FOURTEENTH BI-ANNUAL REPORT OF THE MONETARY POLICY COMMITTEE

Central Bank of Kenya

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APRIL 2015

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 fourteenth 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, exchange rates and inflation and other activities of the Committee in the six months to April 2015. Copies of MPC Press Statements and the Minutes of all the Meetings of the MPC between November 2014 and April 2015 are attached to the Report for your information.

Dr. Haron Sirima, OGW
Deputy Governor, Central Bank of Kenya

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MEMBERS OF THE MONETARY POLICY COMMITTEE

Prof. Njuguna Ndung'u (CBS)
Governor, Chairman

Dr. Haron Sirima (OGW)
Deputy Governor, Vice-Chairman

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

Mr. Charles G. Koori
Member

Mrs. Farida Abdul
Member

Prof. Francis Mwega
Member

Mr. John Birech
Member

LEGAL STATUS OF THE MONETARY POLICY COMMITTEE

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

EXECUTIVE SUMMARY

The fourteenth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and economic developments during the six months to April 2015. The monetary policy stance during the period was aimed at maintaining inflation within the allowable margin of 2.5 percent on either side of the Government's medium-term target of 5 percent. This is consistent with the price stability objective of the Central Bank of Kenya (CBK).

The monetary policy measures adopted by the CBK during the period maintained overall inflation within the Government target range. Overall month-on-month inflation eased from 6.43 percent in October 2014 to 5.53 percent in January 2015 mainly reflecting significant declines in the prices of fuel and electricity. However, it rose thereafter to 5.61 percent in February and further to 7.08 percent in April 2015 mainly reflecting significant increases in food prices attributed mainly to a delay in the onset of the long rains. The month-on-month food inflation rose significantly from 7.67 percent in January 2015 to 13.42 percent in April 2015. However, the month-on-month non-food-non-fuel inflation (NFNF), which measures the impact of monetary policy stance, remained below the 5 percent target during the period indicating that there were no adverse demand pressures in the economy in the period. The MPC retained the Central Bank Rate at 8.50 percent throughout the period in order to continue anchoring inflationary expectations and maintaining price stability in the economy.

Despite sustained pressure arising mainly from the global strengthening of the US Dollar and increased demand for foreign exchange to finance imports of capital goods, the exchange rate of the Kenya Shilling maintained a stable depreciation trend against the US Dollar in the six months to April 2015. The impact of the strong US dollar was also reflected across the major international and regional currencies which also depreciated and were more volatile compared with the Kenya Shilling. The Kenya Shilling exchange rate continued to be supported by the resilient foreign exchange inflows through diaspora remittance and sustained confidence in the economy reflected in the massive over-subscription of the re-opened Sovereign Bond in December 2014. The interventions by the CBK through direct sales of foreign exchange to commercial banks stopped short-term excessive volatility in the exchange rate during the period. The CBK accumulated a significant buffer of official usable foreign exchange reserves, which stood at USD 6,859.58 million (equivalent to 4.40 months of import cover) at the end of April 2015. The build-up in reserves was largely supported by the proceeds of tap-sales on Government Sovereign Bond in December 2014. This level of reserves was augmented by the precautionary access under a blended Stand-By Arrangement and Standby Credit Facility negotiated between the Government of Kenya and the International Monetary Fund approved in January 2015 to protect against potential balance of payments shocks. This has boosted the Bank's capacity to respond to short-term volatility in the foreign exchange market.

The effectiveness and transparency of monetary policy formulation and implementation by the CBK continued to be enhanced through its regular interactions with stakeholders in the financial and real sectors and timely release of relevant monetary and financial data. The continued implementation of the Kenya Banks' Reference Rate framework in the period facilitated a transparent credit pricing framework and enhanced the transmission of monetary policy signals through commercial banks' lending rates.

The CBK remains vigilant to risks posed by developments in the domestic and global economies on its overall price stability objective. The monetary policy measures in place, the declining international food prices, lower international oil prices as well as reductions in domestic electricity tariffs due to increased production of geothermal power support a stable outlook for inflation. However, the uncertainty around the timing of the first interest rate increase in the US following the tapering of Quantitative Easing, and the geo-political situation in the Middle East remain a risk to the stability of both the global currency markets and international oil prices.

1. INTRODUCTION

The fourteenth bi-annual Report of the MPC covers the period November 2014 to April 2015. The Report provides an update on macroeconomic developments in response to the monetary policy stance adopted by the CBK in pursuit of its price stability objective during the period.

During the six months to April 2015, the monetary policy stance adopted by the MPC and consequent operations coupled with a decline in energy prices supported stability in the inflation rate. Despite the pressure on the exchange rate in the period, overall inflation remained within the target range prescribed by the Government. The threat of imported inflation was dampened by the significant decline in international oil prices during the period. The 12-month non-food-non-fuel (NFNF) inflation remained below the 5 percent target during the period.

The exchange rate of the Kenya Shilling against the US Dollar maintained a stable weakening trend against the US Dollar in the six months to April 2015. It continued to be supported by the resilient foreign exchange inflows through diaspora remittances and sustained investor confidence in the economy reflected in the massive over-subscription of re-opened Sovereign Bond in December 2014. However, the proportion of imports of goods and services financed by exports of goods and services decreased during the period reflecting a faster rise in imports relative to exports earnings. The composition of imports continued to be dominated by capital goods such as machinery and transport equipment that are essential for enhancing future productive capacity of the economy. The data from Kenya National Bureau of Statistics (KNBS) showed that overall real GDP growth was 5.1 percent in the fourth quarter of 2014 compared with 2.9 percent in a similar period of 2013. The contribution of the financial and insurance sector remained strong; the sector grew by 10.3 percent in the fourth quarter of 2014 from 5.4 percent in a similar period of 2013.

