Central Bank of Kenya

Twenty First Bi-Annual Report of the Monetary Policy Committee

October 2018

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 21st 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 October 2018.

Dr. Patrick Njoroge

Governor

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EXECUTIVE SUMMARY

The twenty first bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments in the economy during the six months to October 2018. 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 Government's 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 the first half of 2018, interest rate caps, and heightened global uncertainties arising from trade tensions among advanced economies and the prolonged Brexit negotiations.

The MPC held three meetings during the six months to October 2018, to review the outcome of its previous policy decisions and economic developments. The MPC retained the Central Bank Rate (CBR) at 9.50 percent during its Meeting in May. During its July Meeting, the Committee lowered the CBR to 9.00 percent noting that economic output was below its potential level, and that there was some room for further accommodative monetary policy. The MPC noted the risk of perverse outcomes arising from the interest rate caps in place. The MPC retained the CBR at 9.00 percent in its September 2018 Meeting, noting the need to monitor any second-round inflationary effects arising from the imposition of VAT on petroleum products, and any perverse response to its previous decisions. The monetary policy stance adopted by the MPC during the period, together with the CBK liquidity management continued to ensure price stability.

Overall inflation remained within the target range during the period. The overall inflation rate stood at 5.5 percent in October 2018 compared to 3.7 percent in April 2018, mainly reflecting higher fuel prices following introduction of 8 percent VAT on petroleum products. Fuel inflation rose to 16.5 percent in October from 10.2 percent in April 2018. However, food inflation remained low and stable at 0.9 percent in October and 0.8 percent in April 2018, supported by improved food supply due to favourable weather conditions. Non-Food-Non-Fuel inflation (NFNF) remained below 5 percent, reflective of muted demand pressures. 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 during the period, supported by balanced flows and a narrowing current account deficit. The current account deficit narrowed to 6.0 percent of GDP in the 12 months to October 2018 from 7.2 percent in October 2017, mainly supported by strong agricultural exports, particularly tea and horticulture, due to favourable weather conditions, lower imports of food and SGR-related equipment, higher receipts from tourism, and resilient secondary income flows mainly through diaspora remittances. The CBK foreign exchange reserves which stood at USD 8,553.1 million (5.6 months of import cover) at the end of October 2018 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 six months to October 2018, with strong liquidity and capital adequacy ratios. The average commercial banks' liquidity and capital adequacy ratios stood at 48.9 percent and 18.4 percent, respectively, in October 2018. The ratio of gross non-performing loans (NPLs) to gross loans declined to 12.3 percent in October 2018 from 12.4 percent in April 2018 mainly reflecting decreases in NPLs in the trade and personal/household sectors. Private sector credit growth picked up during the period particularly to the key sectors of the economy, growing by 4.4 percent in the 12 months to October 2018 from 2.9 percent in April. The CBK 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 CBK continued to monitor the impact of interest rate caps on the economy, as well as on the effectiveness of monetary policy. The MPC held bi-monthly meetings with stakeholders in the financial and real sectors to discuss the basis for its previous decisions. The Governor's media briefings were held to discuss the basis of policy decisions and other market developments. The stakeholder meetings provided a platform for obtaining feedback and improved stakeholders' understanding of the conduct of monetary policy.

1. GLOBAL ECONOMY

Global growth slowed down in the six months to October 2018. The forecast for growth was weighed down by elevated policy uncertainty and tightening of financial conditions. The IMF projected global growth at 3.7 percent for 2018 and 2019, which was 0.2 percentage points lower for both years than the April forecast. The downward revision reflected the negative effects of the trade measures implemented between April and mid-September, tighter financial conditions, geopolitical tensions, and higher oil import bill.

Growth in the advanced economies was expected at 2.4 percent in 2018 and 2.1 percent in 2019. In the United States, growth was projected to moderate to 2.5 percent in 2019 due to the announced trade measures, including the tariffs imposed on USD 200 billion of US imports from China. Growth projections were revised downwards for the Euro Area (1.9 percent) and the United Kingdom (1.5 percent), following surprises that suppressed activity in early 2018. Growth in other major economies was projected to slow down due to suppressed activity, including: Japan (1.1 percent), Germany (1.9 percent), France (1.6 percent), Italy (1.2 percent), and Spain (2.6 percent).

The emerging market and developing economies continued to expand at broadly the same pace as in 2017, despite the weaker outlook in a few economies in the region arising from country-specific factors. Economic activity in the emerging market and developing economies was expected to expand at the same level of 4.7 percent in 2018 and 2019. China and a number of Asian economies were also projected to experience weaker growth in 2019 in the aftermath of the trade measures. The pace of growth recovery in Latin America continued, though at a more subdued pace than anticipated as tighter financial conditions and a drought weighed on growth.

For the Sub-Saharan Africa (SSA) region, economic growth was expected at 3.1 percent in 2018 from 2.7 percent in 2017, supported by higher oil prices lifting growth prospects among oil-exporting economies. Nigerian and South African economies were projected to expand by 2.3 percent and 1.4 percent, respectively in 2018.

Downside risks to global growth have risen in the past six months and the potential for upside surprises has receded. The downside risks involve rising trade barriers; tightening of financial markets conditions particularly pronounced reversal of capital flows to emerging market economies with weaker fundamentals and higher political risk; and waning growth momentum. However, the growth recovery continued to help lift employment and income. There was greater urgency for policies to enhance prospects for strong and inclusive growth by avoiding protectionist reactions to structural change and finding cooperative solutions that promote continued growth.

2. KENYAN ECONOMY

2.1 Overall economy

The domestic economic environment during the six months to October 2018 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 private sector credit growth.

The economy grew by 6.3 percent in the second quarter of 2018 compared to 4.7 percent in the second quarter of 2017 and 5.7 percent in the first quarter of 2018. This performance was supported by recovery in agricultural activities due to favourable weather conditions, robust growth in the services sector, and recovery in industry. Growth in the agriculture sector recovered to 5.6 percent in the second quarter of 2018 from 0.8 percent in the second quarter of 2017 and 5.2 percent in the first quarter of 2018. Growth in the sector largely reflected increased output of tea, coffee, cane delivered to millers, fruits and dairy production. Growth in the services sector remained strong and stable at 6.9 percent in the second quarter of 2018 compared to 7.0 percent, largely supported by robust growth in the Wholesale and Retail trade, Accommodation and Restaurant, Information and Communication, Public administration, Real Estate and Education sectors. The industry sector improved to 4.7 percent in the second quarter of 2018 from 3.6 percent in the second quarter of 2017 on account of recovery of the manufacturing and electricity and water supply sectors. Overall, growth in 2018 was expected to be strong, supported by recovery in agricultural production, alignment of Government spending to the Big 4 priority sectors, a stable macroeconomic environment, an improved business environment, and a favourable external environment.

