Central Bank of Kenya

Twenty Fifth Bi-Annual Report of the Monetary Policy Committee

October 2020

LETTER OF TRANSMITTAL

In accordance with Section 4D of the Central Bank of Kenya Act, it is my pleasure to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the 25th 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 2020.

Dr. Patrick Njoroge

Governor

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Mrs. Sheila M'Mbijjewe
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EXECUTIVE SUMMARY

The twenty fifth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments that affected the economy in the six months to October 2020. Consistent with the price stability objective of the Central Bank of Kenya (CBK), the conduct of monetary policy 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.

Monetary policy was conducted in the context of the global coronavirus (COVID-19) pandemic, which continued to create unprecedented uncertainty in the global economy. Authorities across the world continued to implement a wide range of policies to mitigate the health, social, economic and financial impact of the pandemic.

The MPC held four meetings from May to October 2020 to review the outcome of its previous policy decisions and economic developments, and to put in place appropriate measures to maintain price stability. The Committee maintained an accomodative policy stance in the six months. The MPC retained the Central Bank Rate (CBR) at 7.00 percent during the period, noting that the previous policy measures were having the intended effect on the economy. The monetary policy stance together with CBK liquidity management ensured both price and market stability.

Overall inflation remained within the target range during the period, supported by lower food prices on account of favorable weather conditions across the country, the impact of a reduction in VAT to 14 percent from 16 percent and muted demand pressures. The inflation rate declined to 4.8 percent in October 2020 from 6.0 percent in April. Non-food-non-fuel (NFNF) inflation remained low and stable, indicating muted demand pressures in the economy. CBK continued to monitor the overall liquidity in the economy as well as any threats that could fuel demand driven inflationary pressures.

Global financial markets remained volatile during the period due to uncertainties arising from COVID-19. The foreign exchange market remained relatively stable, supported by a narrowing in the current account deficit to 4.8 percent of GDP in the 12 months to October 2020 from 5.6 percent in April 2020. This narrowing mainly reflected resilient exports particularly of tea, strong diaspora remittances and a lower oil imports bill. The CBK foreign exchange reserves, which stood at USD 8,362.96 million (5.2 months of import cover) in October 2020, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient in the six months to October 2020. The average commercial banks liquidity and capital adequacy ratios remained strong above the statutory requirements. The ratio of gross non-performing loans (NPLs) to gross loans stood at 13.6 percent in October 2020, largely reflecting low business activity in sectors affected by the COVID-19 pandemic. Despite the adverse effects of the pandemic, credit to the private sector remained resilient, growing by 7.7 percent in the 12 months to October 2020. This was supported by improved liqudity conditions and decline in lending rates due to the impact of the accomodative monetary policy stance adopted by the MPC. In June 2020, CBK extended the banking sector emergency measures issued in March to continue supporting the economy. The CBK also closely monitored the implementation of these measures, while ensuring that the interbank market and liquidity management across the sector continued to function smoothly. 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 MPC held virtual meetings with stakeholders in the financial and real sectors after every Meeting, to provide a background to its decisions and obtain feedback. The Governor's post-MPC media briefings provided the basis of policy decisions, and updates on the economy. The meetings improved the understanding of the conduct of monetary policy.

The Bank continued to monitor and remained vigilant to the risks posed by developments in the domestic and global environments, particularly the evolving COVID-19 pandemic, on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The outlook for the global economy remained uncertain in the six months to October 2020, due to the unprecedented disruptions caused by the COVID-19 pandemic across economies, with significant human, economic and social costs. Severe interruptions and restrictions on movement of people resulted in a sharp increase in unemployment levels, constrained supply chains and reduced production.

In October 2020, the IMF projected global growth for 2020 to contract by 4.4 percent, compared to growth of 2.8 percent in 2019. This expected contraction was attributed to the sharp contractions in output in the advanced economies in the first quarter of 2020 due to widespread business closures, severe disruptions to trade and supply chains, and the collapse in global travel. However, the October projection for global growth in 2020 was 0.8 percentage point above the June projection, reflecting a more-than-expected growth in quarter two. This growth outlook continued to be weighed back by lockdowns of economies as the pandemic evolved into the second wave. Global growth was however, projected to recover to 5.2 percent in 2021.

Output in advanced economies was expected to contract by 5.8 percent in 2020, 2.3 percentage points stronger than in the June 2020 projections, from a growth of 1.7 percent in 2019. This upward revision reflected better-than-foreseen U.S. and Euro area GDP outturns in the second quarter. In 2021, growth for advanced economies was projected to strengthen to 3.9 percent. Output in emerging market and developing economies was projected to contract by 3.3 percent in 2020, 0.2 percentage point weaker than in the June projections. China was projected to grow by 1.9 percent in 2020 and 8.2 percent in 2021, on account of the early reopening of the economiy in April, and a strong second quarter GDP growth on the back of strong policy support and resilient exports. In Sub-Saharan Africa (SSA), GDP was projected to contract by 3.0 percent in 2020 from a growth of 3.2 percent in 2019, reflecting the adverse effects of the pandemic on global demand. Additionally, volatility in the global financial markets impacted asset and commodity prices.

International oil prices firmed up between April and August as countries reopened their economies. However, the prices declined between August and October 2020 due to supressed demand arising from the second wave of infections.

Authorities across the world continued to implement a wide range of policies to mitigate the health, social, economic and financial impact of the pandemic. Over the period, countries cautiously reopened their economies, but risks remained elevated particularly with the resurgence of the second wave of infections in some countries. Additionally, the re-emergence of US-China trade tensions continued to pose a significant risk to the recovery of the global economy.

2. DEVELOPMENTS IN THE KENYAN ECONOMY

2.1 Overall Economy

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

In the first quarter of 2020, the economy posted a strong growth of 4.9 percent compared with 5.5 percent in the first quarter of 2019. This resilience in the economy was supported mainly by strong agricultural production, and resilient performance of the services sector. The agriculture sector recorded a growth of 4.9 percent compared to 4.7 percent in the first quarter of 2019, and contributed 1.5 percentage points to real GDP growth. The strong performance of the sector was attributed mainly to favourable weather conditions across the country that supported tea, and sugarcane production, among other crops. The services sector recorded a growth of 5.5 percent compared to 6.5 percent in the first quarter of 2019, supported by strong growth in information and communication, finance and insurance, and transport and storage activities.

In the second quarter of 2020, the economy contracted by 5.5 percent from a growth of 5.1 in second quarter of 2019 on account of the adverse effects of the COVID-19 containment measures put in place. Despite a strong growth in agriculture of 7.3 percent, the services sector suffered a severe shock due to the pandemic. In particular, accommodation and restaurant services sector contracted by 83.2 percent as hotels were closed and travel services were halted. Other sectors that recorded contractions include education (-56.2 percent), transport and storage (-11.4 percent), professional, administration and support services (-15.3 percent), and wholesale and retail trade (-7.0 percent). However, health and public administration registered positive growth rates during the quarter. Overall, the economy registered a 0.3 percent contraction in the first half of 2020 compared to a growth of 5.1 percent in similar period in 2019.