On the international scene, global growth strengthened from 3.4 percent in 2014 to 3.5 percent in 2015 bolstered by stronger growth in the US and United Kingdom as well as lower international oil prices. The growth of the global economy is expected to accelerate in 2016 supported by the accommodative monetary policy adopted by most advanced economies and lower international oil prices. These developments, coupled with the monetary policy stance adopted by the CBK, the declining international food prices, and stable domestic electricity prices indicate a stable outlook for inflation.

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

2. MONETARY POLICY FORMULATION

2.1 Attainment of Monetary Policy Objectives and Targets

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

The Central Bank Rate (CBR) is the base for monetary policy operations and continued to coordinate movements in short-term interest rates in the period. The change in both the direction and magnitude of the CBR signals the monetary policy stance. The monetary policy stance, as signaled by the movements in the CBR, is operationalized through various instruments. These include Open Market Operations (OMO), changes in cash reserve requirements at CBK, foreign exchange market transactions, and the CBK Standing Facility – the CBK Overnight Discount Window when it acts as lender of last resort. To achieve the desired level of liqudity in the market, OMO is conducted using Repurchase Agreements (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 a blended Stand-By Arrangement and Standby Credit Facility negotiated between the Kenyan Government and the International Monetary Fund (IMF) approved in January 2015 to protect against potential shocks. The CBK met its NDA and NIR targets for December 2014 and March 2015 and remained on course with respect to the June 2015 targets. The NDA averaged Ksh -225.4 billion by end March, 2015 compared to the target ceiling of Ksh -206.0 billion while the NIR averaged USD 6,497.8 million against a target floor of USD 5,956.0 million. The annual growth rates of broad money supply (M3) and private sector credit were largely consistent with the respective projected growth paths in the period. The 12-month growth in M3 decreased from 18.9 percent in October 2014 to 16.6 percent in April 2015 – this was against a target of 14.8 percent for April 2015. The 12-month private sector credit growth declined from 23.6 percent to 19.9 percent in the period – this was against a target of 19.4 percent for April 2015.

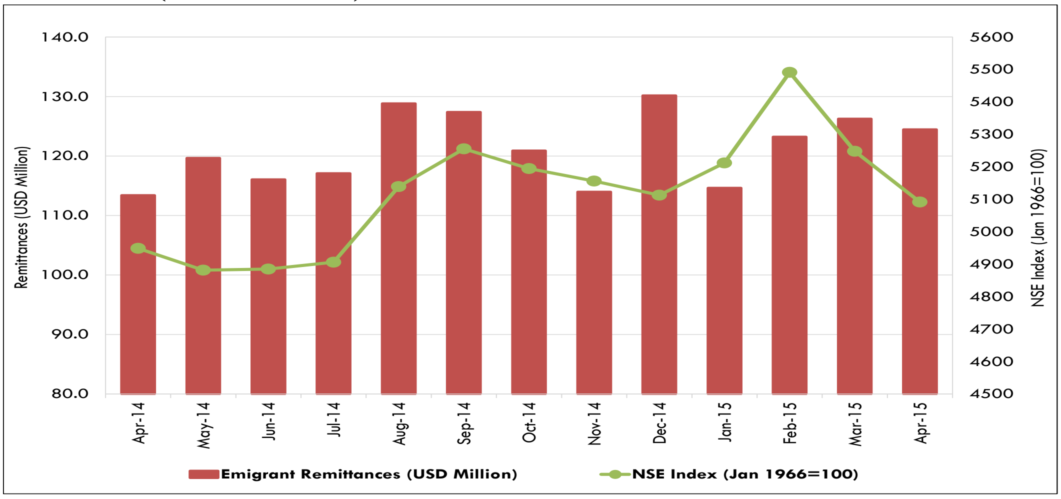
2.2 Economic Environment

The economic environment during the six months to April 2015 was characterized by relative stability of key macroeconomic indicators. This was supported by the prudent monetary policy stance reflected in non-inflationary growth in private sector credit and a generally stable depreciation trend in exchange rate. The NFNF inflation remained stable within the bounds of 5 percent target. Despite short-term inflationary pressure from increases in food prices in February to April 2015, overall inflation rate remained within the prescribed target range in the six months to April 2015.

The exchange rate maintained a stable depreciation trend during the period despite volatility in the global currency markets following the strengthening of the US Dollar. The strengthening of the US Dollar largely reflected the strong recovery in the US economy and the uncertainty around the timing and pace of US monetary policy normalization. In April 2015, the foreign exchange market came under pressure from elevated demand for foreign exchange associated with the seasonal dividend remittance by corporates, against reduced inflows from tea and tourism.

The Kenya Shilling continued to be supported by the resilient foreign exchange inflows through diaspora remittances, foreign investor participation in the Nairobi Securities Exchange (NSE) and confidence in the economy reflected in the massive over-subscription by 400 percent of the Sovereign Bond that was re-opened in December 2014 with the yields lower by 100 basis points. Interventions by the CBK through direct sales of foreign exchange to commercial banks stopped short-term volatility in the period. The diaspora remittances increased from an average of USD 121.7 million in the six months to October 2014 to an average of USD 122.1 million in the six months to April 2015 (Chart 1a). The NSE index dipped slightly in March and April 2015 partly reflecting the impact of incidences of insecurity as well as challenges in the implementation of the Capital Gains Tax.