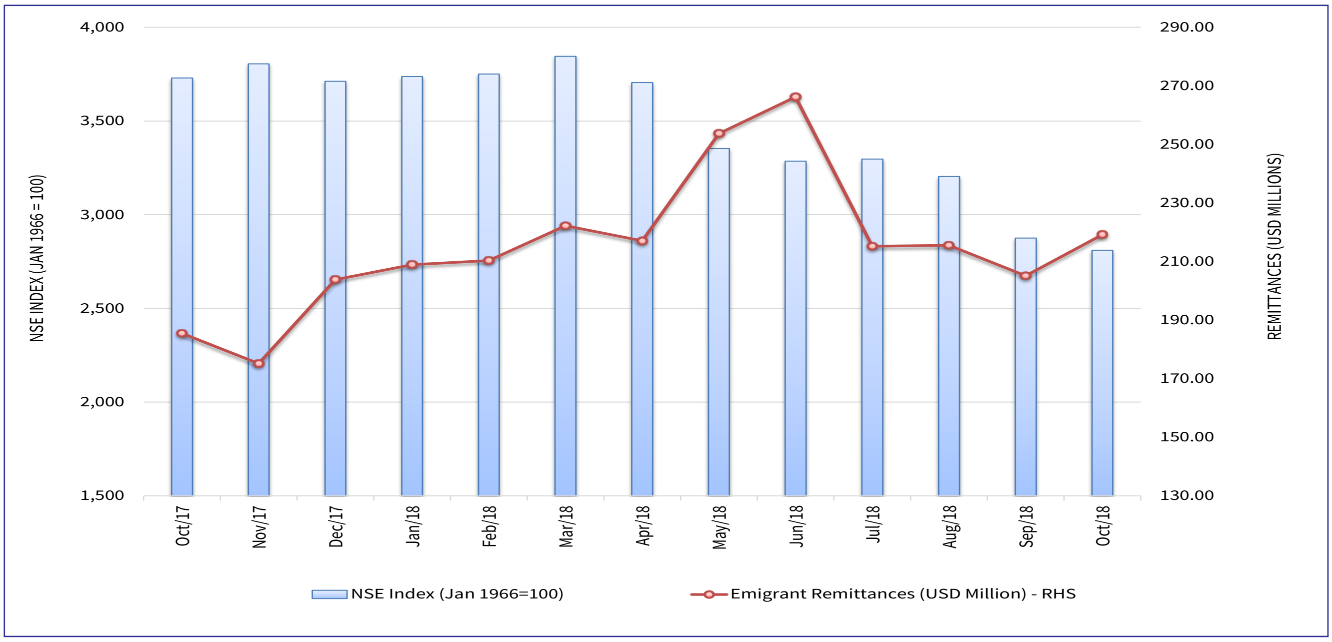
The main risks to strong domestic growth in 2018 include the escalating trade tensions between the US and China, pace of normalization of monetary policy in the advanced economies and delayed Brexit resolution.

2.2 Financial Market Conditions

The domestic foreign exchange market largely remained stable supported by a narrowing current account deficit. Diaspora remittances remained resilient over the period, averaging USD 229.2 million per month in the six months to October 2018 compared to USD 206.3 per month in the six months to April 2018 **(Chart 1a).** The current account deficit narrowed to 6.0 percent of GDP in the 12 months to October 2018 from 7.2 percent during a similar period in 2017. This narrowing was mainly supported by strong agricultural exports, particularly tea and horticulture, due to favourable weather conditions, lower imports of food and SGR-related equipment, higher receipts from tourism, and improved secondary income flows mainly through diaspora remittances. However, 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 USD 8,553.1 million (5.6 months of import cover) in October 2018, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

Activity at the Nairobi Securities Exchange (NSE) declined during the period, mainly reflecting increased uncertainties in the global financial markets. The NSE 20-Share index fell from 3,705.4 points in April to 2,810.3 points in October, representing a 24.2 percent change **(Chart 1a).**

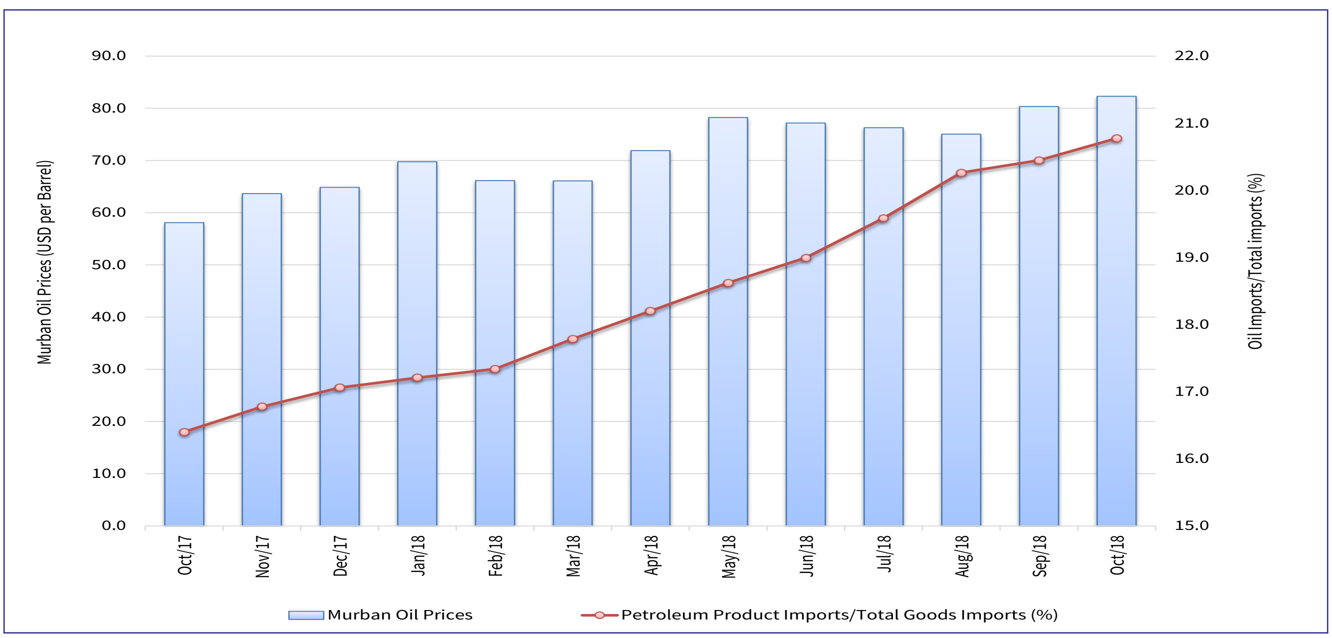
Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE Index (Jan 1966=100)



Source: Central Bank of Kenya and Nairobi Securities Exchange

Changes in international oil prices particularly when the proportion of petroleum products imports in total imports is high has implications on the balance of payments position and the stability of the exchange rate. Murban crude oil price rose from USD 71.9 per barrel in April 2018 to USD 82.3 per barrel in October 2018. Consequently, the proportion of imports of petroleum products in total imports of goods increased to 20.8 percent from 18.2 percent over the same 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