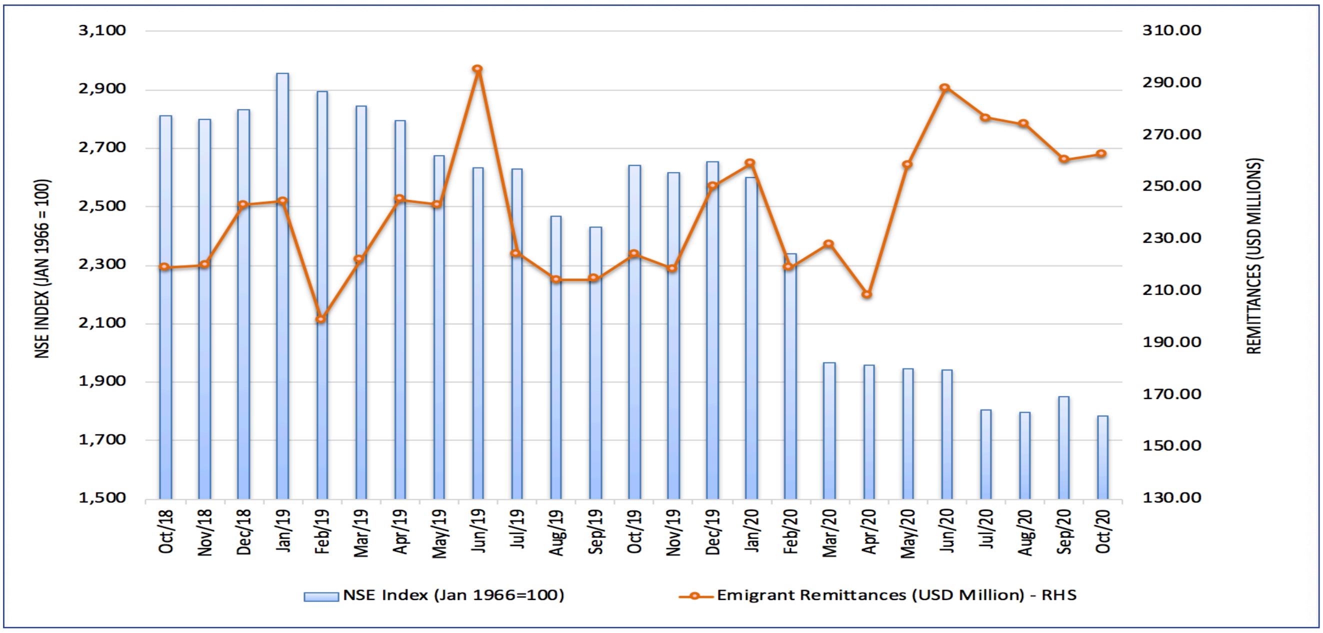
The main upside risks to growth in the six months to October 2020 were coordinated domestic and international interventions to contain and mitigate the negative impact of COVID-19, as well as continued announcement of measures by the government to address the effects of the pandemic and to cushion the economy against its effects. In addition, the fiscal measures put in place by the government provided support to the vulnerable groups in the society. However, the main downside risks to growth in the period included a more protracted spread of the pandemic, emergence of a second wave of infections, and widespread and prolonged lock down of major economies which resulted in a slower-than-anticipated growth of Kenya's trading partners.

2.2 Financial Market Developments

According to the IMF October 2020 WEO, global financial conditions continued to ease, reflecting the impact of aggressive policy measures implemented across economies to mitigate the impact of the COVID-19 shock on the financial system. Interest rates declined consistent with accommodative monetary policy implemented across most countries. Equity markets in emerging market and developing economies firmed up partly supported by the recovery in China which helped to restore portfolio flows to some emerging markets after the sharp reversal in March. However, the recovery in portfolio flows was uneven across countries, with some countries continuing to experience large outflows.

Among major currencies, the U.S. Dollar depreciated between April and late September, mainly reflecting concerns about the impact of rising COVID-19 cases on the pace of recovery of the U.S. economy. The euro appreciated during the period on improving economic prospects and slower increases in COVID-19 cases. The currencies of commodity exporters among advanced economies strengthened as commodity prices firmed. Most emerging market currencies recovered between April and June, after the severe pressures during the market turmoil in March. The Chinese renminbi also strengthened and the currencies of other Asian emerging market economies generally remained

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



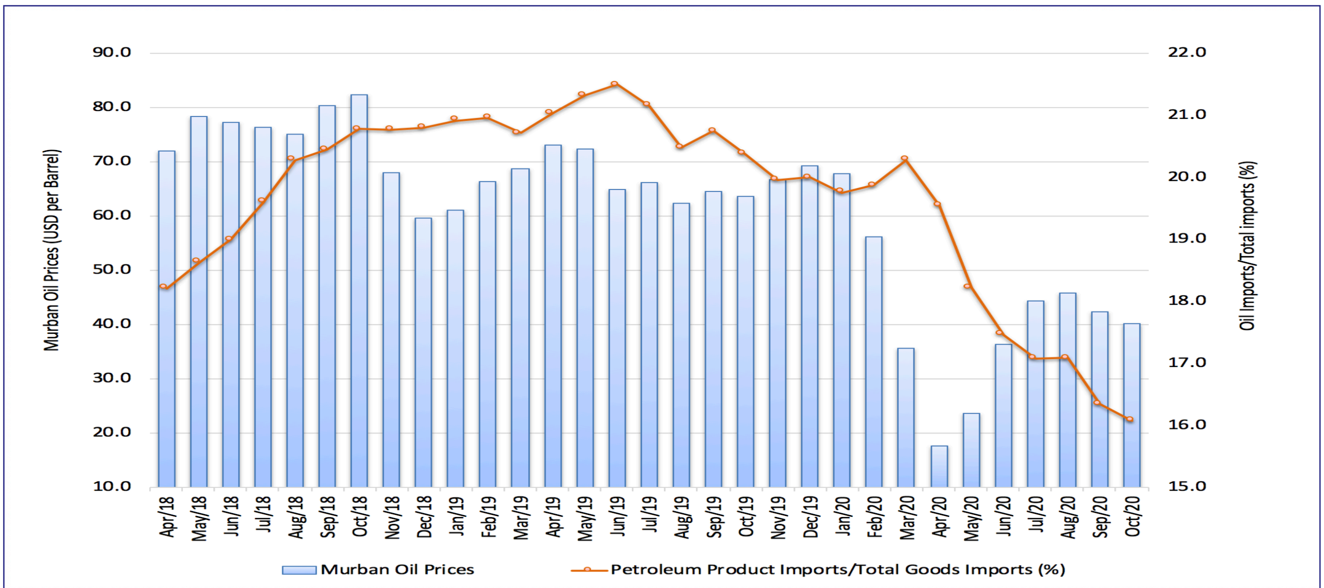
Source: Central Bank of Kenya and Nairobi Securities Exchange

stable. However, the currencies of countries severely affected by the pandemic such as Argentina, Brazil and Turkey weakened in the period.

In the domestic economy, diaspora remittances remained resilient over the period **(Chart 1a)**. However, activity at the Nairobi Securities Exchange (NSE) declined due to COVID-19 related uncertainties. The NSE 20-Share index declined from 1,958.1 points in April to 1,759.9 points in October.

Developments in international oil prices have implications on the balance of payments position particularly when the proportion of imports of