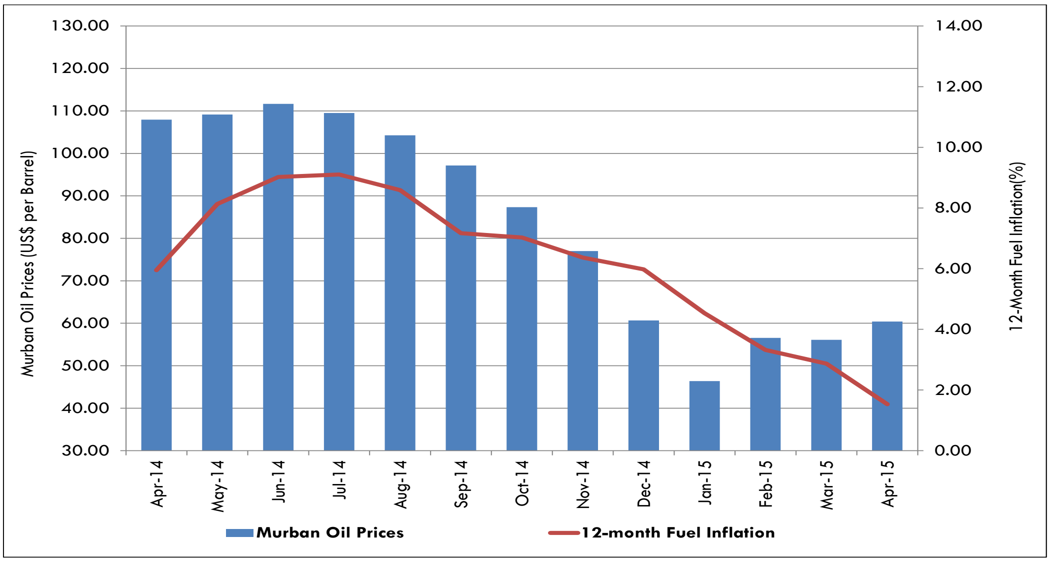
Chart 1a: 12-months Cumulative Diaspora Remittances (USD Million) and NSE Index (Jan 1966=100)



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

International crude oil prices declined significantly between October 2014 and January 2015 reflecting increased production from the United States and Libya, reduced demand particularly from China, and sustained production by the Organization of Petroleum Exporting Countries (OPEC). Consequently, Murban crude oil prices dropped from USD 87.4 per barrel in October 2014 to USD 46.4 per barrel in January 2015. However, following a pick-up in global economic activity which has increased demand for oil coupled with the geo-political situation in the Middle East, international oil prices rose to USD 60.4 per barrel in April 2015. The trend in the prices of international oil prices is closely mirrored in the evolution of fuel inflation in Kenya which includes electricity prices (Chart 1b).

Chart 1b: Murban Oil Prices and the 12-Month Fuel Inflation (%)



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

2.3 Monetary Policy Committee Meetings and Decisions

The MPC continued to monitor developments in the domestic and international markets and took appropriate measures to maintain price stability. Liquidity management operations were sustained to ensure stability in the interbank market and that of short-term interest rates.

The monetary policy measures used to operationalize the MPC policy decisions during the six months to April 2015 maintained inflation rate within the target range prescribed by the Government. The MPC retained the CBR at 8.50 percent in its meetings held on 4th November, 2014, 14th January and 26th February, 2015 in order to continue anchoring inflationary expectations and maintain price stability. The last change in the CBR was on 7th May 2013 when it was lowered from 9.50 percent to 8.50 percent. The monetary policy stance adopted by the MPC supported a non-inflationary growth in credit to the private sector, which remained within the projected path.

The Government fiscal operations over the period covered by this Report were consistent with the monetary policy objectives. The successful re-opening of the Sovereign Bond in December 2014 dampened pressure on both Government domestic borrowing and interest rates. Consequently, the Treasury bill and bond rates were generally stable in the review period. The borrowing plan also remained consistent with the thresholds set in the Medium-Term Debt Management Strategy.

Foreign exchange market operations undertaken by the CBK through direct sale of foreign exchange to banks complemented other liquidity management measures in stabilizing the exchange rate trend and managing expectations over the period covered by this Report. The official usable foreign exchange reserves buffer held by the CBK was supported by the sale by the Government of the proceeds from the re-opened Sovereign Bond. The level of reserves was augmented by the precautionary facility with the IMF approved in January 2015 to protect the country against potential balance of payments shocks. This bolstered the Bank's capacity to respond to shocks in the market.

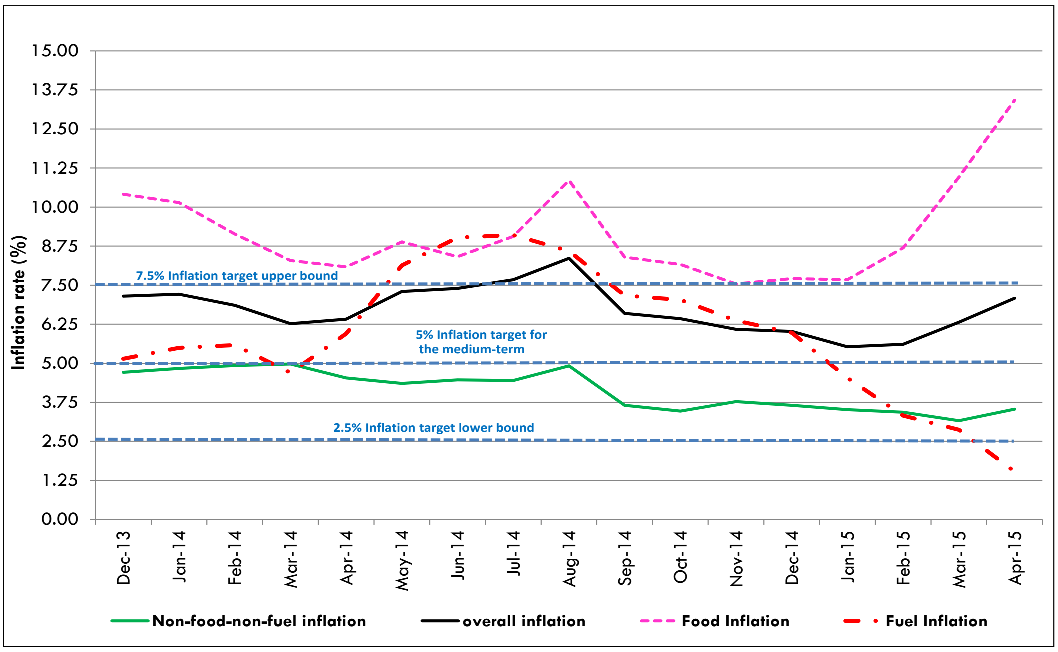
3. OUTCOMES WITH RESPECT TO KEY ECONOMIC INDICATORS

