April 2019 from 9.1 percent in October 2018 and was above the 5.5 percent recorded in April 2018. The faster growth in M3 largely reflected the improvement in private sector credit uptake during the period.

3.2 Monetary Policy Committee Meetings and Decisions

During the period, the MPC held its bi-monthly meetings on November 27, 2018, January 28 and March 27, 2019 to review market and economic developments as well as the outcome of its previous policy decisions on the economy.

The November 2018 meeting was held against a backdrop of domestic macroeconomic stability and strong growth in the first half of 2018. However, the trade wars between the US and China, and the uncertainties surrounding Brexit resolution posed a risk to the pace of recovery of the global economy. The MPC noted that inflation expectations remained well anchored within the target range, and assessed that the economy was operating close to its potential level. The MPC concluded that the current policy stance remains appropriate, and will continue to monitor any perverse response to its previous decisions. The Committee therefore decided to retain the CBR at 9.00 percent.

The MPC meeting in January 2019 was held against a backdrop of domestic macroeconomic stability, increased optimism on the economic growth prospects, lower international oil prices, and increased uncertainties and weaker global growth outlook. Overall inflation remained within the target range largely due to lower food prices following favourable weather conditions, reduction in electricity tariffs, decline in fuel prices, and limited demand-driven inflationary pressures. The MPC noted that the

economy continued to operate close to its potential level. The MPC concluded that the prevailing policy stance remained appropriate, and would continue to monitor any perverse response to its previous decisions. The Committee decided to retain the CBR at 9.0 percent.

The March 2019 MPC meeting was held against a backdrop of domestic macroeconomic stability, sustained optimism on the economic growth prospects despite the delayed onset of the long rains in parts of the country, gradual rise in international oil prices and the weakening of global growth. In addition, the High Court had declared sections 33B (1) and 33B (2) of the Banking Act that provided for interest rate caps, as unconstitutional, null and void. The Court suspended the judgement for one year to enable the National Assembly to relook and consider appropriate amendments. The MPC noted that overall

inflation remained within the target range in January and February, largely due to stable food prices, lower electricity and fuel prices, and muted demand-driven inflationary pressures. The MPC concluded that the prevailing policy stance remained appropriate, and therefore decided to retain the CBR at 9.00 percent.

During the six months to April 2019, the MPC monitored the effects of its previous policy changes, as well as other developments in the domestic and global economy. 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. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC held regular stakeholder forums with Chief Executive Officers of commercial banks and microfinance banks to provide the background to the policy decisions and obtain feedback on the committee's previous policy decisions. The bi-monthly MPC Market Perception 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 every MPC Meeting 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. 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. Over the period covered by this report, the Governor and MPC Members also held meetings with investors to update them on recent economic developments and the outlook for the economy.

5. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to April 2019 ensured that overall inflation remained within the target range. The stability of the exchange rate moderated the risks of imported inflation on the stability of domestic prices. Effective coordination of fiscal and monetary policies continued to support the achievement of price and market stability.

The MPC will continue to monitor developments in the domestic and global economy. 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 2018 – APRIL 2019)

November 2018	The MPC retained the CBR at 9.00 percent
January 2019	The MPC retained the CBR at 9.00 percent
March 2019	The High Court declared Section 33B(1) and 33B(2) of the Banking Act that provided for interest caps unconstitutional, null and void. The National Assembly was given one year to make appropriate ammendments.

GLOSSARY OF KEY TERMS

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

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

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

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

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

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

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

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

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

Term Auction Deposits (TAD): The TAD is used in exceptional market conditions when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options. The CBK seeks to acquire deposits through

a transfer agreement from commercial banks at an auction price but with no exchange of security guarantee.

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

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



Central Bank of Kenya

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