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



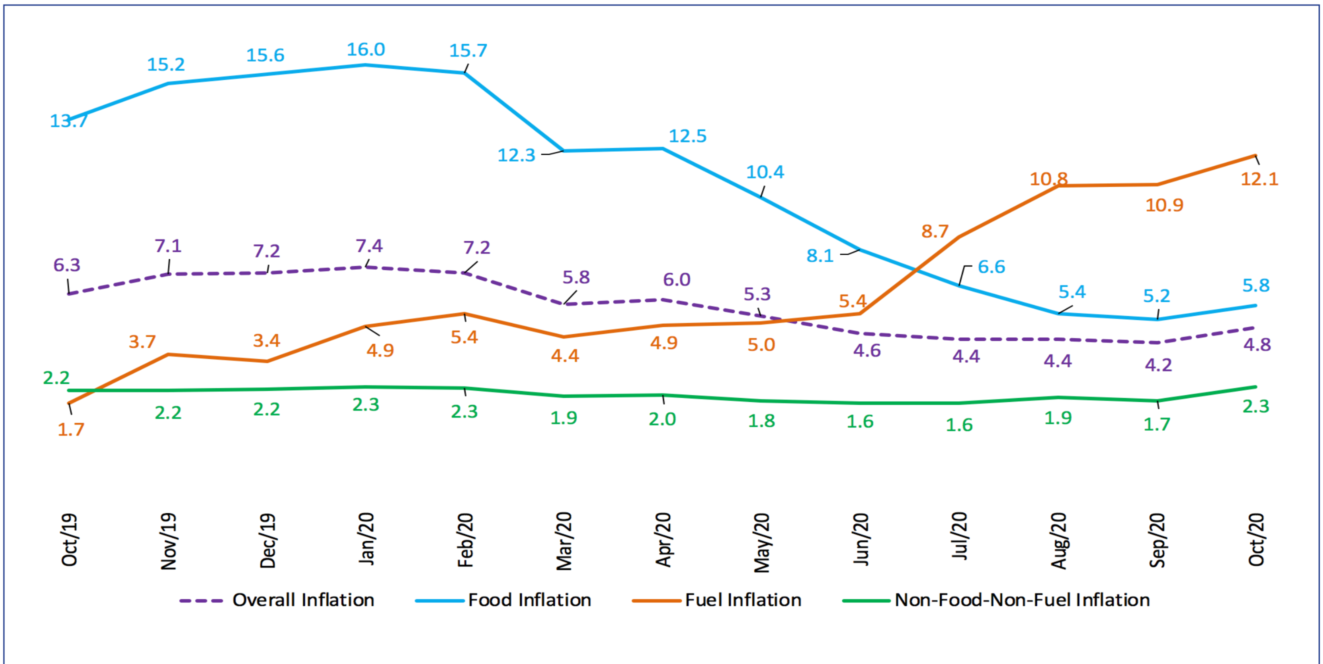
Source: Abu Dhabi National Oil Company and Kenya Revenue Authority petroleum products in total imports is high. Murban crude oil price fell sharply to a low of USD17.6 per barrel in April 2020 due to a decline in demand as economic activity fell following the restrictions caused by the pandemic, amid steady supply. As countries reopened their economies and lifted the containment measures, demand for crude oil rose and prices reached a high of USD 45.7 per barrel in August. However, the second wave of infections suppressed oil demand thereby pushing the prices down to USD 40.2 by the end of October 2020. As a result, the proportion of imports of petroleum products in total imports of goods declined to 16.1 percent in October 2020 from 19.5 percent in April **(Chart 1b)**. These developments supported stability in the foreign exchange market.

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 October 2020. **(chart 2a)** It stood at 4.8 percent in October 2020 compared to 6.0 percent in April 2020 and 6.3 percent in October 2019. This stability in prices was largely supported by lower food prices, the impact of the reduction in VAT to 14 percent from 16 percent and muted demand pressures.

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



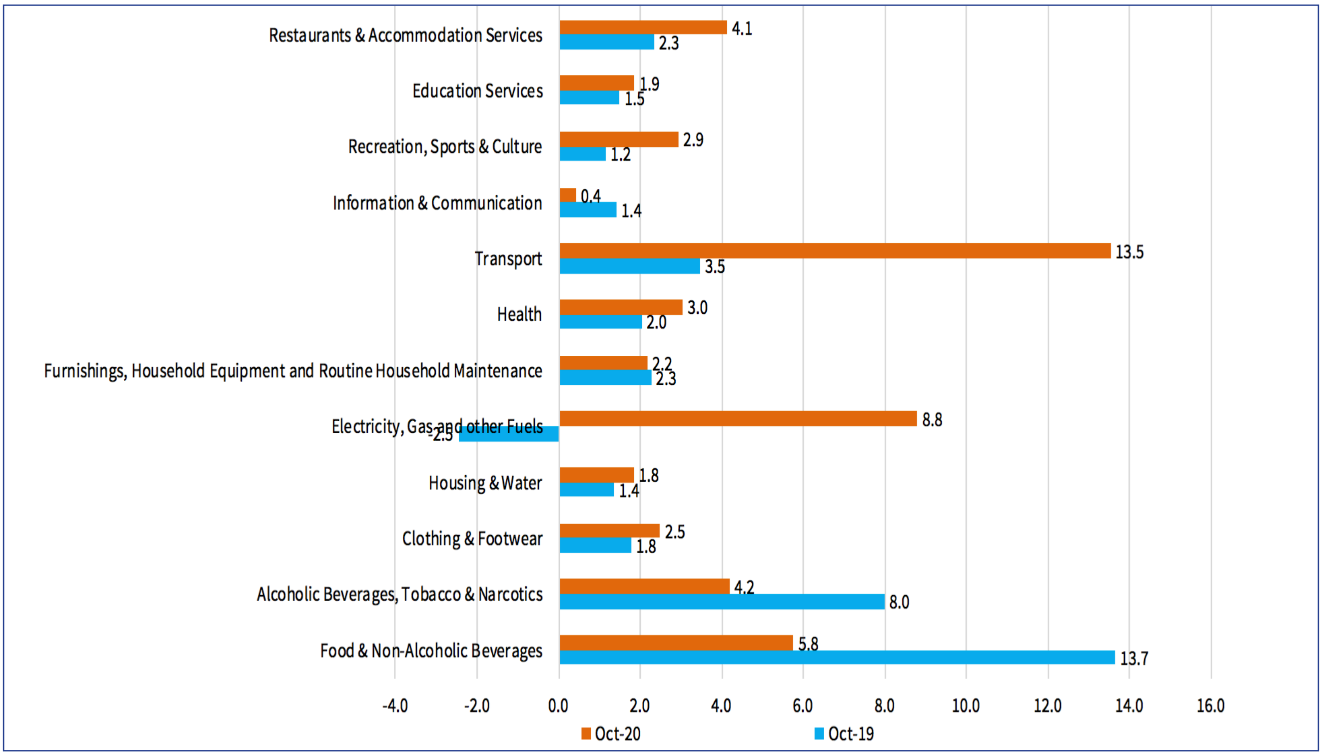
Source: Kenya National Bureau of Statistics and Central Bank of Kenya

Food inflation declined to 5.8 percent in October from 12.5 percent in April 2020, reflecting the impact of favourable weather conditions in most parts of the country on the prices of key short-term food items such as *sukuma wiki* (kales) (weight of 0.5742 in CPI basket) and carrots (weight of 0.1705 in CPI basket). Fuel inflation rose to 12.1 percent in October from 4.9 percent in April 2020, largely due to a rise in international oil prices and disruptions to transport due to Covid-19 containment measures.

Non-food-non-fuel inflation remained low and stable below 5 percent during the period, suggesting that demand pressures in the economy were muted **(Charts 2a)**. Overall, the inflation of all broad categories in the CPI basket except Electricity, gas and other fuels, and transport were within the target range in October 2020 **(Chart 2b)**.

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

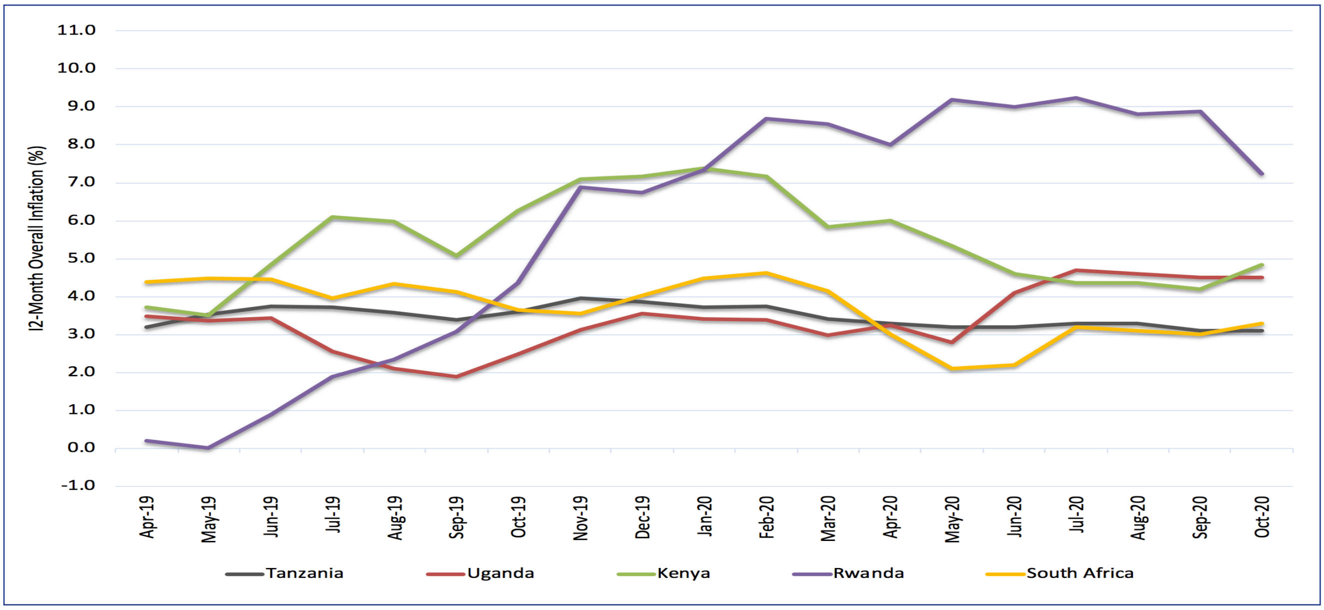
Chart 2b: 12-Month Inflation by Broad CPI Category (%)