3.1 Inflation

The various measures of inflation displayed mixed trends during the six months to April 2015. Overall month-on-month inflation decreased from 6.43 percent in October 2014 to 5.53 percent in January 2015 mainly reflecting significant declines in the prices of fuel and electricity. However, it rose to 5.61 percent in February and further to 7.08 percent in April 2015 mainly reflecting significant increases in food prices. The month-on-month food inflation increased significantly from 7.67 percent in January 2015 to 13.42 percent in April 2015 following the delay in the onset of the long rains (Chart 2a). The 12-month non-food-non-fuel inflation, which measures the impact of monetary policy stance, remained below the 5 percent target during the period indicating that there were no adverse demand pressures in the economy.

The monetary policy measures in place, the declining international food prices and increased production of geothermal power generation which is expected to continue moderating electricity prices, support a stable outlook for inflation. However, the uncertainty around the timing of the first interest rate increase in the US following the tapering of Quantitative Easing (QE), and the geo-political situation in the Middle East remain a risk to the stability of both the global currency markets and international oil prices. These underlying risks have potential to undermine the overall price stability objective through possible exchange rate pass-through to inflation.

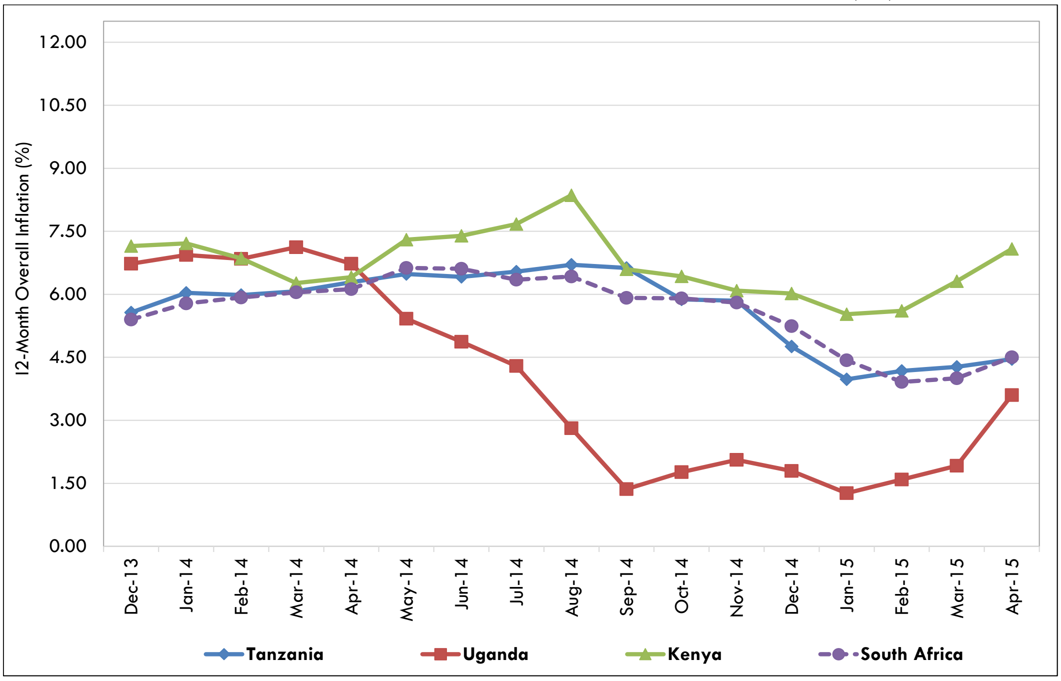
Chart 2a: 12-Month Inflation in Broad Categories (%)



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

The three large economies in the East African Community (EAC) region displayed similar trends in their inflation rates in the six months to April 2015 (Chart 2b). These trends largely reflect a common experience in their composition of the CPI basket, which is largely affected by the movements in prices of food and energy items. A similar trend is shown in the inflation trend for South Africa which has strong trade links with Europe whose exchange rate exhibited significant volatility in the period.

