Central Bank of Kenya

# Eighteenth Bi-Annual Report of the Monetary Policy Committee

*Issued under the Central Bank of Kenya Act, Cap 491*

**April 2017**

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

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## LETTER OF TRANSMITTAL TO THE CABINET SECRETARY FOR THE NATIONAL TREASURY

Honourable Cabinet Secretary,

I have the pleasure of forwarding to you the eighteenth 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. It also covers other activities of the Committee in the six months to April 2017. Copies of MPC Press Statements and the Minutes of all the Meetings of the MPC between November 2016 and April 2017 are attached to the Report for your information.

Patrick Njoroge

**Dr. Patrick Njoroge**
**Governor, Central Bank of Kenya**

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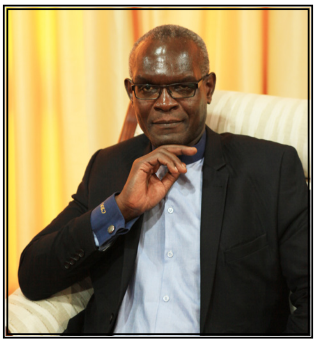
## MEMBERS OF THE MONETARY POLICY COMMITTEE

Dr. Patrick Njoroge
Governor, Chairman

Mrs. Sheila M'Mbijjewe
Deputy Governor

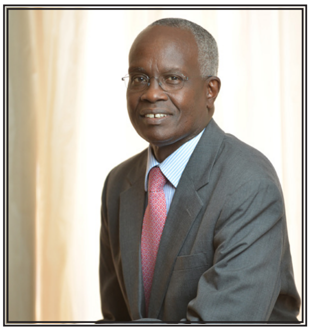
Dr. Kamau Thugge (EBS)
PS, National Treasury
Treasury Representative

Mrs. Farida Abdul
Member



Mr. Charles G. Koori
Member

Prof. Francis Mwega
(Member - Deceased)



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; 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 additional meetings 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 eighteenth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and economic developments during the six months to April, 2017. The monetary policy stance of the Central Bank of Kenya (CBK) 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 CBK. The MPC held three bi-monthly meetings between November 2016 and April 2017 to review the outcome of its previous policy decisions and economic developments, and to put in place appropriate measures to maintain price stability. The MPC retained the Central Bank Rate (CBR) at 10.0 percent during the period. The monetary policy stance together with the CBK liquidity management curbed demand-driven inflationary pressures in the period.

The month-on-month overall inflation remained within the Government target range between November 2016 and January 2017, but exceeded the target range from February to April due to increases in food prices. Food inflation rose sharply in February 2017 reflecting the adverse impact of the prolonged dry weather conditions in the first quarter of 2017 on the prices of key food items. As a result, overall inflation rose to 11.5 percent in April 2017 from 6.5 percent in October 2016. The Government initiated measures to mitigate the impact of the drought on key food items, including zero-rating of taxes on maize and bread, and duty free imports of maize and sugar. As required in the notification on the price stability target, the CBK wrote a letter to the National Treasury explaining: why overall inflation exceeded the target range; the measures the MPC and CBK were taking to address the deviation from the target range; and, the expected time period for overall inflation to return to the target band.

Month-on-month non-food-non-fuel (NFNF) inflation fell to 4.3 percent from 5.4 percent. The 3-month annualised NFNF inflation remained relatively stable in the period, an indication that there were no 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 relatively stable during the period. This reflected a narrowing of the current account deficit due to resilient earnings from tea and horticulture exports, strong diaspora remittances, continued tourism recovery, and a lower petroleum products import bill. International oil prices remained below their historical averages. This, coupled with the stability of the Kenya Shilling, continued to moderate risks of imported inflation. The CBK level of usable foreign exchange reserves rose to historical levels during the period, standing at USD8.3 billion (5.5 months of import cover) at the end of April 2017 from USD7.7 billion (equivalent to 5.1 months of import cover) at the end of October 2016. These reserves, together with the Precautionary Arrangements with the International Monetary Fund (IMF) continued to provide adequate buffers against short term shocks.

The banking sector remained resilient during the period. The average commercial banks' liquidity and capital adequacy ratios remained strong, while the distribution of liquidity in the sector improved. The guidance provided by the CBK to banks in November 2016 on the preparation of Internal Capital Adequacy Assessment Process (ICAAP) will ensure that banks have adequate capital that is aligned to the risk profile and business opportunities. The CBK is strengthening the sector to ensure greater transparency and stronger governance, and to promote effective business models and innovation. The Bank continued to implement additional measures to lower the cost of credit on a sustainable basis including promoting innovation in the banking sector leveraging on ICT, and strengthening the Credit Reference Bureaus to provide for a credit scoring framework.

Growth of credit to the private sector slowed down to 2.4 percent over the 12 months to April 2017 partly due to significant repayments in manufacturing, transport and communication sectors. The MPC continued to monitor the implications of the capping of interest rates on lending and the transmission of monetary policy. Following the adoption of the law capping interest rates in September 2016, the CBK suspended the Kenya Bankers Reference Rate (KBRR) framework in January 2017.

The Bank continued to hold regular interactions with stakeholders in the financial and real sectors, as well as the media. Bi-monthly meetings with Chief Executive Officers of commercial and microfinance banks were held to discuss the background information underpinning the MPC's decisions. The Governor's media briefings after every MPC meeting ensured that the press was informed on the background to the MPC decisions and other developments in the banking sector. These forums continued to provide a regular feedback mechanism and improved understanding of monetary policy decisions. The Governor and MPC Members also held meetings with potential investors in order to brief them on recent economic developments and the outlook for the economy.

The Bank remained vigilant to the risks posed by developments in the domestic and global economies on its overall price stability objective. The main risks to inflation related to the persistence of the impact of the drought on food prices, and potential volatility in international oil prices following the decision by the major oil producers to reduce production. Risks from the global economies related to uncertainties in the global financial markets particularly with regard to the U.S. economic and trade policies, normalisation of monetary policy in the advanced economies, and the Brexit outcome. Nevertheless, the monetary policy measures in place, exchange rate stability, government measures to increase the supply of key food items, and continued coordination between monetary and fiscal policies were expected to continue to support the price stability objective.