Source: Kenya National Bureau of Statistics

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

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



Source: Respective country central bank websites

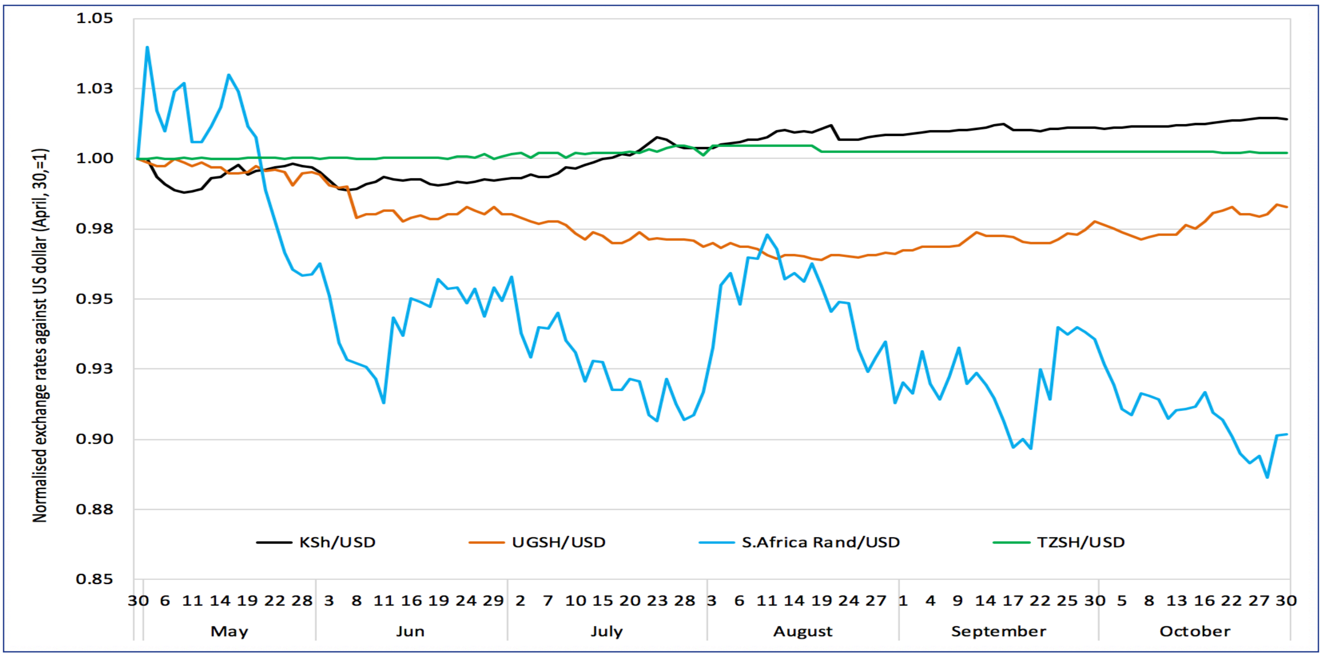
2.3.2 Foreign Exchange Market Developments

The foreign exchange market remained relatively stable in the six months to October 2020, supported mainly by a narrowing in the current account deficit. The deficit narrowed to 4.8 percent of GDP in the 12 months to October 2020 from 5.6 percent in April 2020, largely reflecting resilient exports particularly of tea, strong diaspora remittances and a lower import bill driven by decline in international oil prices. Diaspora remittances averaged USD 270.3 million per month in the six months to October 2020 compared to USD 230.7 million per month in the six months to April 2020.

The CBK foreign exchange reserves, which stood at USD 8,363.0 million (5.2 months of import cover) in October 2020, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

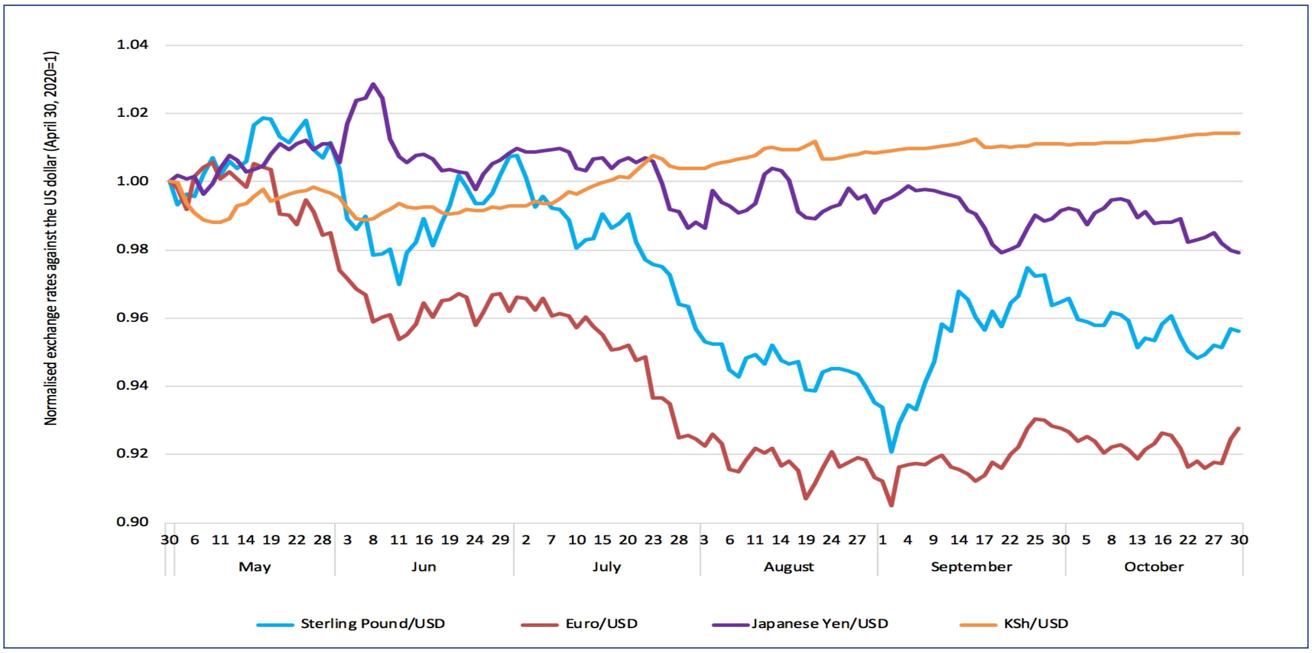
Global financial markets were volatile in March and April mainly due to significant strengthening of the U.S. Dollar and increased uncertainties with regard to the impact of the COVID-19 pandemic. The markets experienced higher volatility in April impacting asset and commodity prices, largely due to increased uncertainty created by the pandemic. Exchange rates of major international and regional currencies against the US Dollar in the six months to October 2020 were also volatile **(Charts 3a and 3b).** The resilience of Kenya's external sector supported the relative stability in the Kenya Shilling.