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



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

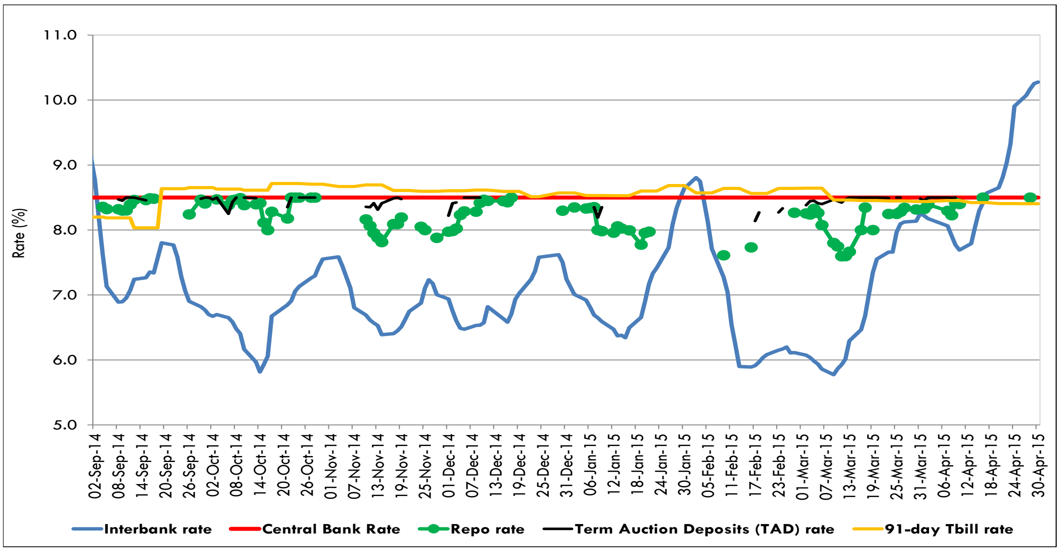
3.2 Interest Rates

3.2.1 Short-Term Interest Rates

The sustained liquidity management by the CBK through Open Market Operations (OMO) ensured stability in the interbank market in the six months to April 2015 (Chart 3a). As a result, the movements in short-term interest rates were closely aligned to the CBR. However, the interbank rate rose above the CBR towards the end of April 2015 reflecting a build-up in Government deposits at the CBK and the CBK OMO activity to withdraw excess liquidity following the adoption of a tightening bias in its monetary policy to anchor inflation expectations. The MPC retained the CBR at 8.50 percent during the period.

The CBK also continued to engage with stakeholders in the banking sector to explore strategies for enhancing the use of Horizontal Repos towards redistributing liquidity in the interbank market.

Chart 3a: Trends in Short-Term Interest Rates (%)



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

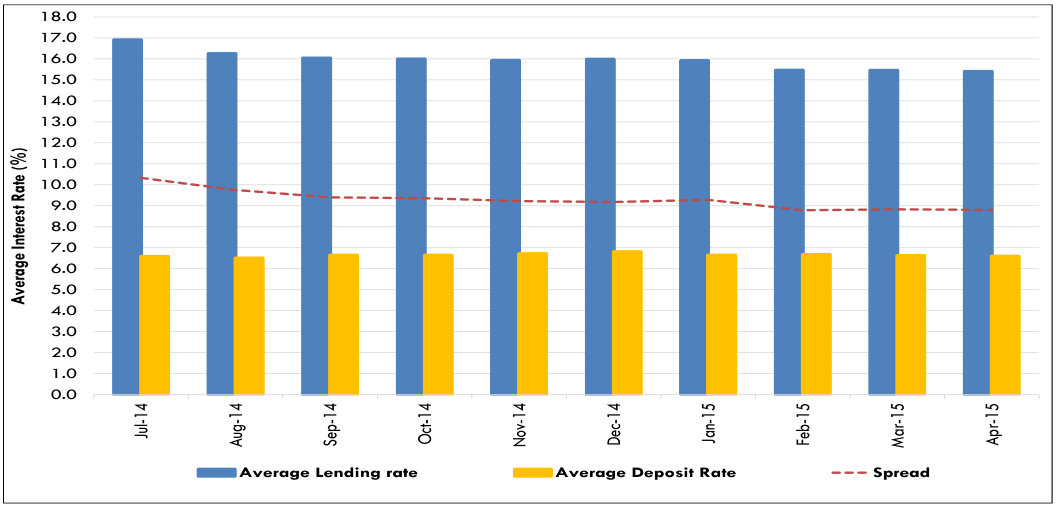
3.2.2 Commercial Banks' Interest Rates and Spreads

The CBK continued to work with stakeholders including the Kenya Bankers Association (KBA) to implement initiatives aimed at improving the efficiency of the banking sector. The Kenya Banks' Reference Rate (KBRR) framework was introduced in July 2014 to facilitate transparency in credit pricing and improve the transmission of monetary policy effects through commercial banks' lending rates. The KBRR framework was developed as an outcome of discussions between the stakeholders, CBK and The National Treasury. The KBRR was developed as part of the recommendations to enhance the supply of private sector credit and mortgage finance in Kenya by facilitating a transparent credit pricing framework. It is the base rate for all commercial banks' lending.

The CBK reviewed the KBRR from 9.13 percent to 8.54 percent on 14th January 2015 due to the decline in the 91-day Treasury bill rate. Data from all commercial and microfinance banks showed that new and existing loans amounting to Ksh.877.45 billion had been converted to the KBRR framework by end of April 2015 up from Ksh.732.2 billion by end of December 2014. The average commercial banks' lending rates declined gradually from 16.91 percent in July 2014 to 15.40 percent in April 2014 (Chart 3b). The average deposit rate increased marginally from 6.59 percent to 6.60 percent during the period reflecting increased banks' competition for deposits. As a result, the spread between the average commercial banks' lending rate and deposit rate declined from 10.32 percent to 8.80 percent in the period. This trend is expected to continue as more loans are issued under the KBRR framework.

The MPC continued to engage the Chief Executive Officers of commercial banks through the KBA on various issues through the bi-monthly forums. This has continued to facilitate moral suasion and provided a regular feedback mechanism based on a dialogue initiated through the MPC's Market Perception Surveys.