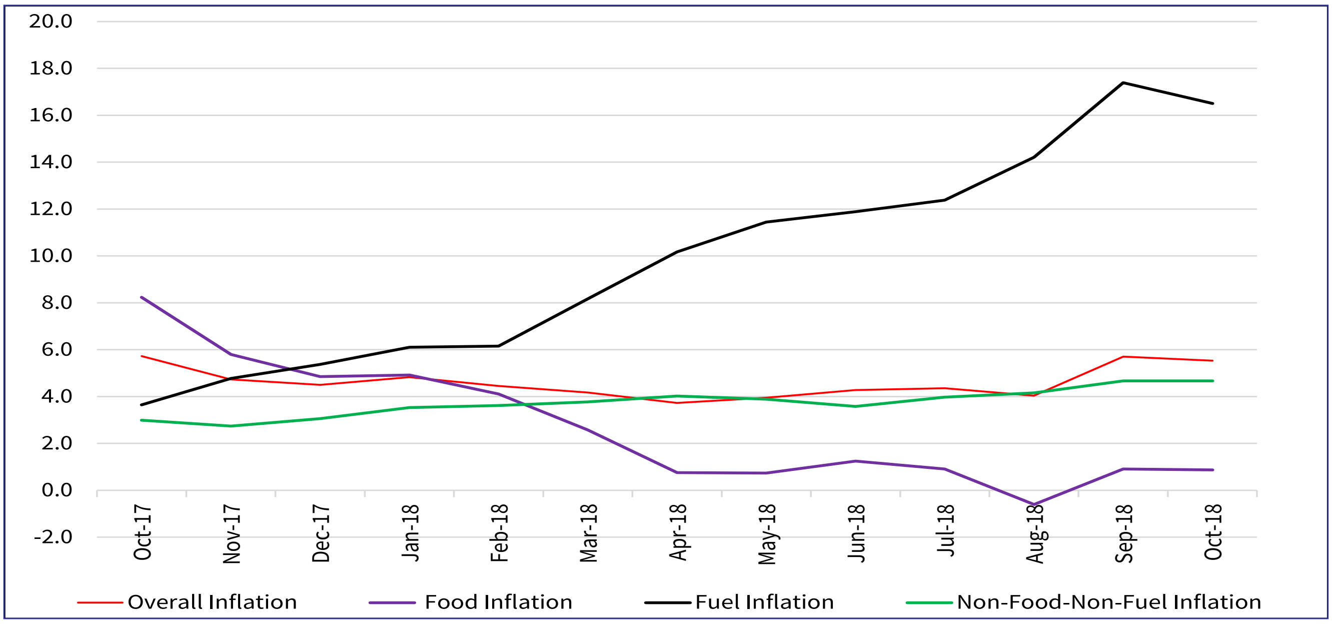
2.3 Developments in Key Economic Indicators

2.3.1 Inflation

Overall inflation remained within the target range in the six months to October 2018 **(Charts 2a).** The inflation rate rose to 5.5 percent in October 2018 from 3.7 percent in April 2018 mainly on account of higher fuel prices following introduction of an 8 percent VAT on petroleum products. Fuel inflation rose to 16.5 percent in October 2018 from 10.2 percent in April 2018, reflecting higher energy prices. Food inflation remained low and stable at 0.9 percent in October and 0.8 percent in April 2018, supported by low food prices owing to increased agricultural production as weather conditions remained favorable. Non-Food-Non-Fuel inflation (NFNF) remained below 5 percent, reflective of muted demand pressures. The NFNF inflation rate rose to 4.7 percent from 4.0 percent in the period due to the tax revisions on key commodities.

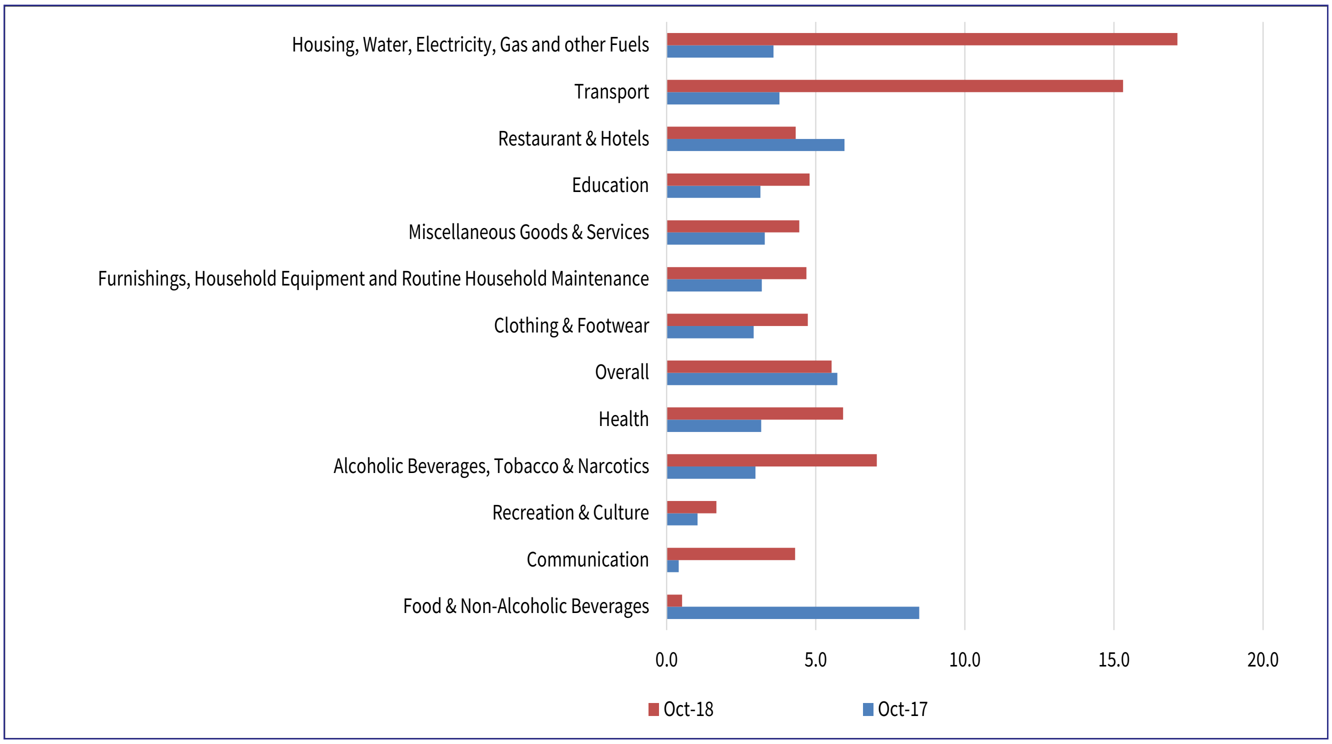
The inflation rates for all the CPI categories except Housing, Water, Electricity, gas and other fuels, and Transport remained within the target range in October 2018 **(Chart 2b).** The trend in the overall inflation rates across the East African Community (EAC) countries, displayed similar patterns over the period **(Chart 2c).**