## 1. INTRODUCTION

The eighteenth bi-annual Report of the MPC reviews economic developments in the period May to April 2017 and outcomes of the monetary policy stance adopted by the Committee in pursuit of its price stability objective.

Food prices rose sharply in February 2017 reflecting the impact of the prolonged dry weather conditions in the first quarter of 2017. As required by the notification on the price stability target, the CBK wrote a letter to the National Treasury explaining why overall inflation exceeded the target range, measures the MPC and CBK were taking to address the deviation from the target range, and the expected time period for overall inflation to return to the target band. The monetary policy measures adopted by the MPC curtailed demand driven inflation pressures. The foreign exchange market was relatively stable reflecting the narrowing of the current account deficit. The performance of the economy in 2016 and the first quarter of 2017 was strong largely due to the resilience of the non-agriculture sectors, continued public investment in infrastructure, strong private consumption, and recovery of the tourism sector.

On the international scene, risks to the global economy remained elevated partly due to uncertainties on future economic and trade policies of the new U.S. administration, normalisation of monetary policies in the advanced economies, and the Brexit outcome.

The remainder of this Report is structured as follows. Section 2 provides highlights of the monetary policy formulation during the period, while Section 3 provides a discussion of the impact of policy 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

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 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 FY2016/17 was 5 percent 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 operationalized through various instruments including: Open Market Operations (OMO), changes in cash reserve requirements at CBK, foreign exchange market operations, 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).

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 Precautionary Arrangements with the International Monetary Fund (IMF) aimed at safeguarding the economy against exogenous shocks which could lead to balance of payments needs, while helping to anchor pro-growth macroeconomic and institutional reforms. The CBK met its NDA and NIR targets for December 2016 and March 2017, and was on track with respect to the June 2017 targets.

The annual growth rates of broad money supply (M3) and private sector credit were below their projected growth paths in the period. The 12-month growth in M3 slowed down from 6.9 percent in October 2016 to 3.6 percent in December and increased thereafter to 7.0 percent in April 2017. Growth in private sector credit declined from 4.7 percent in October 2016 to 2.4 percent in April 2017.

### 2.2 Domestic and Global Economic Environments

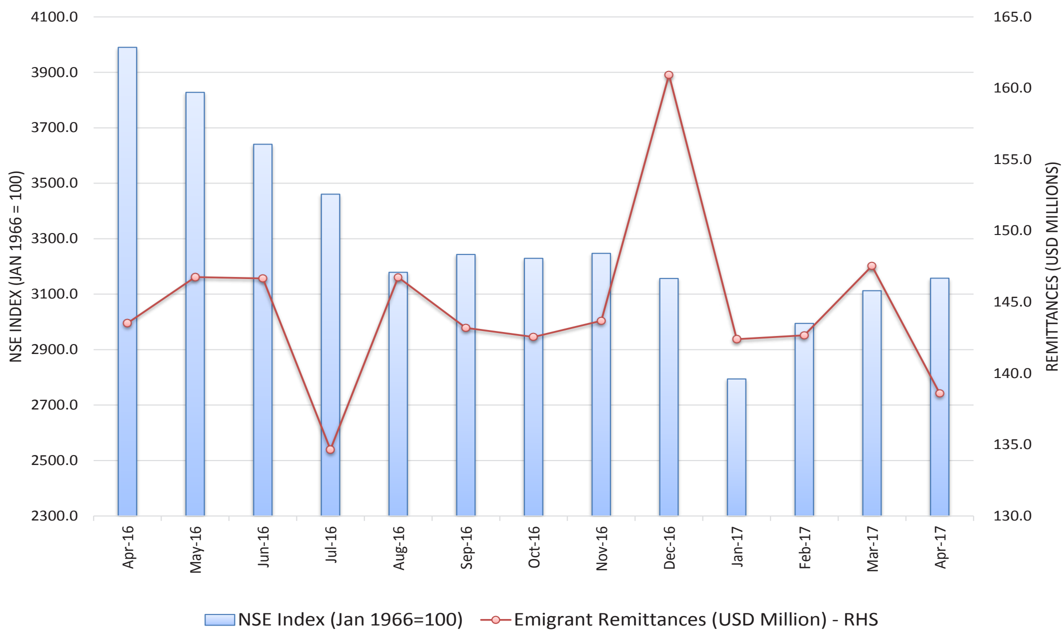
The domestic economic environment during the six months to April 2017 was characterised by a sharp increase in food prices following the drought conditions experienced in the first quarter of 2017, persistent slowdown in private sector credit growth, and uncertainties on the impact of the capping of interest rates on monetary policy and the overall economy. Internationally, uncertainties persisted on the future economic and trade policies of the new U.S. administration, and the Brexit outcome.

Global growth slowed to 3.2 percent in 2016 from 3.4 percent in 2015. The slowdown in global growth in 2016 was largely due to the subdued growth for the advanced economies following Brexit, and a weaker-than expected growth of the U.S. economy. Sub-Saharan African (SSA) growth declined to 1.4 percent in 2016 from 3.4 percent in 2015 driven largely by lower commodity prices and a weak global economy. Global economic activity is expected to pick-up slightly to 3.5 percent in 2017 supported by recovery in investment, manufacturing, and trade. Risks to the global outlook in 2017 relate to pressures for inward-looking policies in advanced economies which may slowdown trade and investment, and the Brexit outcome.

The foreign exchange market remained relatively stable supported by the narrowing of the current account deficit due to improved earnings from tea and horticulture, a reduction in imports of petroleum products due to lower price, resilient diaspora remittances and improved tourism performance. Diaspora remittances increased to an average of USD146.0 per month during the six months to April 2017 compared to an average of USD143.4 million per month in the six months to October 2016 (Chart 1a). The Nairobi Securities Exchange (NSE) recorded a gradual recovery from the fall attributed to uncertainties in the global economy and initial effects of the capping of interest rates on the prices of banking sector listed stocks. The NSE index stabilised in January, and rose gradually thereafter to 3,157.6 in April 2017.