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (April 30, 2020 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (April 30, 2020 = 1)



Source: Central Bank of Kenya

2.3.3 Balance of Payments Developments

The current account balance improved moderately to a deficit of USD 4,726.9 million in the 12-months to October 2020 (4.8 percent of GDP) from a deficit of USD5,002.3 million (5.2 percent of GDP) over a similar period in 2019. This reflected a slowdown in goods imports by 8.8 percent over the period and a 2.7 percent increase in goods export. This decline in the import bill was associated with lower international oil prices due to reduced global demand, as well as disruptions to international trade due to the COVID-19 pandemic. Services exports, particularly transportation and travel services, declined by 35.7 percent and 36.7 percent, respectively, reflecting the disruptions in the sector due to COVID-19 containment measures, both domestically and internationally.

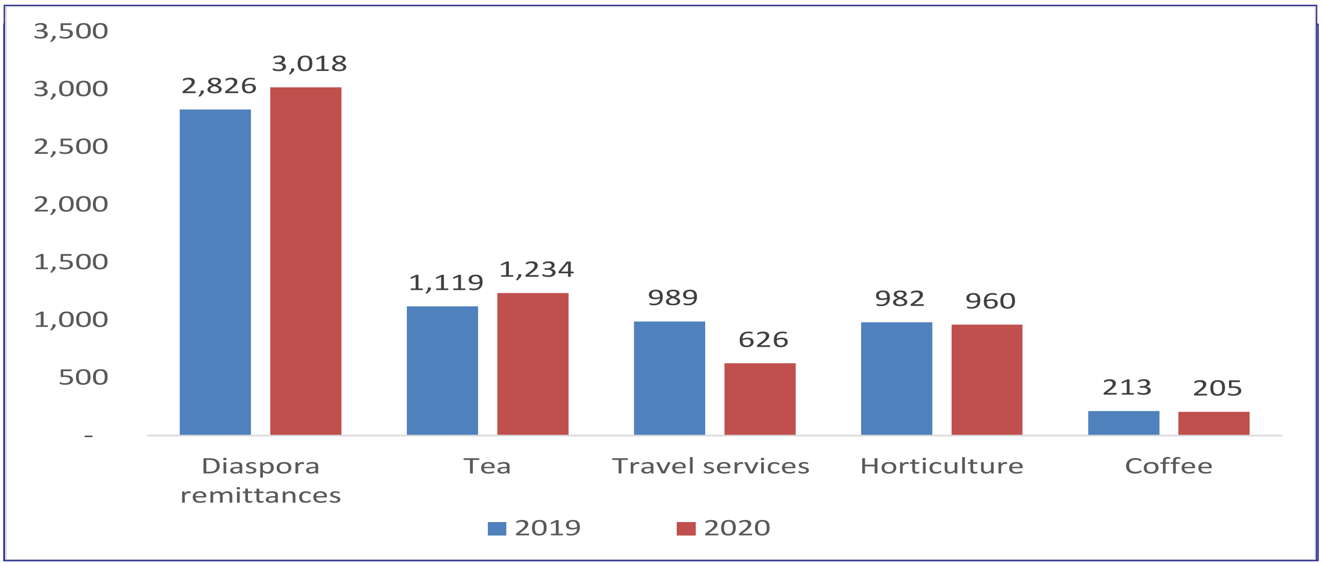
The financial account recorded lower net inflows of USD 3,214.1 million in the 12-months to October compared to USD 6,156.3 million over a similar period in 2019. This reflected a faster decrease in foreign direct investment (FDI) liabilities than the increase in FDI assets, slowdown in other investment inflows and decrease in external borrowing by the government and private sector.

The capital account inflows declined to USD 121.0 million in the 12 months to October 2020 compared to USD 219.0 million in the 12-months to October 2019, primarily reflecting inflows of government grants.

The value of merchandise exports increased to USD 6,006.1 million in the 12 months to October 2020 from USD 5,848.6 million in the 12-months to October 2019, largely reflecting increases in tea and other exports by 10.3 percent and 2.8 percent, respectively, that more than offset the decline in horticulture (2.3 percent), coffee (3.5 percent) and manufactured goods (7.3 percent). Earnings from tourism also declined over the period, partly reflecting the impact of the pandemic on global travel **(Chart 4a)**.

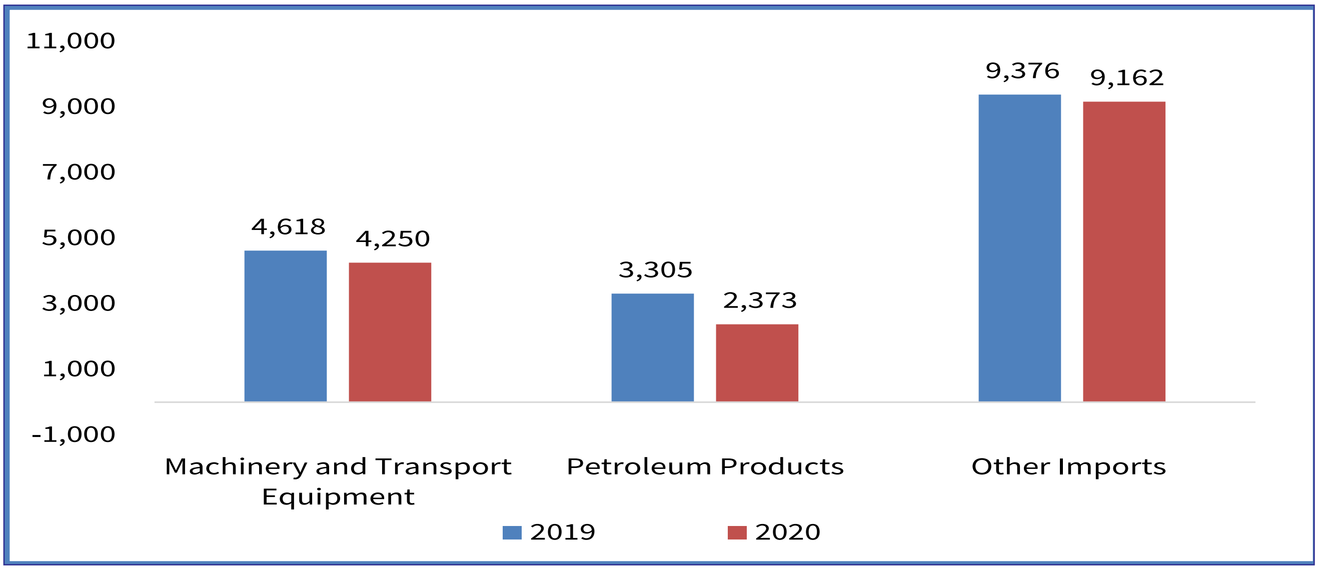
Merchandise imports declined to USD 14,766.2 million in the 12-months to October 2020 from USD 16,205.3 million over a smilar period in 2019. The decline in imports was mainly driven by imports of petroleum products, which fell by 28.2 percent on account of lower global oil prices. **(Chart 4b).**