Chart 3b: Trends in Commercial Bank Interest Rates (%)



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

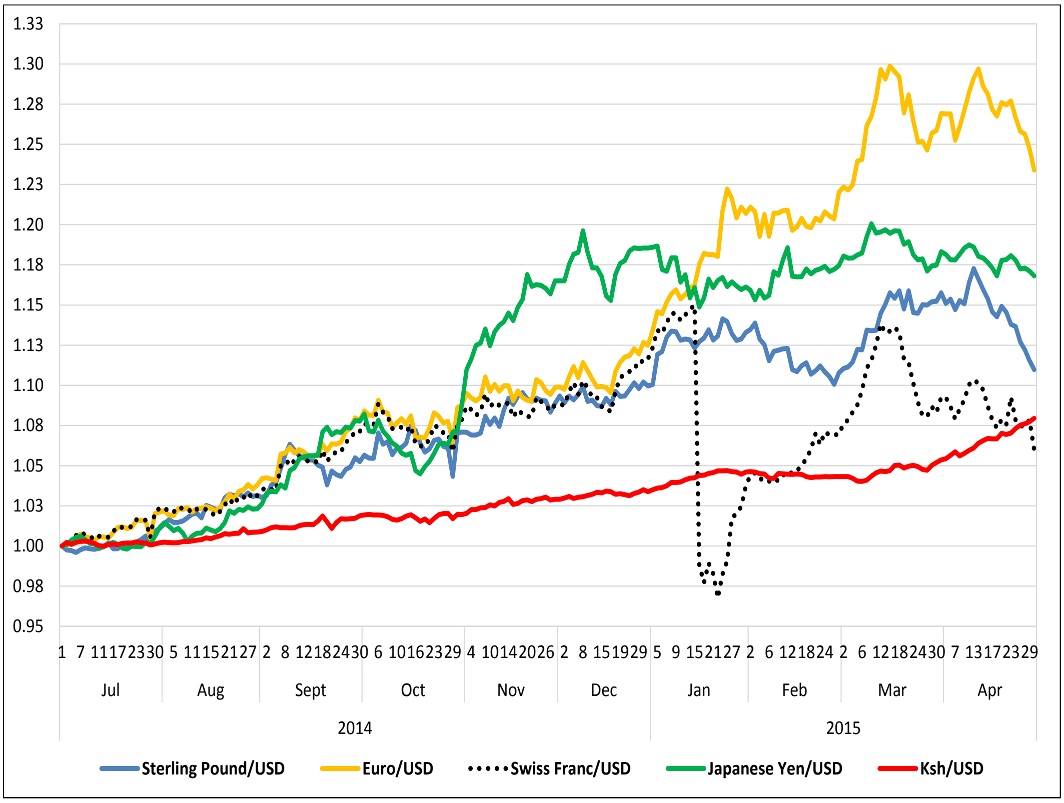
3.3 Exchange Rates

Despite short-term pressures arising from the global strengthening of the US Dollar, the exchange rate of the Kenya Shilling maintained a stable depreciation trend against the US Dollar during most of the six months to April 2015. However, the foreign exchange market came under significant pressure in April 2015 on account of the seasonal dividend remittance by corporates. As shown in Chart 4a and 4b, the depreciation trend with respect to the US Dollar was reflected across the major international currencies – Euro, Pound Sterling, Japanese Yen and Swiss Franc – and regional currencies – South African Rand, Ugandan Shilling and Tanzanian Shilling. These currencies depreciated faster and were more volatile against the US Dollar compared to the Kenya Shilling. Specifically, the Kenya Shilling depreciated by 4.3 percent between January and April 2015; the Ugandan Shilling by 8.8 percent; the Tanzanian Shilling by 14.0 percent; and the Euro by 10.9 percent.

The global strengthening of the US Dollar largely reflected the strong recovery in the US economy which bolstered the demand for US dollar denominated assets. The strong US Dollar in the global currency markets was also attributed to expectations of lower interest rates in the Eurozone following adoption of QE by the European Central Bank (ECB) in January 2015 coupled with the weak growth recovery in the Eurozone. The removal of the Swiss Franc cap to the Euro by the Swiss National Bank in January 2015 in anticipation of the QE by the ECB caused volatility in the European markets. The Kenya Shilling exchange rate continued to be supported by the resilient foreign exchange inflows through diaspora remittances. Interventions by the CBK through direct sales of foreign exchange to commercial banks stopped short-term volatility in the foreign exchange market during the period.