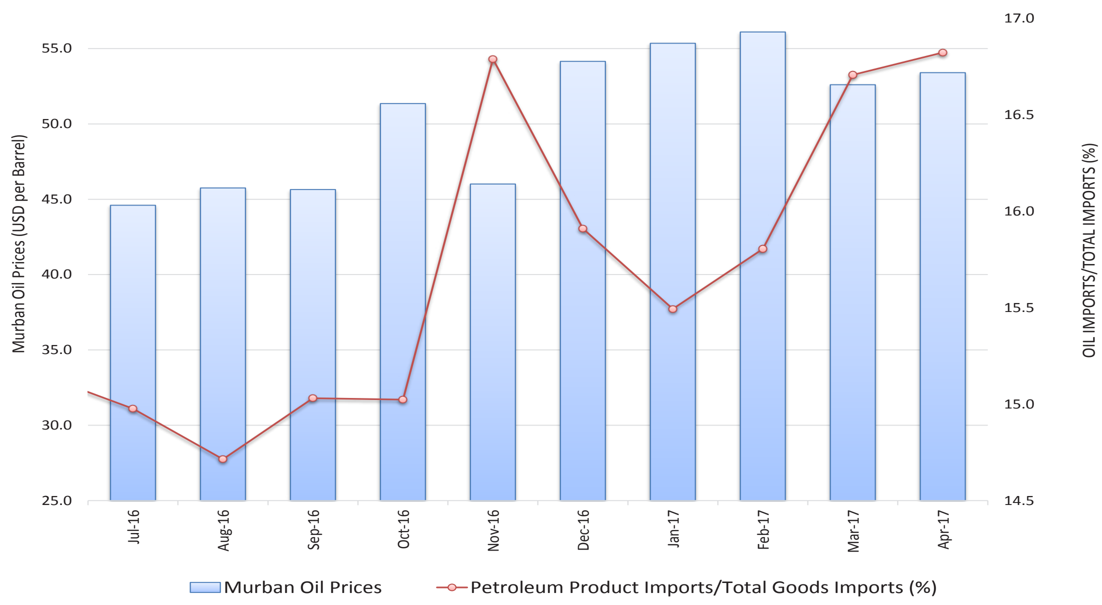
Murban crude oil prices rose to USD53.4 per barrel in April 2017 from USD51.4 in October 2016 due in part to the decision by the major oil producing countries to reduce supply (Chart 1b). As a result, the proportion of imports of petroleum products in total imports of goods increased from 15.0 percent in the 12-months to October 2016 to 16.8 percent in the 12-months to April 2017 (Chart 1b).

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




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

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




***Source**: Central Bank of Kenya and Kenya Revenue Authority*

## 2.3 Monetary Policy Committee Meetings and Decisions

The MPC held its bi-monthly meetings on November 28, 2016, January 30, 2017 and March 27, 2017 to review developments in the domestic and international markets, and to put in place appropriate measures to maintain price stability. The MPC retained the CBR at 10.0 percent during the period. The MPC continued to closely monitor the impact of the capping of interest rates on the transmission mechanism of monetary policy decisions.

The CBK continued to work closely with the National Treasury to ensure coordination of monetary and fiscal policies for overall macroeconomic stability. The execution of the Government domestic borrowing programme continued to support a stable yield curve and market stability.

The Bank continued to closely monitor the foreign exchange market in view of the risks posed by increased uncertainties in the global financial markets. The CBK's foreign exchange reserves, together with the Precautionary Arrangements with the IMF (equivalent to USD1.5 billion) continued to provide adequate buffers against short term shocks.

The monetary policy measures in place were expected to continue moderating demand-driven inflationary pressures, while stability of the exchange rate was expected to moderate any possible effects of imported inflation on the price level. The CBK also continued to monitor any second round effects of the rise in food prices to NFNF inflation.

## 3. IMPACT OF POLICY ON KEY ECONOMIC INDICATORS

### 3.1 Inflation

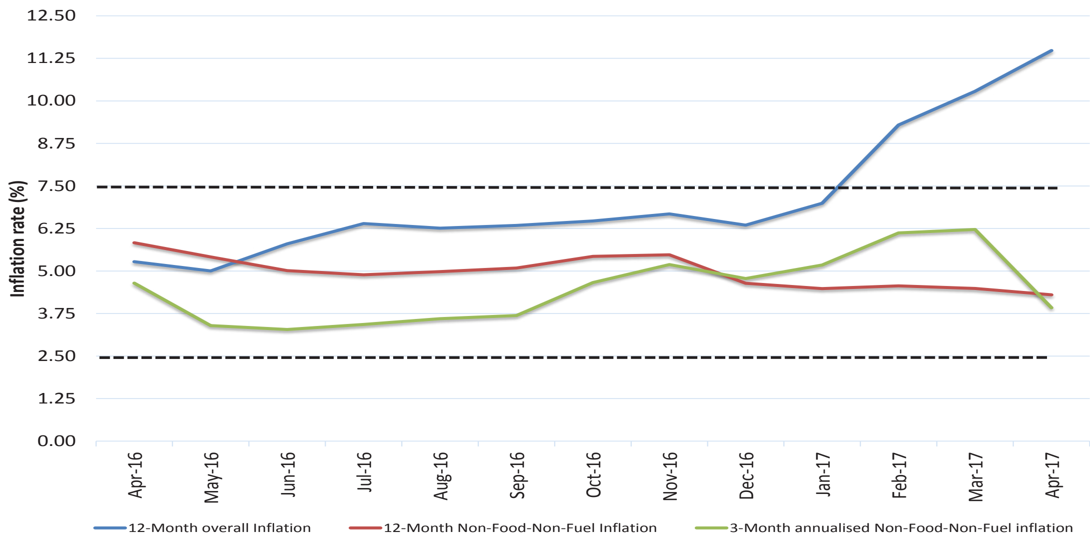
Month-on-Month overall inflation remained within the within the prescribed target range between November 2016 and January 2017, but exceeded the target range between February and April 2017 due to high prices of food (Chart 2a). Overall inflation rose to 11.5 percent in April 2017 compared with 6.5 percent in October 2016. Food inflation rose sharply from 11.0 percent in October 2016 to 21.0 percent in April (Charts 2a and 2b). This reflected the adverse impact of the drought conditions in the first quarter of 2017 on the supply of key food items. The contribution of *food and non-alcoholic beverages* to overall inflation rose to 9.2 percentage points in April 2017 from 4.7 percentage points in October 2016. The Government initiated measures to mitigate the impact of the drought on key food items. These measures included zero-rating of taxes on maize and bread, and duty free imports of maize and sugar.