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

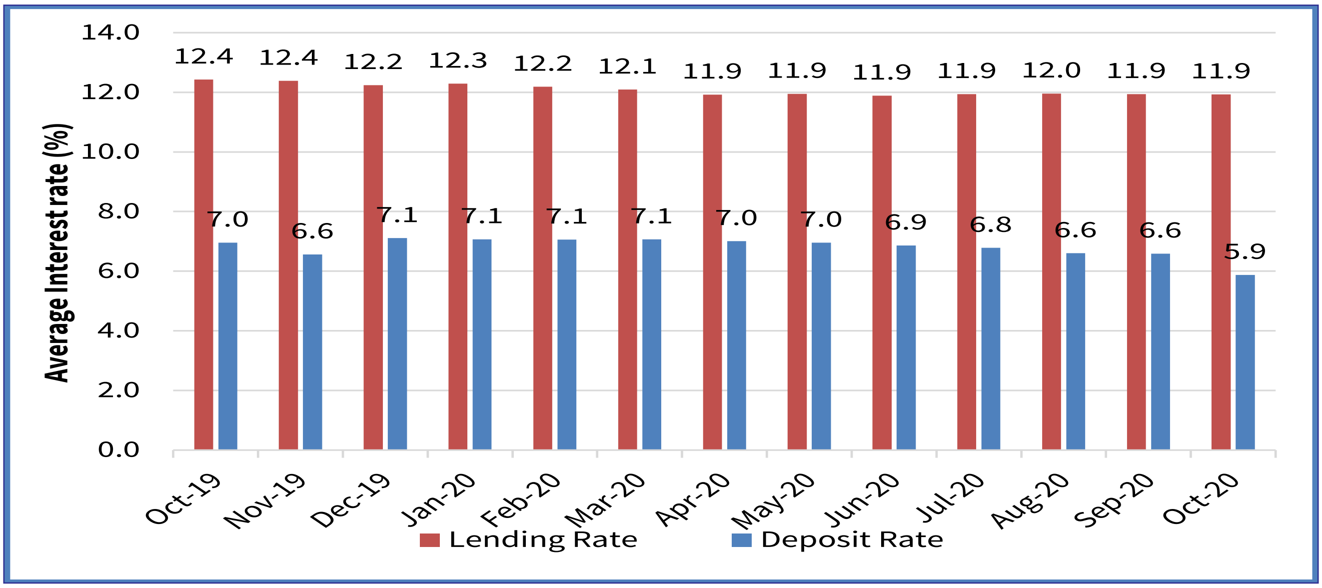
During the period under review, the CBK continued to monitor global developments, particularly the effects of COVID-19 pandemic, the post-Brexit resolution and the U.S. economic and trade policies, on trade and investment. The U.K. and U.S. accounted for 8.4 percent and 9.0 percent, respectively, of Kenya's total exports in the 12 months to October 2020. Exports to other trading blocs such as the EAC, COMESA and the EU, respectively, accounted for 25.3 percent, 27.0 percent and 23.2 percent of total exports over the period, compared to 23.4 percent, 24.1 percent and 22.3 percent of total exports in the six months to April 2020, respectively.

2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the six months to October 2020. The average commercial banks liquidity and capital adequacy ratios stood at 53.3 percent and 17.6 percent in October 2020. The ratio of gross non-performing loans (NPLs) to gross loans stood at 13.6 percent in October 2020, largely reflecting increases in NPLs in the transport and communication, energy and water, tourism, restaurant and hotels and real estate sectors, mainly due to COVID-19 pandemic-related disruptions of businesses. The increases in NPLs were partially offset by loan repayments and recoveries in the trade, manufacturing and building and construction sectors.

With regard to interest rates, the average commercial banks' lending rate declined to 11.9 percent in October 2020 from 12.4 percent in October 2019, largely reflecting the impact of the accomodative monetary policy stance adopted by the MPC. The average deposit rate also declined **(Chart 5)**.

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



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Growth in credit to the private sector remained resilient in the six months to October 2020, despite the adverse effects of COVID-19 on some sectors of the economy. The 12-month growth in credit to the private sector stood at 7.7 percent in October 2020. Strong growth in credit was observed in agriculture, manufacturing, transport and communications, real estate and consumer durables sectors **(Table 1).** These sectors accounted for an average of 50.1 percent of total credit to the private sector during the period.

Lending to the manufacturing sector, which was strong during the period, was largely towards large food and beverage manufacturers for working capital purposes. These borrowers accounted for 35.4 percent of credit to manufacturing sector, which was the largest share in October 2020. This was supported by recovery in demand with the improved economic activity following the easing of COVID-19 containment measures, and accommodative monetary policy. The planned operationalisation of the Credit Guarantee Scheme for the vulnerable Micro, Small and Medium sized Enterprises (MSMEs), was expected to de-risk lending by commercial banks, and is critical to increasing credit to this sector.

The value of loan applications and approvals increased to KSh 154.2 billion and KSh 143.7billion, respectively, in October 2020 from KSh 111.2 billion and KSh 86.8 billion in April 2020. The increase in the value of loan applications was recorded across all the sectors, but mainly in the household sector (comprising private household loans and loans to finance consumer durables), which increased by 48.3 percent in October 2020 relative to the April 2020 levels. The services sector (transport, ICT, trade and business activities) also recorded a significant increase in loan applications, at 47.1 percent over the same period. The productive sector (agriculture, manufacturing, building and construction, real estate and mining and quarrying activities) recorded a relatively lower increase in applications, at 26.1 percent over the same period. Loan approvals to the household, services and productive sectors rose by 48.6 percent, 85.1 percent and 76.9 percent, respectively. The increase in loan application and approvals largely reflected a recovery in economic activity following lifting of lockdowns and reopening of services previously closed, including hotels and restaurants, travels, partial reopening of schools and reduced curfew hours.

Table 1: 12-Month growth in private sector credit

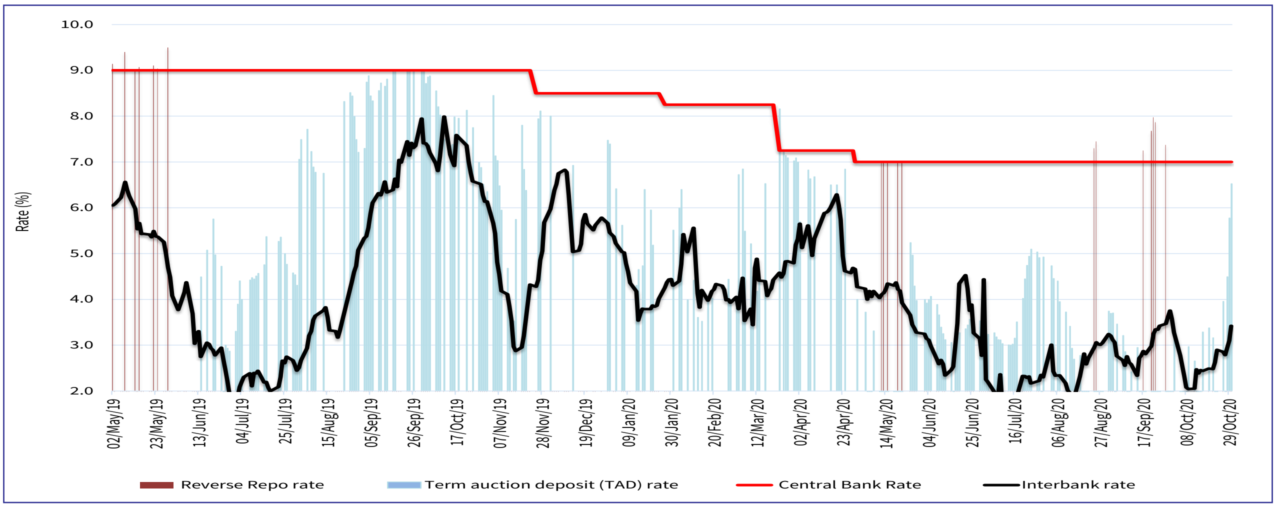
	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20
Total Credit to Private Sector	**9.0**	**8.2**	**7.7**	**7.9**	**8.3**	**7.6**	**7.7**
Agriculture	2.8	2.6	2.2	1.1	0.9	1.7	17.0
Manufacturing	20.1	18.2	11.1	10.0	13.1	12.6	7.8
Trade	10.3	8.0	9.4	9.1	8.1	6.6	2.5
Building & construction	7.7	5.7	4.6	5.5	5.2	4.1	8.2
Transport & communication	9.1	5.7	14.9	20.7	19.0	20.6	21.1
Finance and insurance	3.1	8.4	3.2	3.5	4.6	-3.3	-2.2
Real estate	4.8	4.4	4.9	5.0	6.8	6.6	7.6
Mining & quarrying	11.0	5.8	10.0	11.3	12.0	8.2	-14.2
Private households	2.2	3.2	3.6	5.4	5.1	3.5	7.3
Consumer durables	19.6	16.7	15.2	13.8	13.7	15.6	15.7
Business services	1.2	2.7	5.3	3.2	3.4	4.1	5.9
Other activities	14.3	16.9	-3.7	-6.7	-7.6	-5.8	-10.4