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



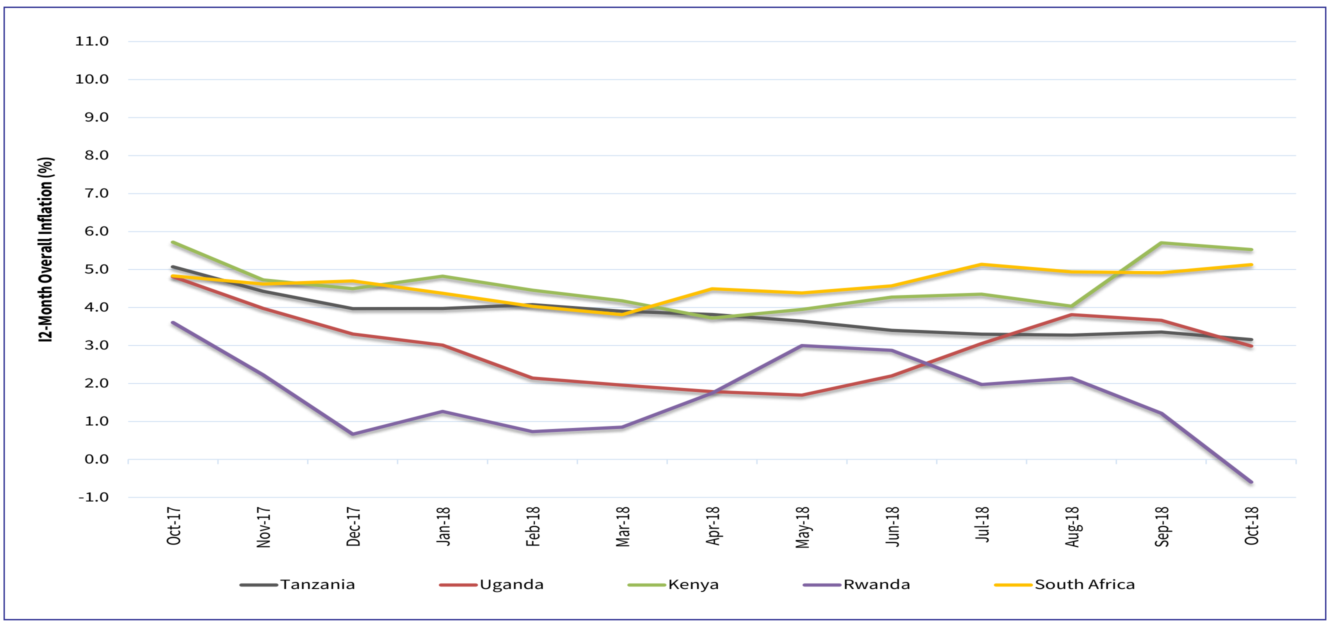
Source: Kenya National Bureau of Statistics and Central Bank of Kenya

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

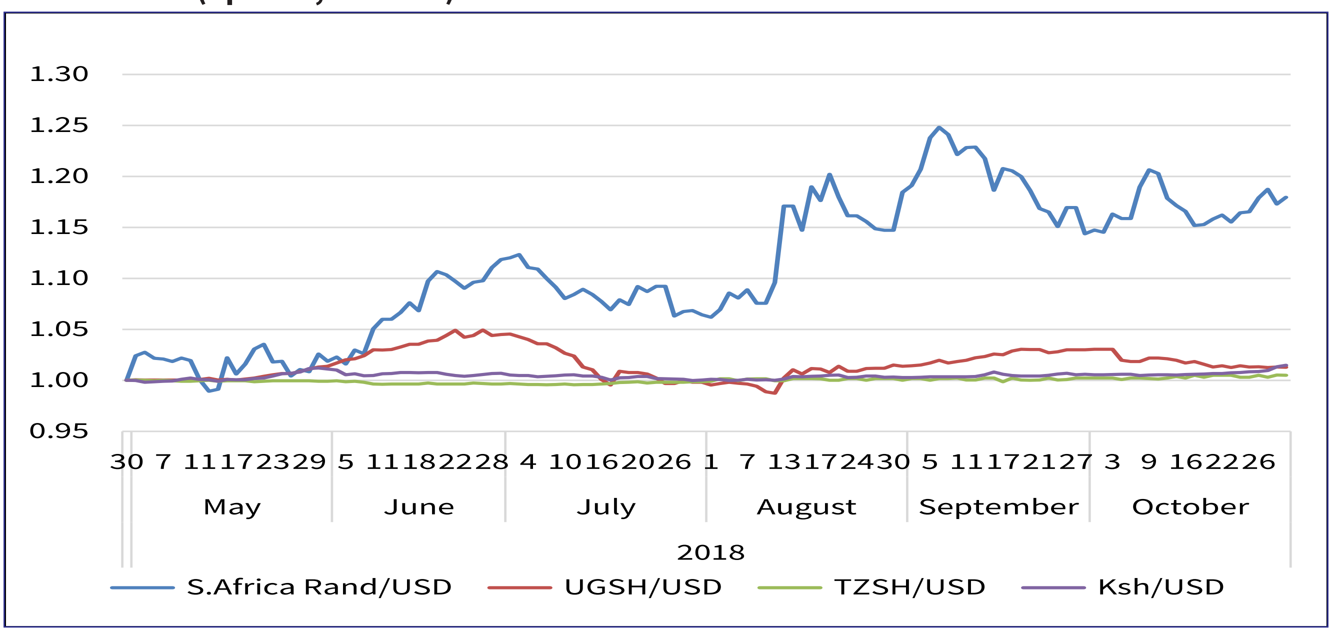
2.3.2 Foreign Exchange Market Developments

The foreign exchange market remained relatively stable in the six months to October 2018, despite uncertainties in the global financial markets. This stability was largely supported by a narrowing in the current account deficit, due in part to resilient inflows from diaspora remittances and receipts from tourism, tea and horticulture exports. Diaspora remittances remained resilient over the period, averaging USD 229.2 million per month in the six months to October 2018 compared to USD 206.3 per month in the six months to April 2018. The current account deficit narrowed to 6.0 percent of GDP in the 12 months to October 2018 compared to 7.2 percent of GDP in October 2017.

The level of CBK usable foreign exchange reserves stood at USD 8.3 billion (5.5 months of import cover) at the end of October 2018. These reserves, together with the Precautionary Arrangements with the IMF in place till September 2018 continued to provide an adequate buffer against short term shocks in the foreign exchange market.