The main food items that contributed to the high food inflation between February and April were kale-sukuma wiki, tomatoes, sifted maize flour, sugar, Irish potatoes, loose maize grain, fresh unpacked milk, fresh packed milk, and cabbages. These food items account for 12.1 percent of the total CPI basket (translating to 33.6 percent of the food basket), and contributed 3.7 percentage points to overall inflation and 4.7 percentage points to food inflation in April 2017.

Despite the increase in food prices, non-food-non-fuel (NFNF) inflation declined to 4.3 percent from to 5.4 percent in the period. The 3-month annualised NFNF inflation remained relatively stable in the period, an indication that there were no demand pressures in the economy. The monetary policy stance adopted by the MPC together with the CBK liquidity management, including Open Market Operations, curbed the threat of demand-driven inflationary pressures.

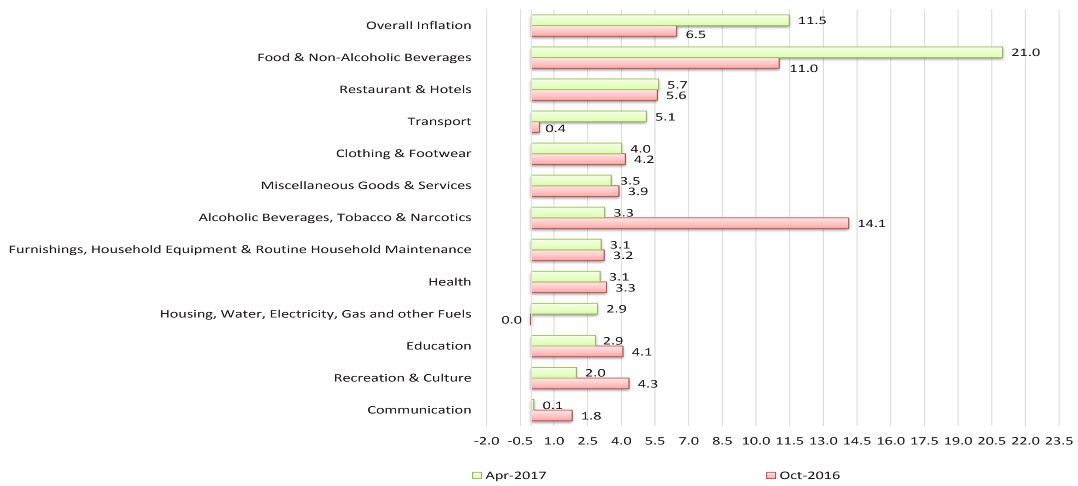
The East African Community (EAC) region, which has a fairly similar composition of the CPI basket, displayed divergent trends in respective inflation rates (Chart 2c). Whilst inflation rose in Kenya, Rwanda, Uganda and Tanzania largely due to high food prices, it fell in South Africa reflecting improved weather conditions which resulted in lower food prices.