Source: Central Bank of Kenya

2.3.6 Interest rates

Short term interest rates declined and remained below the CBR during the six months to October 2020, reflecting improved liquidity conditions in the market following the lowering of the CBR in March and April and reduction in the CRR in March. The interbank rate averaged 2.92 percent in the period, compared to 4.76 percent in the six months to April 2020. Liquidity management operations by the CBK continued to ensure stability in the market **(Chart 6a).**

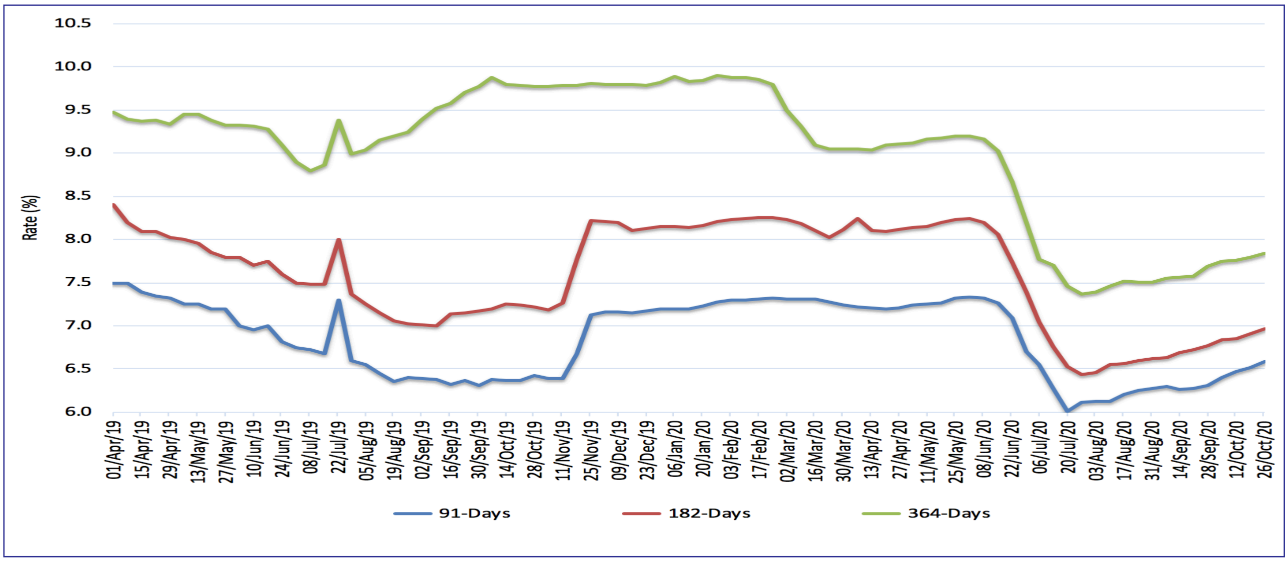
Chart 6a: Trends in Short Term Interest Rates



Source: Central Bank of Kenya

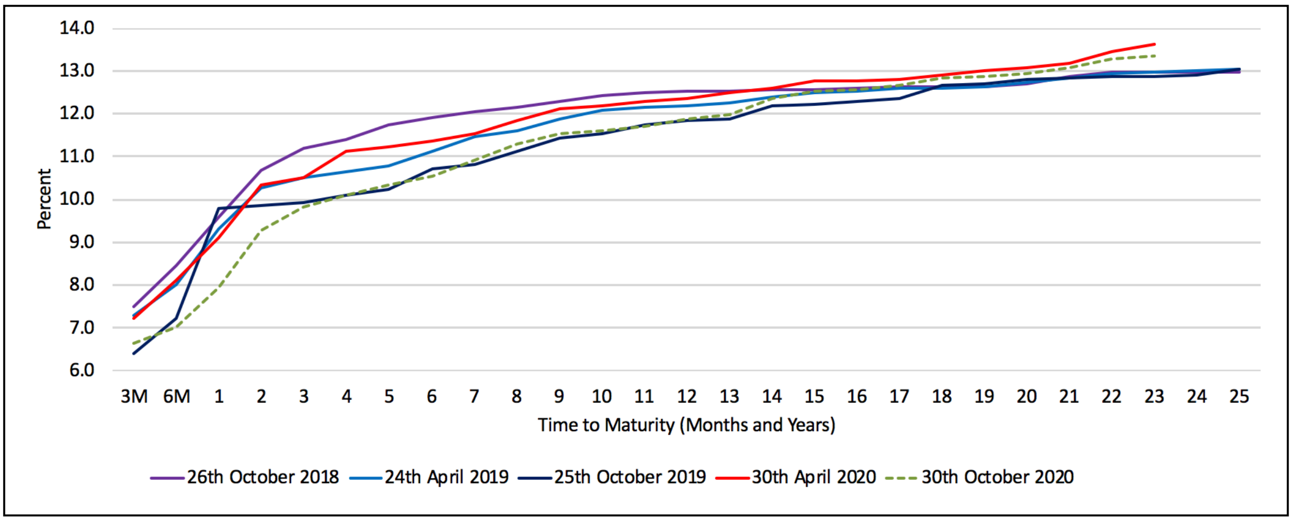
Similarly, interest rates on government securities declined during the six months to October 2020 **(Chart 6b and 6c).** The decline in the interest rates reflected improved liquidity in the government securities market following the lowering of the CBR, and is also an outcome of effective coordination of monetary and fiscal policies, particularly in the implementation of the government domestic borrowing programme.

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

During the six months to October 2020, 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 inflation target provided by the Cabinet Secretary for the National Treasury at the beginning of FY2020/21 was 5 percent with an allowable margin of 2.5 percent on either side.

The Central Bank Rate (CBR) remained the base for monetary policy operations and its adjustments both in direction and magnitude continued to reflect the stance of monetary policy. The monetary policy stance continued to be operationalised 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 was conducted using Repurchase Agreements (Repos) and Term Auction Deposits (TAD).

The annual growth in the broad money (M3) and private sector credit remained within their projected growth paths through the period under review. In particular, the 12-month growth in M3 rose to 11.5 percent in October 2020 from 8.6 percent in April 2019. The growth in M3 largely reflected the improvement in private sector credit uptake during the period.

3.2 Monetary Policy Committee Meetings and Decisions

Over the six months to October 2020, the MPC held meetings on May 27, June 25, July 29 and September 29, 2020. These meetings were held against a backdrop of the continuing COVID-19 pandemic, and measures taken by authorities around the world to contain its spread. The meetings reviewed the impact of previous MPC measures to prevent the pandemic from becoming a severe economic and financial crisis.

In the May meeting, the MPC assessed the economic impact so far, and the outcomes of its policy measures that were deployed in March and April to mitigate the adverse economic effects and financial disruptions. The MPC noted that the global economic outlook for 2020 had deteriorated further and remained highly uncertain mainly reflecting widespread business closures, severe disruptions to trade and supply chains, and the collapse in global travel. Inflation expectations remained well anchored within the target range, supported by improved food supply, lower international oil prices, the impact of the reduction of VAT and muted demand pressures. The MPC noted the resilient growth in the private sector credit and recovery in horticultural exports following lifting of restrictions in key export destinations and increased cargo capacity. The MPC concluded that the accommodative monetary policy stance remained appropriate, and therefore decided to retain the CBR at 7.00 percent.