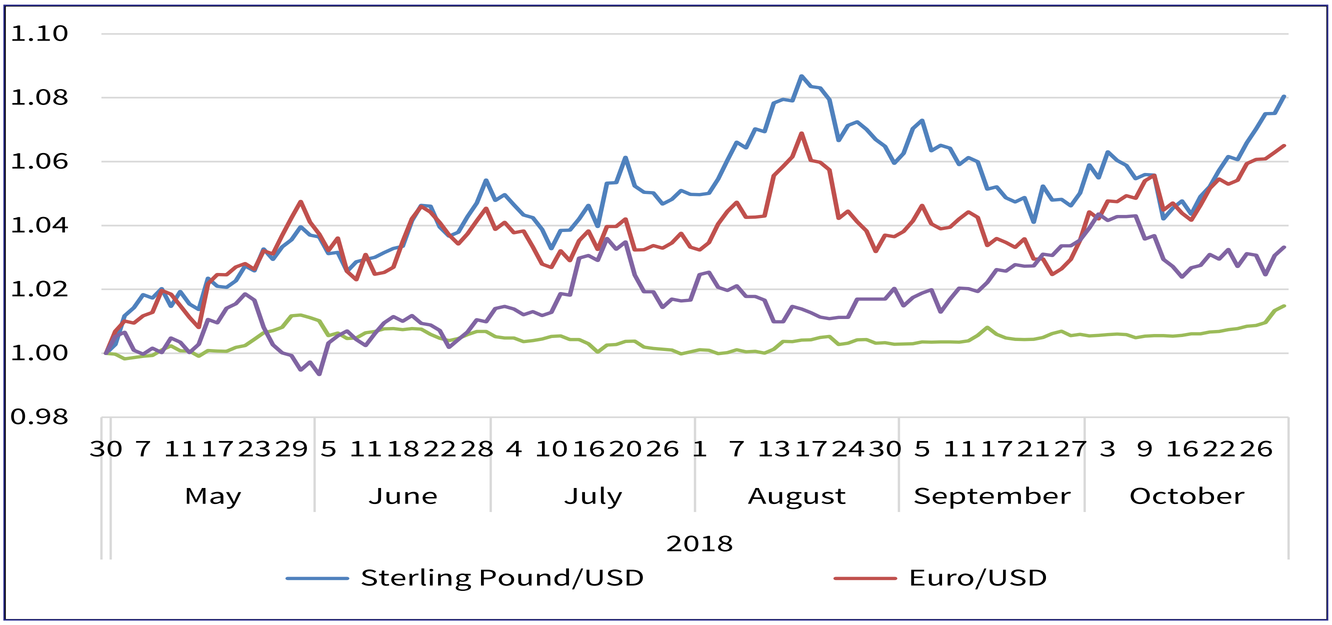
The major international and regional currencies' exchange rates against the US dollar in the six months to October 2018 remained more volatile than the Kenya shilling/US dollar exchange rate **(Charts 3a and 3b).** This reflects the resilience of Kenya's external sector with diversification of export products and destination countries. The volatility in the major currencies exchange rates against the US dollar was mainly as a result of uncertainties from the trade tensions between the US and China, U.S. economic and trade policies, delayed 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 (April 30, 2018 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (April 30, 2018 = 1)



Source: Central Bank of Kenya

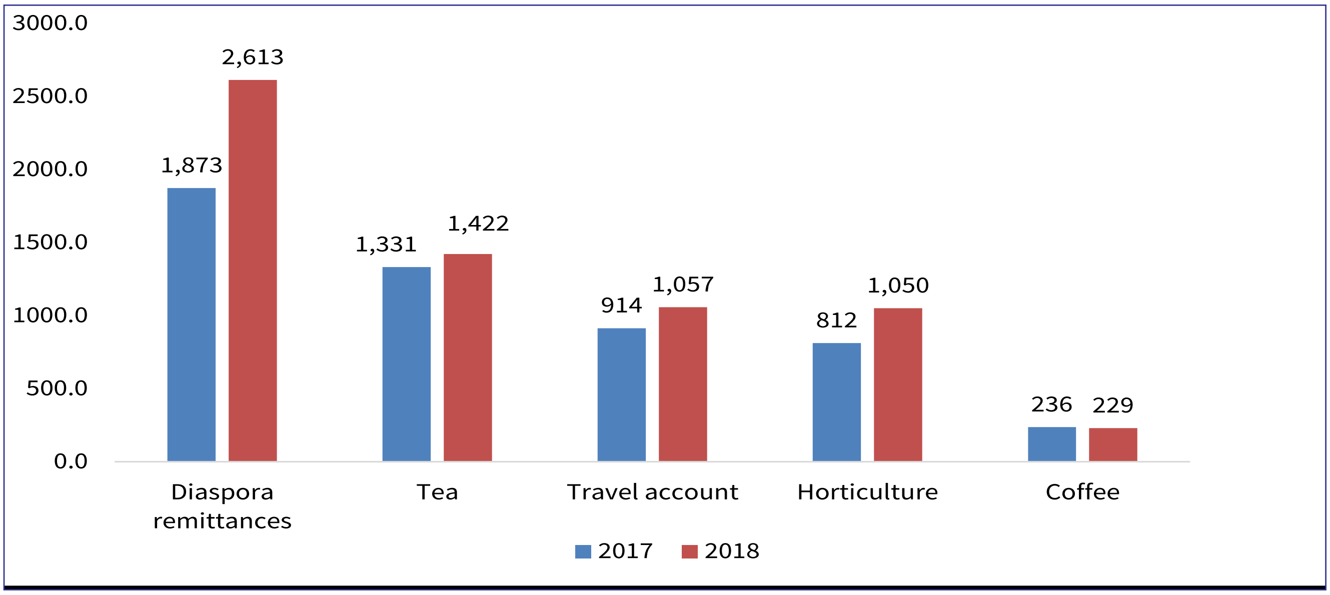
2.3.3 Balance of Payments Developments

The overall balance of payments position recorded a surplus of USD 1,354 million (1.5 percent of GDP) in the year to October 2018 compared to a deficit of USD 708 million (0.9 percent of GDP) in the year to October 2017. This was largely attributed to increased financial account inflows which more than offset the current account deficit.

The current account deficit narrowed to USD 5,243 million (6.0 percent of GDP) in the year to October 2018 from USD 5,708 million (7.2 percent of GDP) in the year to October 2017 largely due to reduced importation of SGR-related transport equipment and food, resilient earnings from exports and increased secondary income transfers. The value of merchandise exports improved to USD 6,156 million in the year to October 2018 from USD 5,776 million in the year to October 2017 mainly reflecting increased receipts from tea and horticulture **(Chart 4a)**. The value of merchandise imports increased to USD16,337 million from USD15,754 million in the period. Imports of petroleum products were higher in the period reflecting higher international oil prices **(Chart 4b)**, which more than offset the decline in imports of machinery and transport equipment due to completion of Phase 1 of the SGR Project. In addition, food imports remained low following completion of the maize subsidy programme– whose imports contributed about 1.4 percentage points of GDP to the current account deficit in 2017.

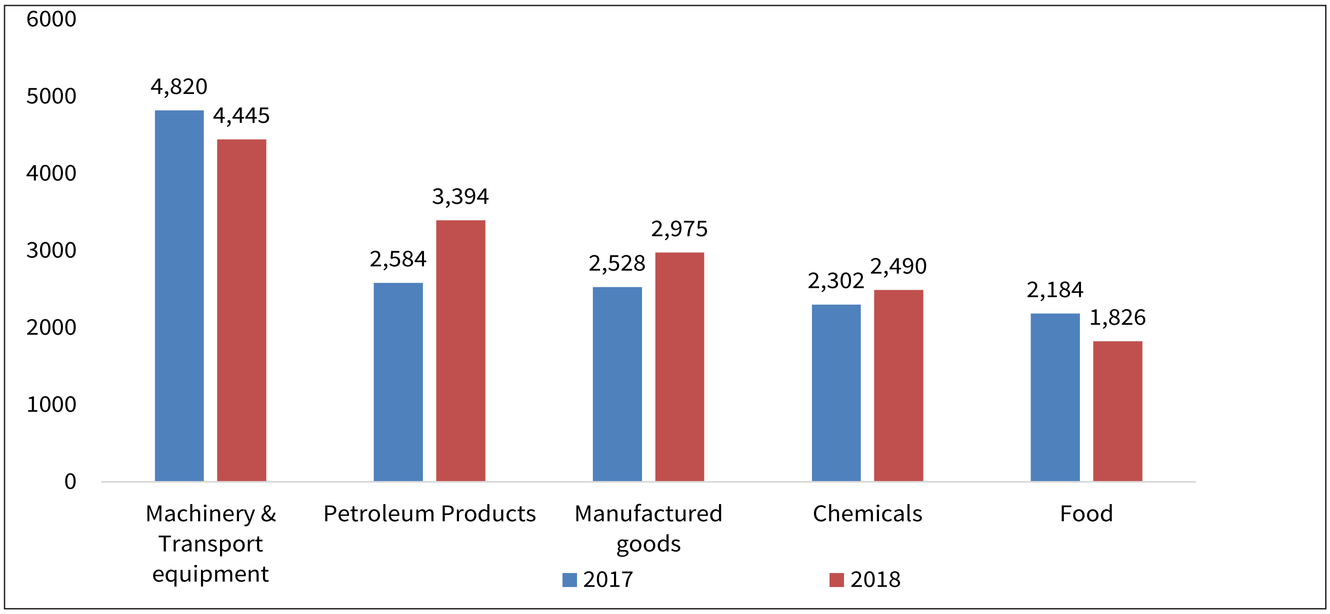
The projected current account deficit in 2018 was revised downwards to 5.2 percent of GDP from 5.4 percent reflecting resilience in tea and horticulture exports, slower pace in the growth of import of oil products as international oil prices stabilize and a decline in food imports.