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



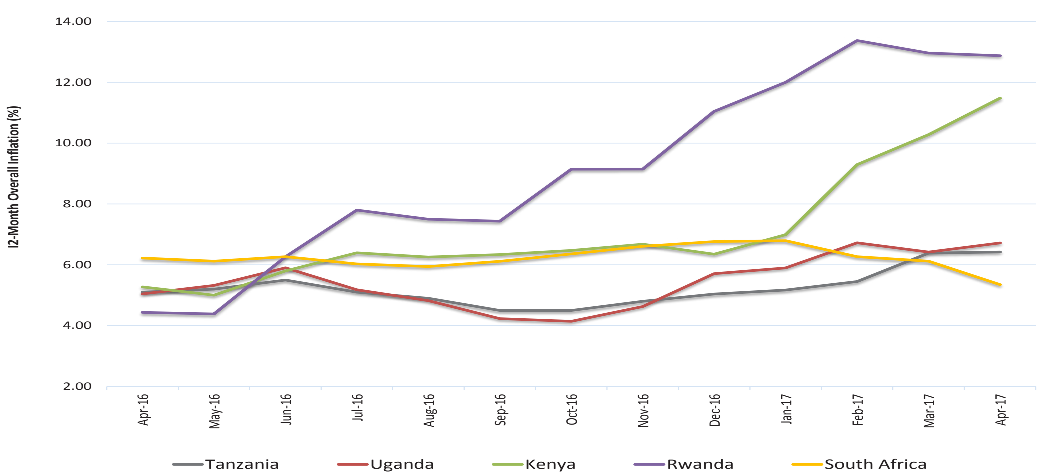

***Source***: *Kenya National Bureau of Statistics and Central Bank of Kenya*

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




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

## Chart 2c: 12-Month Inflation in Selected Countries (%)




***Source***: *Websites of respective central banks*

## 3.2 Foreign Exchange Market Developments

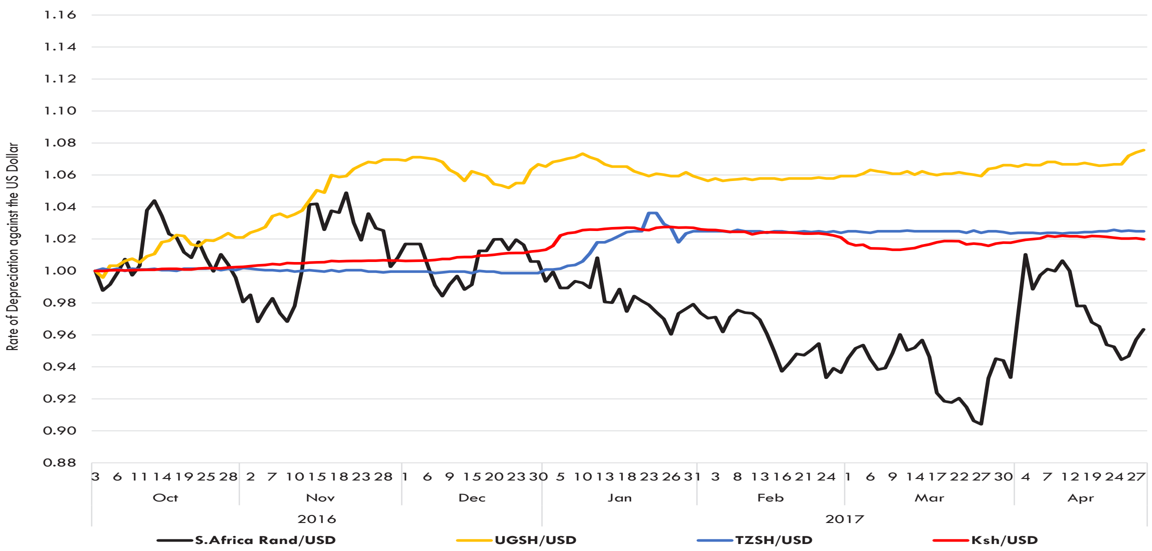
Despite volatility in the global financial markets attributed mainly to uncertainties with respect to economic and trade policies of the new U.S. administration and Outcome of Brexit, the foreign exchange market was relatively stable in the six months to April 2017. This was largely due to improved earnings from tea, coffee and horticulture exports, a lower petroleum products import bill due to lower oil prices, resilient diaspora remittances, and continued recovery of tourism.

The stability of the foreign exchange market also reflected the resilience and diversified nature of the economy relative to its peers. The Kenyan economy is diversified in terms of export products and external markets, which is a major source of resilience against adverse effects of external shocks on exports. About 40 percent of Kenya's exports were to Africa in the year to April 2017.

The CBK's foreign exchange reserves rose to an all time high in the period, due in part to planned external borrowings by the Government. The CBK level of usable foreign exchange reserves stood at USD8.3 billion (5.5 months of import cover) at the end of April 2017 compared with USD7.7 billion (5.1 months of import cover) at the end of October 2016. These reserves, together with the Precautionary Arrangements with the IMF continued to provide a buffer against short term shocks.

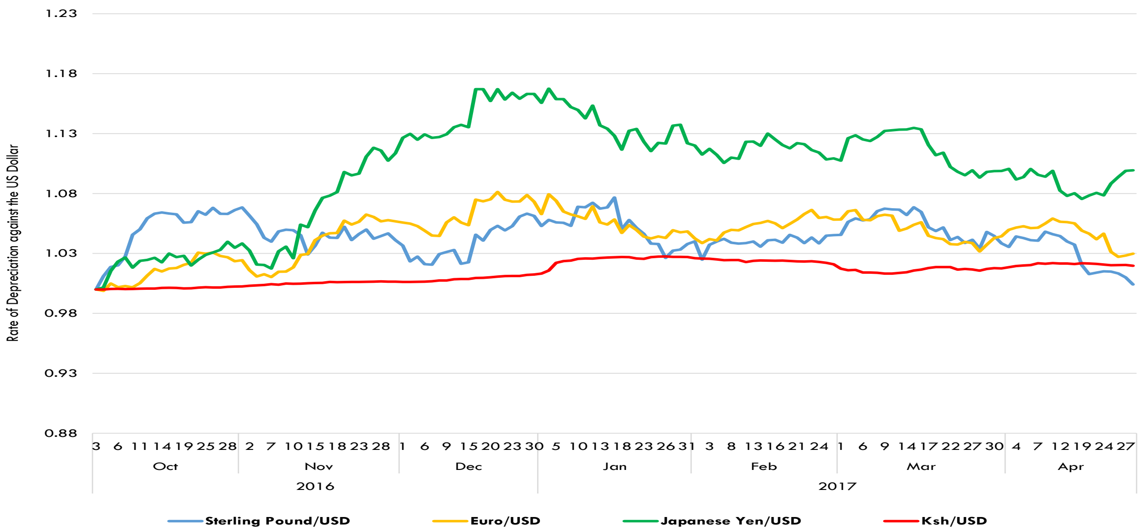
Most regional and major international currencies were volatile against the U.S. dollar largely due to volatility in the global financial markets (Charts 3a and 3b). Global financial markets were volatile due to uncertainties with regard to the economic and trade policies of the new U.S. administration, normalisation of monetary policies in the advanced economies, the Brexit outcome, and expectations of expansionary fiscal policies in the U.S.

**Chart 3a: Rate of Depreciation of the Kenya Shilling and Regional Currencies against the U.S. dollar (October 3, 2016 =1)**