The June MPC meeting noted that inflation expectations remained well anchored within the target range, supported by improving food supply due to favourable weather conditions, lower international oil prices, the impact of the reduction of VAT and muted demand pressures. The MPC noted that the banking sector remained stable and resilient with improved credit to the private sector and recovering exports particularly tea and horticulture following easing of supply restrictions in key destination markets. The MPC also noted that the policy measures deployed since March were having intended outcomes and decided to retain the CBR at 7.00 percent.

The July 2020 meeting was held in the context of a sharp contraction in global output in the first half of 2020. The IMF had projected a gradual recovery of the global economy in the second half following the lifting of COVID-19 containment measures and the effects of the fiscal and monetary policy measures put in place. However, the risks to the recovery remained elevated due to a resurgence in COVID-19 cases in countries that had commenced reopening. Although the Kenyan economy was resilient in the first quarter of 2020, growth in key services sectors was expected to be severely subdued in the second quarter of 2020 due to the COVID-19 containment measures. The MPC noted that inflation remained well anchored, supported by lower food prices, the impact of the reduction of VAT and muted demand pressures. The MPC concluded that the prevailing accommodative monetary policy stance remained appropriate, and that the stance would be augmented by the implementation of the measures in the FY2020/21 Budget. The Committee decided to retain the CBR at 7.00 percent.

The September meeting was held at a time when authorities around the world had taken measures to reopen their economies, through lifting of the COVID-19 containment measures. The MPC assessed the economic impact of the pandemic, and the outcomes of its previous policy measures. The MPC noted that the effects of the measures continued to be transmitted through the economy and were having the intended effect. The MPC also noted that leading economic indicators for the Kenyan economy for the third quarter pointed to a strong recovery in economic activity from the disruptions witnessed in the second quarter of 2020. A survey of hotels by the CBK conducted in September indicated recovery from the COVID-19 disruptions that had led to closures in April and May. Inflation remained well anchored while banking sector remained stable and resilient. The MPC concluded that the accommodative monetary policy stance remained appropriate, and would be augmented by the implementation of the measures in the FY2020/21 Budget. The MPC therefore decided to retain the CBR at 7.00 percent.

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

The monetary policy measures implemented by the Bank continued to support economic recovery from the devastating effects of the COVID-19 pandemic.

The lowering of the CBR from 8.25 percent to 7.25 percent in March, and further to 7.00 percent in April 2020, was a signal to commercial banks to lower their interest rates on credit facilities and to avail affordable credit to MSMEs countrywide. Consequently, interest rates declined in the six months to October 2020, thereby supporting demand for credit by the private sector.

The MPC reduced the Cash Reserve Ratio (CRR) to 4.25 percent in March 2020 from 5.25 percent, thereby releasing KSh35.2 billion to the commercial banks and increasing their liquidity. As at end October 2020, a total of KSh32.6 billion (92.7 percent) of these funds had been used to support lending to the sectors affected by COVID-19, especially to the tourism, trade, transport and communication, real estate, manufacturing and agriculture sectors. In addition, CBK extended the maximum tenor of Reverse Repurchase Agreements (REPOs) from 28 to 91 days. The average commercial banks liquidity increased from 51.2 percent in April to 53.3 percent in October, thereby increasing funds available for lending.

In line with the emergency measures announced by CBK on March 18 to provide relief to borrowers, loans amounting to KSh 1.38 trillion (46.5 percent of the total banking sector loan book of KSh 2.97 trillion) had been restructured by the end of October 2020. Of this, personal and household loans amounting to KES 303.1 billion (36.1 percent of the gross loans to this sector) had their repayment period extended. For other sectors, a total of KSh 1,076.9 billion had been restructured mainly to trade (18.7 percent), manufacturing (22.7 percent), real estate (14.5 percent) and agriculture (12.8 percent). These measures continued to provide the intended relief to borrowers.

In March, the Bank worked with commercial banks and payment service providers to waive charges on low value mobile transactions in order to promote the use of cashless payments and contain the spread of COVID-19 through use of cash. This measure resulted in an increase in volumes and values of low value transfers between bank and mobile e-wallets indicating a gradual shift towards digital platforms and less utilisation of physical access channels. As a result, an additional 1.6 million Kenyans, close to 10 percent of the mobile money subscription base, were using mobile money as at October following the measures. This also pushed up transactions outside bank branches from 90 percent before the pandemic to over 94 percent during the pandemic.

On the fiscal front, the Tax Relief Measures, the Stimulus Programme, payment of pending bills, and transfers to elderly, orphans and other vulnerable groups cushioned businesses and households from the adverve impact of the pandemic and supported recovery of the economy.

At the peak of the pandemic the government stopped international passenger flights in order to contain the spread of the virus, but retained cargo flights in order to sustain exports especially of horticulture. In addition, the government approved the conversion of passenger planes into cargo planes to increase capacity. Consequently, exports were less affected while importation of supplies especially medical was achieved.

5. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC Market Perceptions Surveys carried out during the period as well as regular communication with the key stakeholders facilitated the MPC in its market information gathering process for effective conduct of forward-looking monetary policy. The MPC also continued to simplify its Press Releases to enhance the clarity of information communicated to the public, media, financial sector and other stakeholders. The MPC expanded the coverage of the Surveys to private sector firms in the environs around its new currency center in Kisii.

The MPC introduced two more surveys in September, specifically for the hotels and flower farms in order to assess the impact of COVID-19 and to monitor the state of recovery of the sectors. These sectors employ a signficant proportion of Kenyans. The survey reports, showed steady recovery from the closures and scaling down of operations recorded in April and May following the onset of the pandemic. In particular, 96 percent of the respondent hotels were open in October, compared to 56 percent in April, with increased re-engagement of employees. An average bed occupancy of 23 percent was reported. With regards to the flower farms, all indicated that they were operational, compared to 56 percent in April. Employment and export orders for flowers had improved and were close to pre-COVID-19 levels. Respondents also indicated that orders for flower exports over the next four months were strong, with a risk of disruptions from a tightening of COVID-19 containment measures in key markets following the second wave of infections.

Over the period, the MPC Chairman held virtual stakeholder meetings with the Chief Executives of commercial and microfinance banks after every MPC Meeting in order to apprise them on the background to its decisions and to obtain feedback. In addition, the Chairman of the MPC held virtual press conferences after each MPC meeting to brief the media on the backgound to MPC decisions and measures undertaken by the CBK to support macroeconomic stability as well as mitigate the impact of COVID-19 on the economy.

The Governor also held virtual meetings with various potential investors to brief them on economic developments and the outlook for the economy. The MPC continued to monitor the implementation of monetary policy decisions by the CBK. The committee also continued interaction with other government agencies such as the National Treasury and Kenya National Bureaue of Statistics (KNBS) on various data issues.

6. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to October 2020 continued to support price stability, while also providing support to households and businesses in mitigating the adverse impact of COVID-19 pandemic. The stability of the exchange rate moderated any possible distortions that imported inflation would have had on the stability of domestic prices. The continued coordination of fiscal and monetary policies during the period also supported the achievement of price and market stability.

The CBK will continue to monitor developments in the domestic and global economy, the impact of the pandemic on the economy, the transmission of the monetary policy and other measures previously taken, and their effects on price stability. The CBK will also continue to explore and implement measures aimed at promoting the efficiency of the money markets, improve the conduct of liquidity management and adopt measures to support access and affordability of credit to the private sector, particularly the MSMEs.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (MAY – OCTOBER, 2020)

October	Release of October 2020 World Economic Outlook by the IMF
September	CBR retained at 7.00 percent
August	• Resumption of international passenger flights for Kenya
July	• CBR retained at 7.00 percent • Presidential announcement on phased reopening of the economy and lifting of travel ban in Nairobi, Mombasa and Mandera
June	CBR retained at 7.00 percent
May	CBR retained at 7.00 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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