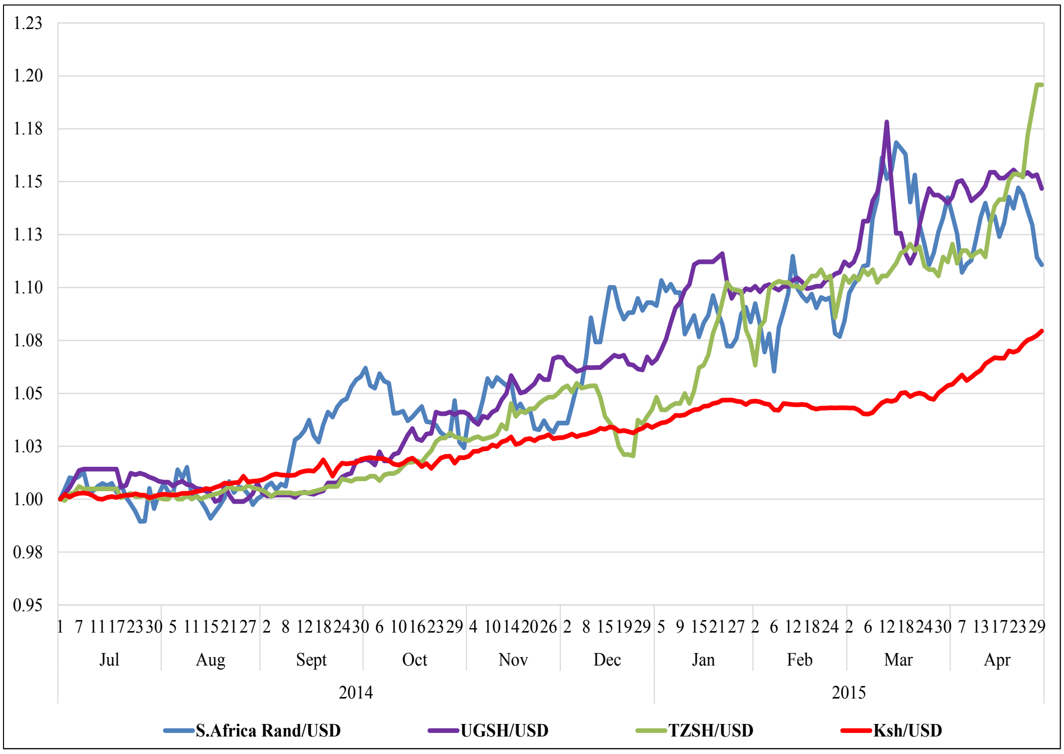
The CBK level of usable foreign exchange reserves stood at USD 6,859.58 million (equivalent to 4.40 months of import cover) at the end of April 2015. This level of reserves was augmented by the precautionary access under a blended Stand-By Arrangement and Standby Credit Facility negotiated between the Government of Kenya and the IMF approved in January 2015 to protect against any balance of payments shocks. This has boosted the Bank's capacity to respond to short-term volatility in the foreign exchange market.

Chart 4a: Normalised Exchange Rates of the Kenya Shilling and Major International Currencies against the US Dollar (1st July 2014 = 1)



Source: *Central Bank of Kenya*

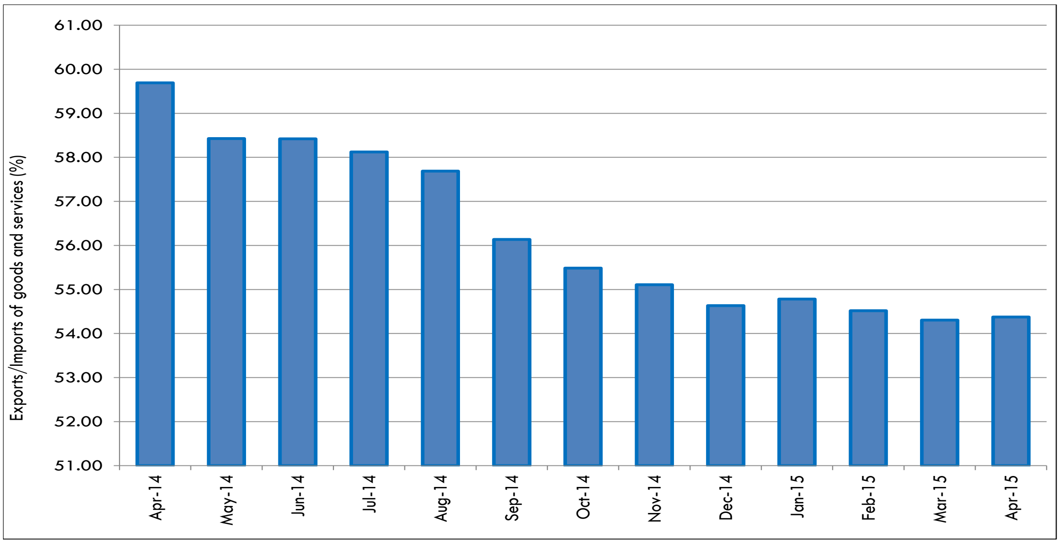
Chart 4b: Normalised Exchange Rates of the Kenya Shilling and Major Currencies in the Region against the US Dollar (1st July 2014 = 1)



Source: *Central Bank of Kenya*

The movements in the exchange rate of the Kenya Shilling against the US Dollar in the six months to April 2015 also reflected the higher demand for the US Dollar following increased economic activity and imports coupled with reduced supply (Chart 5). The 12-month cumulative proportion of imports of goods and services financed by exports of goods and services decreased from an average of 57.4 percent in the six months to October 2014 to 54.4 percent in the six months to April 2015. Foreign exchange earnings from tea and tourism which constitute a significant part of Kenya's foreign exchange earners slowed down mainly on account of the weak global demand and lower tea prices. There has also been an increase in imports of machinery and equipment, which was mainly towards infrastructure development as well as modernisation of the aircraft fleet at the Kenya Airways. Imports of machinery and other equipment accounted for about 30.5 percent of total imports in the 12-months to April 2015. These are essential for enhancing the future productive capacity of the economy. However, the lower international oil prices provided some relief with respect to demand for foreign exchange to finance petroleum product imports.

Chart 5: Trend in the 12-Month Exports/Imports of Goods and Services (%)