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

**Chart 3b: Rate of Depreciation of the Major International Currencies against the U.S. dollar (October 3, 2016 =1)**




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

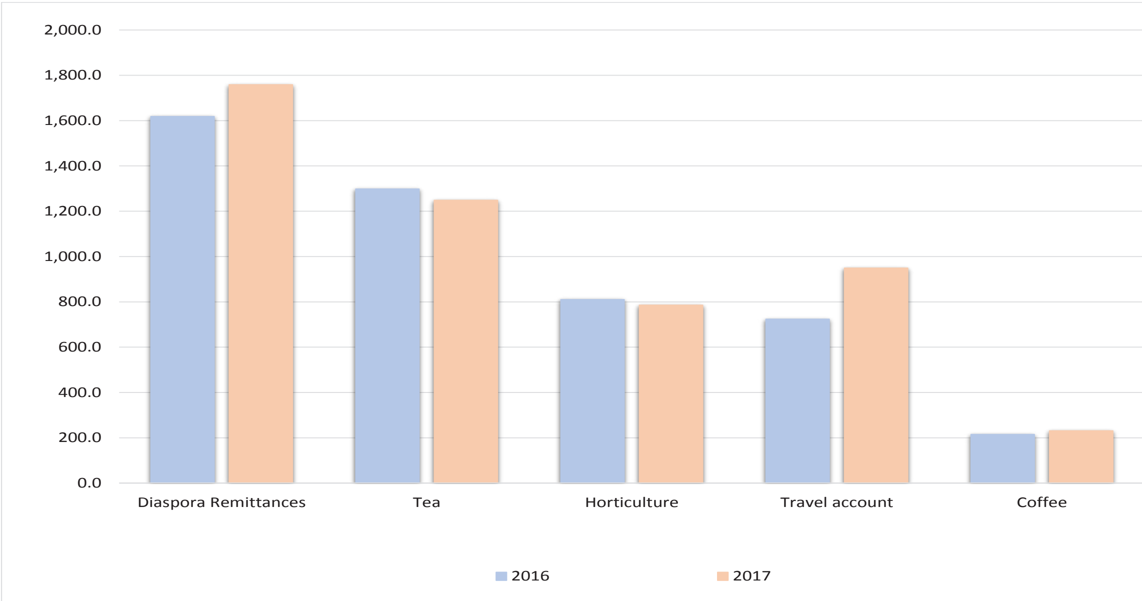
## 3.3 Balance of Payments Developments

The overall balance of payments position recorded a deficit of USD838.7 million (1.2 percent of GDP) in the year to April 2017 compared to a deficit of USD515.6 million (0.8 percent of GDP) in the year to April 2016. This was reflected in the widening of the current and capital account deficits. The current account deficit widened to USD4,553.8 million (6.2 percent of GDP) in the year to April 2017 from USD3,288.7 million (5.2 percent of GDP) in the year to April 2016 largely due to short-term import demand for cereals, sugar, and Standard Gauge Railway (SGR) related transport equipment.

The value of merchandise imports increased from USD13,732.9 million in the year to April 2016 to USD14,590.0 million in the year to April 2017 and was mainly reflected in the value of imports of other exports. The value of imports of machinery and transport equipment to USD4,663.8 million from USD5,181.9 million. Over the same period, the value of merchandise exports declined to USD5,708.0 million from USD6,087.2 million largely due to a fall in re-exports. Receipts from tea and horticulture remained resilient despite lower export volumes due to adverse weather conditions in the first quarter of 2017. Receipts from tourism, coffee exports and diaspora remittances remained strong (Chart 4a). Additionally, imports of machinery and transport equipment were lower in the year to April 2017 reflecting completion of the first phase of the SGR (Chart 4b). The petroleum products import bill was relatively stable in the period reflecting lower international oil prices.

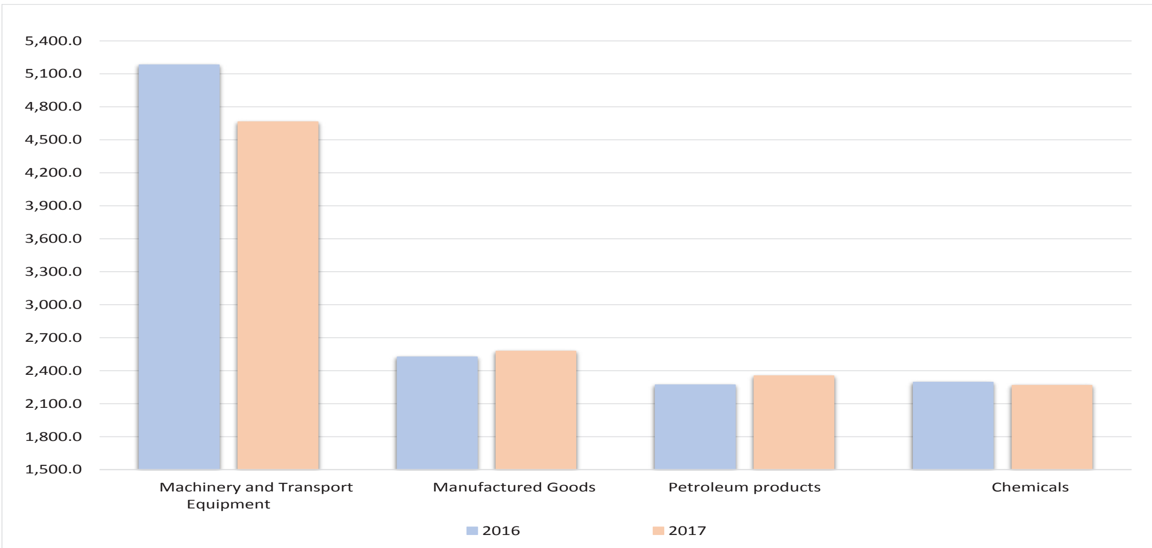
The CBK continued to monitor the impact of Brexit as well as futture policies of the new U.S. administration since these developments have implications on trade and investment. The U.K. and U.S. accounted for 6.2 percent and 8.0 percent, respectively, of Kenya's exports at the end of April 2017. Kenya's exports to the U.S. are mainly through the African Growth and Opportunity Act (AGOA) framework.

**Chart 4a: Foreign Exchange Inflows from Major Export Categories in the Year to April (USD Million)**




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

**Chart 4b: Imports by Major Categories in the Year to April (USD Million)**



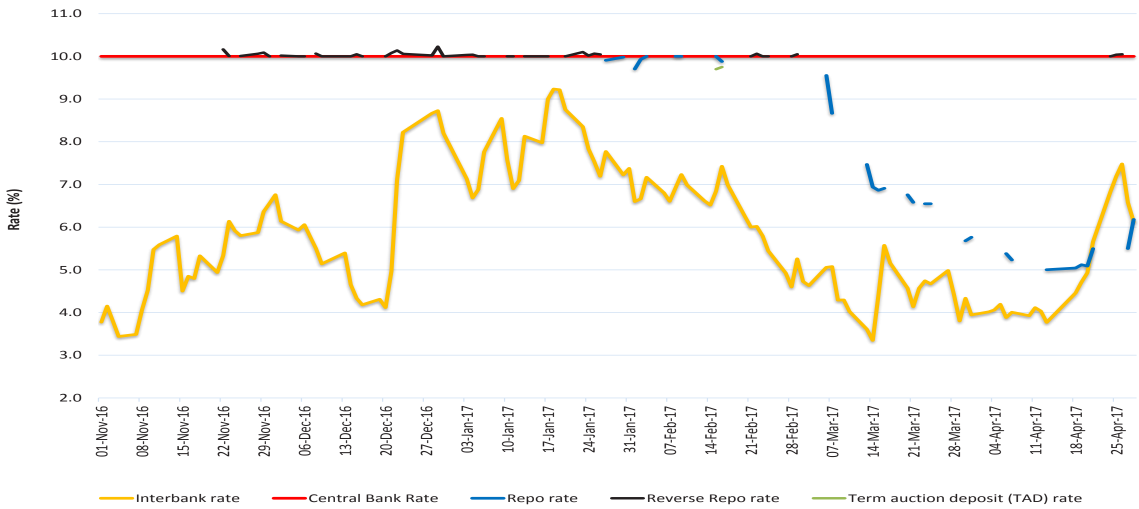

***Source**: Central Bank of Kenya*

## 3.4 Interest Rates Developments

The interbank rate remained below the CBR during the six months to April 2017 reflecting improved liquidity conditions in the market. However, the liquidity distribution remained uneven across the bank tiers due to segmentation in the interbank market. Liquidity management operations by the CBK continued to ensure stability in the market. The CBK used Reverse Repos to supply liquidity to segments of the market facing shortages, and Repos and Term Auction Deposits to withdraw liquidity from segments of the market with surpluses (Chart 5a).