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



Source: Kenya National Bureau of Statistics and Kenya Revenue Authority

The financial account surplus improved to USD 6,291 million in the year to October 2018 from USD 5,878 million in the year to October 2017. The improvement was largely in foreign direct investments. The CBK continued to monitor the impact of Brexit as well as the new U.S. economic policies since these developments have implications on trade and investment.

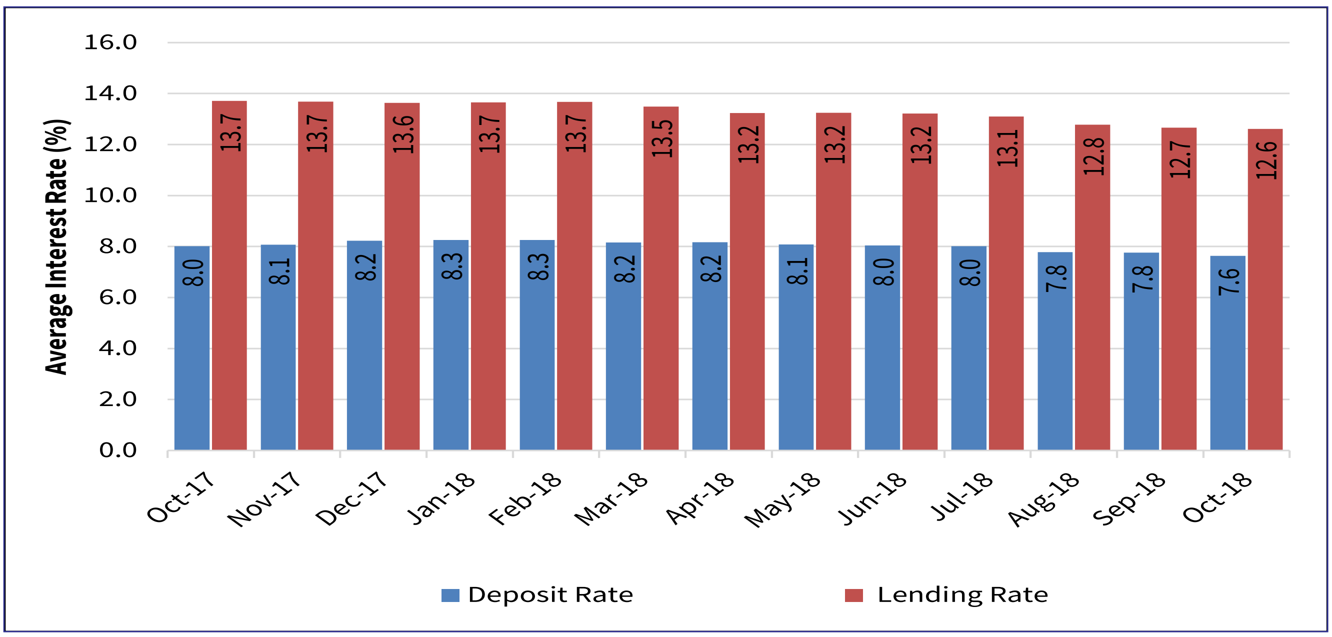
In terms of direction of trade, the U.K. and U.S. accounted for an average of 6.6 percent and 7.5 percent, respectively, of Kenya's total exports over the six months to October 2018 compared to 6.5 percent and 7.7 percent in the six months to April 2018. Exports to other trading blocs such as the EAC, COMESA and the EU, respectively, accounted for an average of 21.1 percent, 24.2 percent and 21.2 percent over the period, compared with 21.8 percent, 24.8 percent and 21.1 percent of total exports in the six months to April 2018, respectively.

2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the six months to October 2018, with strong liquidity and capital adequacy ratios. The average commercial banks liquidity and capital adequacy ratios stood at 48.9 percent and 18.4 percent respectively, in October 2018. The ratio of gross non-performing loans (NPLs) to gross loans fell to 12.3 percent in October 2018 from 12.4 percent in April 2018, mainly reflecting decreases in NPLs in the trade and personal/household sectors. Banks also continued with mitigation measures to reduce NPLs, including recovery efforts.

The average commercial banks' lending and deposit rates remained stable within the interest rate caps and floor, respectively, during the period **(Chart 5).** The CBK continued to monitor and analyze the impact of interest rate caps on the economy, as well as on the effectiveness of monetary policy.

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 4.4 percent in the 12 months to October 2018 from 2.9 percent in April 2018 **(Table 1).** Credit to the manufacturing, building and construction, finance and insurance, real estate, consumer durables and business services sectors grew by 14.8 percent, 7.1 percent, 1.2 percent, 9.1 percent, 7.6 percent and 12.1 percent, respectively, in the 12 months to October 2018. However, credit to agriculture, transport and communication and Mining and quarrying contracted. 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.

Banking data show that the value of loan applications and approvals increased, respectively, to KSh 161.9 billion and KSh 143.7 billion in October 2018 from KSh 112.6 billion and KSh 96.6 billion in April 2018. The increase in the value of loan applications was recorded across all the sectors, but mainly in the wholesale and retail trade sector by 84.6 percent in October 2018, relative to the April 2018 levels. The services sector (Finance and insurance, business activities, and Social, Community & Personal Services) also recorded a significant increase in loan applications at 37.4 percent over the same period. The productive sector (agriculture, manufacturing, building and construction, real estate and mining and quarrying activities) recorded a 55.7 percent increase in applications over the same period. Similarly, loan approvals to the household, services and productive sectors also increased, by 41.8 percent, 37.7 percent and 54 percent, respectively.