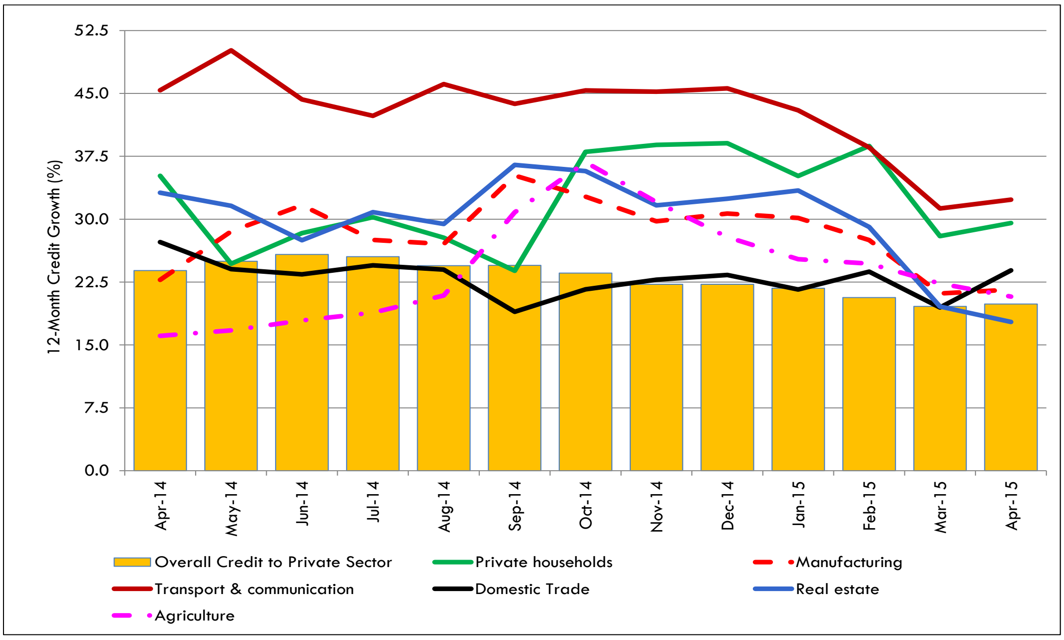
***Source**: Kenya National Bureau of Statistics*

3.4 Credit to Private Sector

Growth in bank credit to private sector remained strong between November 2014 and April 2015 with demand sustained by improved economic activity and continued investor confidence in the economy. However, the 12-month annual growth in overall private sector credit decelerated from 23.6 percent in October 2014 to 19.9 percent in April 2015, which was consistent with the projected non- inflationary growth path in the monetary programme (Chart 6). The growth in private sector credit in the period was channelled towards key sectors of the economy including agriculture, manufacturing, trade, transport and communication, finance and insurance, real estate and construction. The ratio of gross non-performing loans to gross loans increased from 5.4 percent in October 2014 to 5.8 percent suggesting a modest rise in credit risk. However, the banking sector continued to build capital buffers to mitigate against any adverse business cycle effects.

The monetary policy stance adopted by the MPC is expected to continue supporting a non-inflationary credit expansion to the key sectors of the economy in the remainder of financial year 2015/16.

Chart 6: Annual Growth in Private Sector Credit (%)



Source*: Central Bank of Kenya*

4. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

During the period November to April 2015, the MPC continued to hold bi-monthly stakeholder forums with Chief Executive Officers of commercial banks through the KBA Governing Council. The Committee continued to improve on the information gathering processes through the bi-monthly Market Perceptions Surveys and communication with key stakeholders on the MPC decisions to obtain feedback. The MPC also continued to improve on its Press Releases by simplifying them and making them better focused to the public, media, financial sector and other stakeholders. Consequently, the media and public understanding of monetary policy decisions and their expected impact on the economy has continued to be enhanced.

The Chairman of the MPC accompanied the Cabinet Secretary for the National

Treasury to a meeting with the Senate Standing Committee on Finance, Trade and Budget in December 2014. The meeting discussed various issues including factors contributing to the weakening of the Kenya Shilling, banks' lending rates and Government policy initiatives to increase availability of credit as well as lower interest rates, relationship between interest rates and exchange rates, the impact of the introduction of the KBRR, and the impact of recently floated Euro Bond on interest rates.

As part of enhancing its responsibility, MPC members participated in various conferences locally and internationally over the period covered by this Report. The conferences enable MPC members to share their experiences with other policy experts on critical challenges underlying monetary policy effectiveness in developing countries under different monetary policy frameworks and facing different macroeconomic shocks. MPC members also held meetings with various investors during the period in order to brief them on economic developments and the outlook for the economy. The MPC prepared various briefs on economic and financial developments which were presented in the various local and international meetings.

5. CONCLUSION

The monetary policy measures used to operationalize the MPC policy decisions in the six months to April 2015 contributed to stability in the inflation rate, which remained within prescribed target range despite volatility in the global currency markets. The ongoing Government measures to promote foreign direct investment and implementation of policies to promote exports and consumption of locally produced goods will support the long-term stability of the exchange rate. This will support the overall price stability objective of the CBK.

The MPC will continue to monitor developments in the domestic and global economy and take appropriate measures to sustain price stability.

APPENDIX: CHRONOLOGY OF EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2014 - APRIL 2015)

Date	Events
November 2014	a. The CBK sold a net of USD 127.5 million in line with the CBK's exchange rate policy. b. Expansion of agency banking network in the country with National Bank of Kenya partnering with Postbank
December 2014	a. The CBK sold a net of USD 85.0 million in line with the CBK's exchange rate policy. The Bank also purchased USD 815 million from the Government proceeds of the re-opened Sovereign Bond. b. Mauritius Commercial Bank Limited opened a representative office in Nairobi
January 2015	The CBK sold USD 93.0 million directly to commercial banks in line with the CBK's exchange rate policy.
February 2015	The CBK purchased USD 50.0 million offered by commercial banks in line with the CBK's exchange rate policy.
March 2015	The CBK sold a net of USD 43.0 million in line with the CBK's exchange rate policy.
April 2015	a. The CBK sold USD 263.0 million directly to commercial banks in line with the CBK's exchange rate policy. b. The Garissa terrorist attack on 2nd April, 2015 had implications on tourism performance.

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the month-on-month movement of price indices of all consumer 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 signals the CBK's monetary policy stance.

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

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

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

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

Repurchase Agreement (Repo): 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 limited by the CBK.

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

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

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