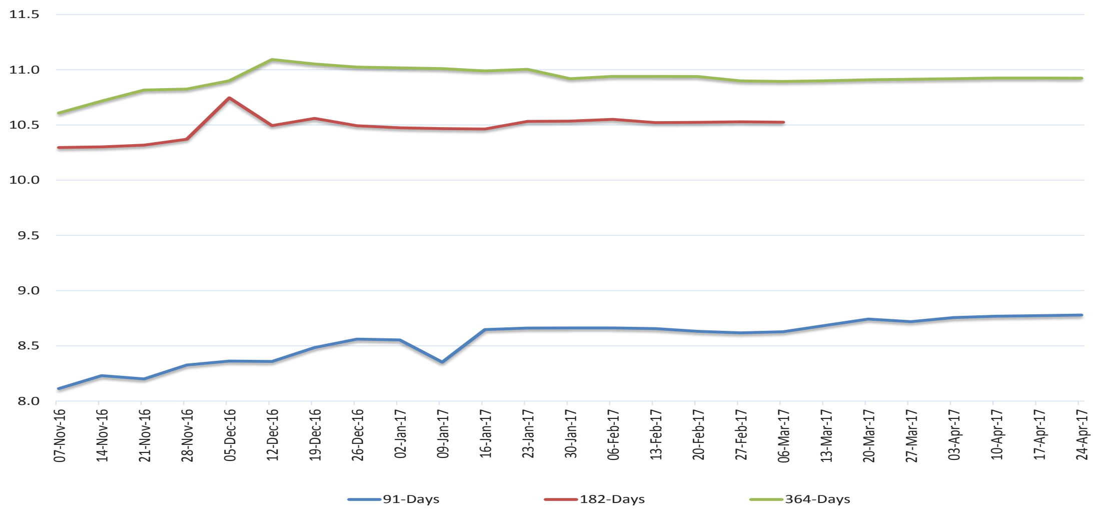
The interest rates on Government securities were stable during the six months to April 2017, an indication of coordination of monetary and fiscal policies (Chart 5b). The implementation of the Government domestic borrowing programme continued to support market stability and a stable yield curve of Government securities. Consistent with the domestic debt management strategy adopted during the period, 182-day Treasury bills were not issued in March and April 2017.

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




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

**Chart 5b: Average Interest Rates on Treasury Bills (%)**




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

### 3.5 Banking Sector Developments

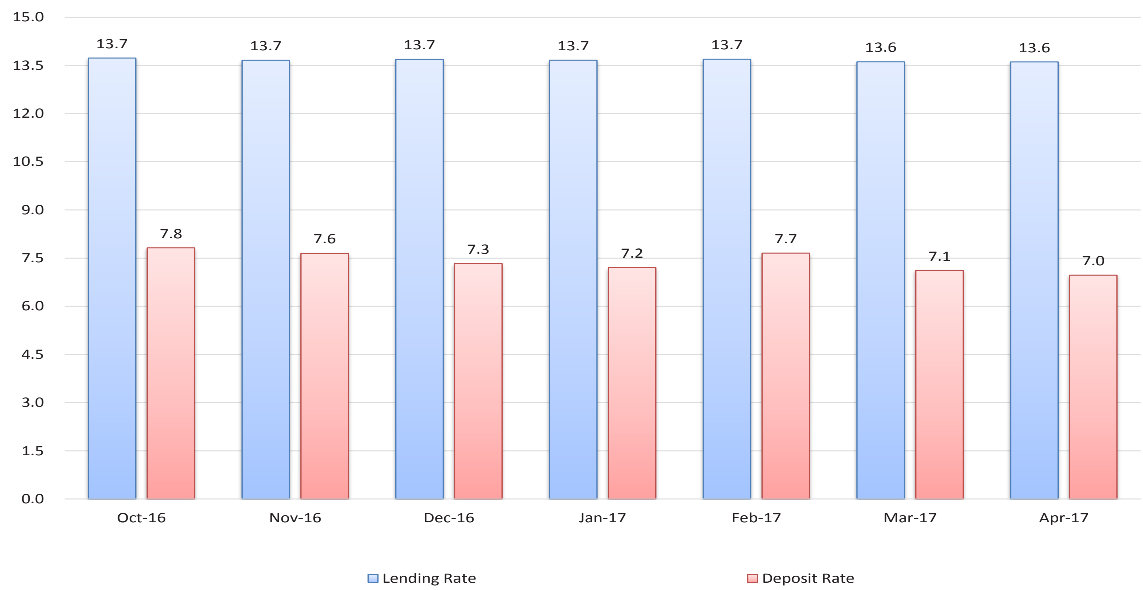
The banking sector was resilient in the six months to April 2017. The average commercial banks liquidity rose from 43.6 percent in October 2016 to 44.4 percent in April 2017. The capital adequacy ratio stood at 18.8 percent in April 2017 compared with 19.1 percent in October 2016. The CBK provided guidance to banks in November 2016 on the preparation of Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP will ensure that banks have adequate capital that is aligned to the risk profile and business opportunities.

The ratio of gross non-performing loans (NPLs) to gross loans increased slightly to 9.6 percent in April 2017 compared to 9.3 percent in October 2016 due in part to reclassification of loans in line with the required reporting standards and slower growth of credit. The CBK continued to closely monitor liquidity and credit risks in the sector. The average commercial banks' lending rates flattened out within the interest rate caps during the period (Chart 6). Banks funding costs decreased particularly from February 2017 reflecting lower average deposit rates.