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

	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18
Total Credit to Private Sector	**2.9**	**3.9**	**4.3**	**4.3**	**4.3**	**3.8**	**4.4**
Agriculture	-4.4	-3.3	-4.7	-6.5	-4.3	-6.0	-5.6
Manufacturing	10.1	12.1	12.2	11.5	13.2	11.9	14.8
Trade	5.0	6.8	8.5	6.5	6.9	3.2	4.0
Building & construction	14.3	9.2	13.3	13.5	14.7	11.1	7.1
Transport & communication	-17.8	-14.9	-12.7	-10.7	-11.0	-9.1	-7.7
Finance and insurance	10.1	2.6	3.8	8.5	3.5	6.6	9.1
Real estate	3.6	3.7	3.8	4.3	0.9	1.7	1.2
Mining & quarrying	-4.4	-3.5	-9.1	0.2	-9.1	-15.5	-11.6
Private households	2.6	3.8	2.9	2.9	2.7	5.1	5.1
Consumer durables	5.0	5.5	7.8	9.1	11.5	7.8	7.6
Business services	2.8	11.0	6.7	3.3	6.5	4.3	12.1
Other activities	-2.2	-7.5	-7.9	-5.8	-4.6	2.7	-12.4

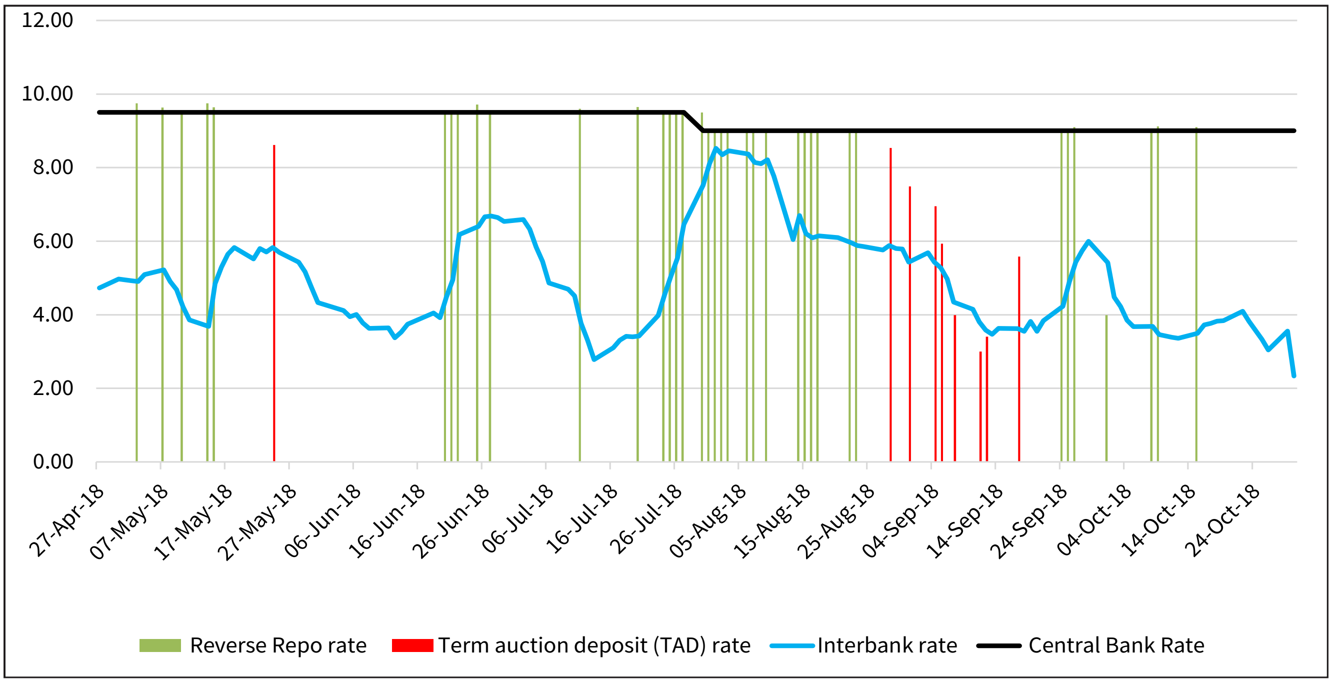
Source: Central Bank of Kenya

2.3.6 Interest rates

Short term interest rates remained below the CBR during the six months to October 2018, reflecting improved distribution of liquidity in the market. In particular, the average interbank rate declined to 4.93 percent during the period from 6.29 percent in the six months to April 2018. Liquidity management operations by CBK ensured stability in the market. During the period, Reverse Repos were used to supply liquidity to segments of the market facing shortages. Repos and Term Auction Deposits were used to withdraw liquidity from segments of the market with surpluses **(Chart 6a).**

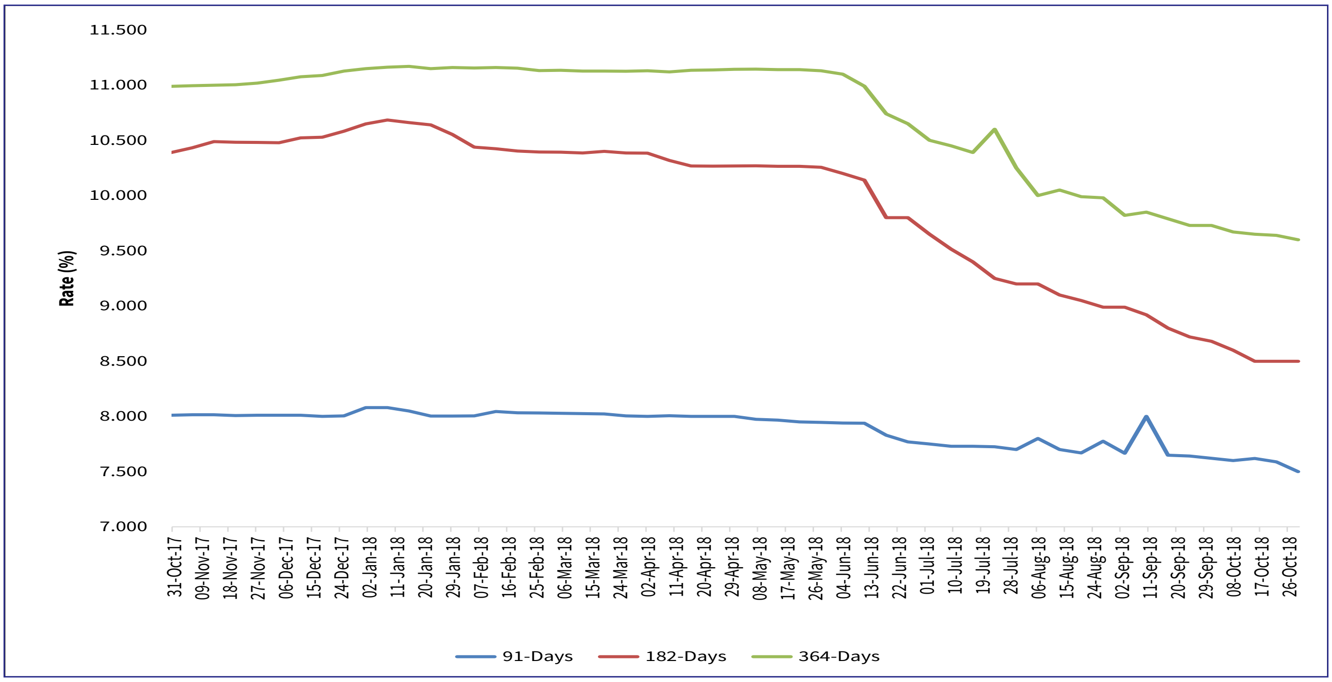
The interest rates on Government securities declined during the six months to October 2018, as reflected in the yields and the yield curve of Government securities **(Chart 6b and 6c)** and continued to support the implementation of the Government domestic borrowing programme at a lower cost.