The CBK continued to monitor the impact of the Banking (Amendment) Act on monetary policy and the overall economy. Following the adoption of the law capping interest rates in September 2016, the CBK suspended the Kenya Bankers Reference Rate (KBRR) framework in January 2017. 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 Bank implemented measures to lower the cost of credit on a sustainable basis including promoting innovation in the banking sector, leveraging on ICT, and strengthening the Credit Reference Bureaus to provide for a credit scoring framework.

The MPC continued to hold meetings with stakeholders in the banking sector during the six months to April 2017. Bi-monthly meetings were held with Chief Executive Officers of commercial banks and microfinance banks to discuss the background to MPC decisions. The meetings also provided a regular feedback mechanism.

**Chart 6: Commercial Banks' Average Interest Rates and Spreads (%)**




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

### 3.6 Developments in Private Sector Credit

The 12-month growth in credit to the private sector decelerated from 4.7 percent in October 2016 to 2.4 percent in April 2017 (Table 1). Credit growth slowed down in most sectors including agriculture, manufacturing, building and construction, finance and insurance, and business services. Nevertheless, credit growth was resilient in some sectors including real estate, trade, transport and communication, private households and consumer durables.

The MPC analysed the preliminary impact of capping interest rates on lending by banks in the period. Available data showed that the number of loan applications increased by 23.4 percent between August 2016 and April 2017, but the value of loan applications decreased by 18.3 percent, suggesting smaller size of loan applications. The number of loan approvals increased by 35.7 percent while their value decreased by 16.3 percent. Moreover, a survey of commercial banks' lending to Micro, Small and Medium Enterprises (MSMEs) showed that lending to the sector fell by an estimated 5.7 percent between August 2016 and April 2017. Nevertheless, small banks recorded an increase in lending to the sector during the period.

The slowdown in private sector credit growth in the period was largely due to a slowdown in the manufacturing sector, delays in registration of land titles and building approvals, and availability of alternative external financing for key private sector projects. Additionally, the slowdown reflected significant repayments in the manufacturing sector.

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

| | Oct-16 | Nov-16 | Dec-16 | Jan-17 | Feb-17 | Mar-17 | Apr-17 |
|---|---|---|---|---|---|---|---|
| **Total Credit to Private Sector** | **4.7** | **4.6** | **4.3** | **4.2** | **3.8** | **3.3** | **2.4** |
| Agriculture | 4.1 | 7.5 | 5.0 | -2.5 | -1.2 | -9.3 | -8.7 |
| Manufacturing | -4.3 | -4.0 | -2.4 | -6.8 | -8.6 | -7.8 | -6.9 |
| Trade | 13.7 | 16.7 | 17.1 | 14.4 | 10.9 | 11.0 | 7.6 |
| Building and construction | -4.8 | -5.3 | -2.8 | -0.8 | 8.3 | 0.6 | -2.3 |
| Transport and communication | 14.3 | 15.8 | 14.6 | 10.0 | 7.6 | 11.2 | 9.7 |
| Finance and insurance | -4.7 | -5.7 | 9.3 | 0.0 | 0.9 | -4.4 | -11.5 |
| Real estate | 9.4 | 8.9 | 11.2 | 10.3 | 9.5 | 12.2 | 13.2 |
| Mining and quarrying | -36.4 | -21.3 | -19.1 | -17.5 | -25.5 | -34.0 | -34.2 |
| Private households | 9.9 | 10.5 | 19.5 | 14.3 | 15.2 | 12.9 | 10.1 |
| Consumer durables | 10.8 | 14.1 | 11.8 | 12.2 | 12.2 | 10.9 | 12.1 |
| Business services | -2.0 | -11.6 | -34.8 | -13.0 | -13.7 | -15.6 | -15.1 |
| Other activities | -15.5 | -24.2 | -21.2 | -24.5 | -22.6 | -16.7 | -13.7 |

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

# 4. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC held regular stakeholder forums between November 2016 and April 2017 in order to enhance the understanding of the background and impact its decisions. In this regard, bi-monthly meetings were held with Chief Executive Officers of banks. The Committee also 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 Press Releases were simplified to enhance their clarity to the public, media, financial sector and other stakeholders.

The Governor, who is the MPC Chairman, held press conferences after MPC Meetings to brief the media on measures undertaken by the CBK to ensure macroeconomic and financial stability. 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. The Governor held meetings with potential investors in order to brief them on recent economic developments and the outlook for the economy.

During the period, MPC Members participated in conferences locally as part of enhancing their responsibility, and to share experiences. The Members held meetings with potential investors, and also participated in the World Bank and IMF Spring Meetings as well as other forums organised by these institutions to launch country economic updates and regional economic reports.

## 5. WAY FORWARD

The monetary policy measures adopted by the MPC in the six months to April 2017 moderated demand-driven inflationary pressures, while stability of the exchange rate moderated any possible effects of imported inflation on the price level. The MPC expected overall inflation to return to the Government target band in the third quarter of 2017. The CBK will continue to monitor the transmission of the policy interventions and their impact on consumer prices. Coordination of monetary and fiscal policies continued to support market stability.

The Central Bank will continue to implement measures aimed at promoting the efficient working of the interbank market , sustainably reducing the cost of credit, and improve liquidity management. The MPC will continue to monitor the impact of interest rate capping on lending and the overall economy, as well as the implications of other developments in the domestic and global economy to ensure price stability.

**APPENDIX: CHRONOLOGY OF EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2016 - APRIL 2017)**

| | |
|---|---|
| ***November 2016*** | The Central Bank Rate (CBR) was retained at 10.0 percent. |
| | U.S. elections |
| ***January 2017*** | The Central Bank Rate (CBR) was retained at 10.0 percent. |
| | The CBK suspended the KBRR framework. |
| ***February 2017*** | Acquisition of Giro Bank by Investment and Mortgages Bank |
| ***March 2017*** | The Central Bank Rate (CBR) was retained at 10.0 percent. |
| | Introduction of M-Akiba |
| | Diamond Trust Bank Announces plans to acquire Habib Bank Ltd |

## 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 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 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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