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



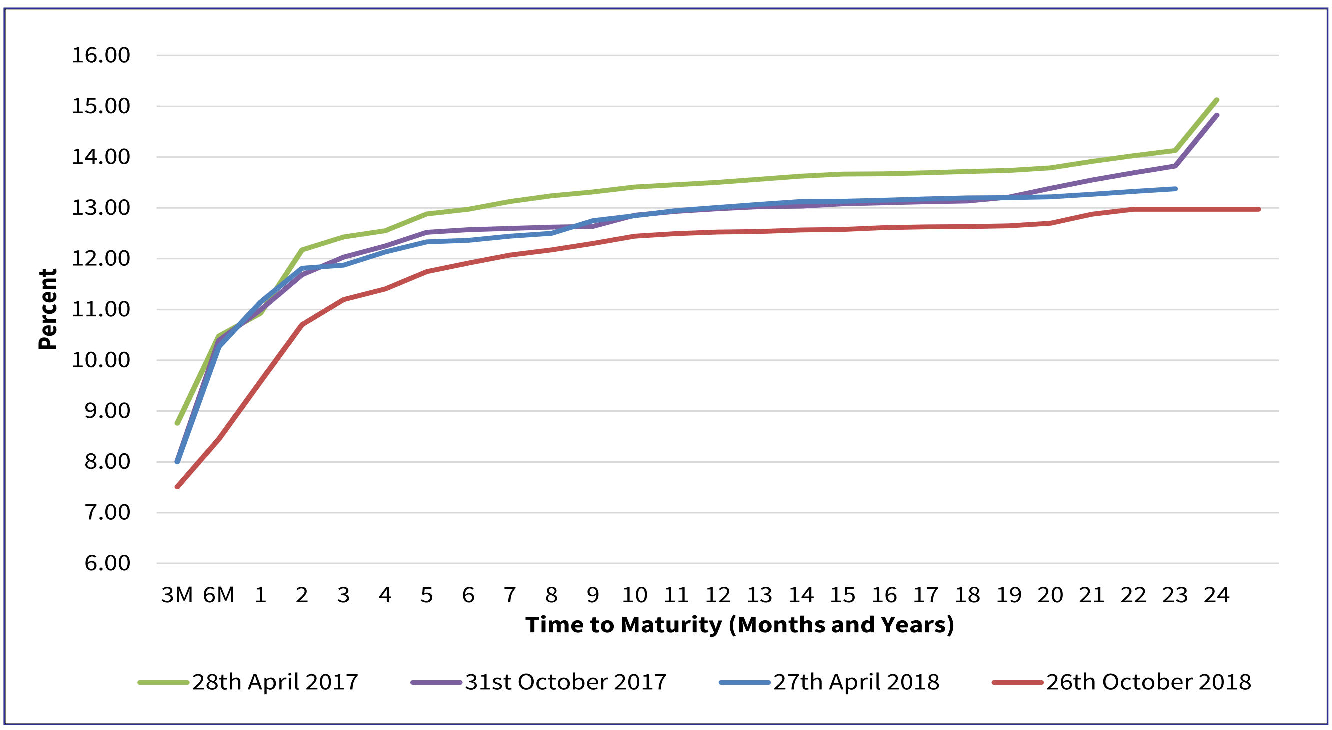
Source: Central Bank of Kenya

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 FORMULATION

3.1 Attainment of Monetary Policy Objectives and Targets

The MPC formulated monetary policy to achieve and maintain overall inflation within the target range as provided by the Cabinet Secretary for the National Treasury at the beginning of every fiscal year. The 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.

The 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 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 October 2018 from 5.5 percent in April 2018, and was above the 7.2 percent recorded in October 2017. 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 six months to October 2018, the MPC held three bi-monthly meetings on May 28, July 30 and September 25, 2018. The meetings reviewed market and economic developments as well as the outcome of its previous policy decisions on the economy.

The May 2018 meeting was held against a backdrop of sustained macroeconomic stability, favourable weather conditions, increased optimism on domestic economic growth prospects, and rising international oil prices. However, uncertainties remained particularly with regard to the U.S. economic and trade policies, rising international oil prices, and the pace of monetary policy normalization in advanced economies. The MPC noted that inflation expectations remained well anchored within the target range and assessed that the economy was operating below it potential level. The Committee noted that its policy action of reducing of the CBR by 50 basis points at its March meeting was yet to be fully transmitted to the economy, and there was need to further assess any perverse outcomes arising from interest rate caps. The Committee decided to retain the CBR at 9.5 percent.

The July 2018 meeting was held against a backdrop of improved economic fundamentals: a strong pick-up in economic activity; increased optimism on the economic growth prospects; favourable weather conditions; and continued strengthening of the global economy. However, uncertainties to the growth outlook had increased particularly with regard to the escalating trade tensions among the advanced economies, Brexit negotiations, and pace of monetary policy normalization in the advanced economies that could increase volatility in global financial markets. Preliminary assessment of the impact of the lowering of the CBR in March 2018 under the interest rate capping regime showed that the change had a smaller and slower impact on key macroeconomic variables such as credit and economic growth. The Committee noted that the economy continued to operate below its potential level with improving growth prospects, and therefore decided to lower the CBR to 9.00 percent from 9.50 percent.

The September 2018 meeting was held against a backdrop of macroeconomic stability, sustained optimism on the economic growth prospects, and increased uncertainties in the global financial markets particularly with regard to escalation of international trade tensions and the resolution of Brexit. The MPC noted that overall inflation remained within the target range but concluded that there was need to monitor the second-round inflationary effects arising from the imposition of VAT on petroleum products, and any perverse response to its previous decisions. 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 October 2018 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 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 in the six months to October 2018 to provide the background to the policy decisions and obtain feedback on the committee's previous policy decisions. The bi-monthly MPC Market Perceptions Surveys carried out during the period as well as regular communication with the key stakeholders facilitated the MPC in its market information gathering process for effective conduct of forward-looking monetary policy.

The Governor 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 Chairman and MPC Members also held meetings with investors to discuss recent economic developments and the outlook for the economy.

5. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to October 2018 ensured that inflation was maintained within the target range. The stability of the exchange rate moderated the risks of imported inflation on the stability of domestic prices. Coordination of fiscal and monetary policies continued to support the achievement of price and market stability.

The CBK will continue to monitor developments in the domestic and global economy. The Bank will also 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.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (MAY – OCTOBER 2018)

May 2018	The Central Bank Rate (CBR) was retained at 9.5 percent.
July 2018	The Central Bank Rate (CBR) was reduced from 9.5 percent to 9.0 percent.
September 2018	The Central Bank Rate (CBR) was retained at 9.00 percent.

GLOSSARY OF KEY TERMS

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

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

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

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

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

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

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

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

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

Term Auction Deposits (TAD): The TAD is used in exceptional market conditions when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options. The CBK seeks to acquire deposits through a transfer agreement from commercial banks at an auction price but with no exchange of security guarantee.

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

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

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