Central Bank of Kenya

Thirtieth Bi-Annual Report of the Monetary Policy Committee

April 2023

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 30th Monetary Policy Committee Report. The Report outlines the monetary policy formulation, developments in the key indicators of the economy, and other activities of the Committee in the six months to April 2023.

Dr. Patrick Njoroge

Governor

TABLE OF CONTENTS

MEMBERS OF THE MONETARY POLICY COMMITTEE

Dr. Patrick Njoroge
Governor

Mrs. Sheila M'Mbijjewe
Deputy Governor

Dr. Susan Koech
Deputy Governor

Dr. Margaret Chemengich
External Member

Dr. Chris Kiptoo
PS, The National Treasury

Prof. Jane K. Mariara
External Member

Dr. Benson Ateng'
External Member

Mr. Humphrey Muga
External Member

Mr. David Luusa
Director, Financial Markets

Prof. Robert Mudida
Director, Research

EXECUTIVE SUMMARY

The thirtieth 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 April 2023. The conduct of monetary policy during the period was aimed at achieving and maintaining overall inflation within the Government's target range of 2.5 percent on either side of the 5 percent medium-term target, which is consistent with the price stability objective of the Central Bank of Kenya (CBK).

Monetary policy in the period was conducted against a backdrop of increased global uncertainties, reflecting financial sector stability concerns in the advanced economies, volatile financial markets, weaker global growth outlook, continuing geopolitical tensions particularly the war in Ukraine, and continued tightening of monetary policy in advanced economies. Most currencies in emerging and developing economies weakened against the U.S. Dollar, due to the tightening of U.S. monetary policy. Nevertheless, inflation in the advanced economies continued to decline, following continued easing of global supply chain constraints, and declines in commodity prices particularly of oil and food.

The MPC held three meetings between November 2022 and April 2023, to review the outcome of its previous policy decisions and economic developments, and to put in place appropriate measures aimed at maintaining price stability. The MPC tightened further the monetary policy stance in the period to anchor inflation expectations attributed to the higher prices of food and fuel. In November 2022, the MPC raised the Central Bank Rate (CBR) from 8.25 percent to 8.75 percent, noting sustained inflationary pressures, and elevated global risks. The MPC retained the CBR at 8.75 percent in January 2023, noting that the impact of the tightening of monetary policy in November 2022 was still transmitting in the economy. Additionally, the MPC noted that the Government measures to allow duty-free imports on specific food items such as maize were expected to moderate domestic prices. In March 2023, the MPC raised the CBR to 9.50 percent from 8.75 percent, noting sustained inflationary pressures.

Consistent with the National Treasury's notification to the CBK on the price stability target for FY2022/23, the CBK provided a letter explaining the reasons why overall inflation has remained above the target and the measures that the MPC and CBK are taking to address the deviation. Overall inflation declined to 7.9 percent in April 2023, from 9.5 percent in November 2022, mainly driven by declines in food prices. Food inflation fell to 10.1 percent in April 2023 from 15.4 percent in November 2022, due to improved supply largely attributed to the rains. Fuel inflation increased to 13.2 percent in April from 11.6 percent in November 2022, mainly due to the scaling down of the fuel subsidy and increases in electricity prices. The NFNF inflation remained below 5 percent, reflecting the impact of monetary policy measures and easing prices of some imported goods. CBK continued to monitor the overall liquidity in the economy as well as any threats that could fuel demand driven inflationary pressures.

The performance of the economy remained resilient in 2022, largely driven by robust growth of the services sector. Real GDP grew by 4.8 percent in 2022 compared to a revised growth of 7.6 percent in 2021, supported by robust activity in the finance and insurance, information and communication, transport and storage, and accommodation and food services sectors. Nevertheless, the performance of the agriculture sector was subdued due to the unfavorable weather conditions experienced in the country. Leading indicators of economic activity pointed to continued resilient performance in the first quarter of 2023, supported by a wide range of sectors.

The foreign exchange market remained relatively stable, despite increased uncertainties in the global financial markets and a stronger U.S. Dollar. This stability was supported by strong receipts from exports of goods and services, as well as resilient remittances inflows. The current account deficit was estimated at 5.2 percent of GDP in the 12 months to April 2023 compared to 4.8 percent of GDP over a similar period in 2022, mainly reflecting an increase in imports particularly of oil. The CBK foreign exchange reserves, which stood at USD 6,508 million (3.62 months of import cover) at the end of April 2023, continued to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient in the six months to April 2023, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans stood at 14.6 percent in April 2023 compared to 13.8 percent in October 2022, reflecting increased NPLs in manufacturing, trade, financial services, personal and household, and building and construction sectors. Private sector credit growth remained resilient at 13.2 percent in April 2023, compared to 13.3 percent in October 2022.

The CBK continued to implement the reforms outlined in the White Paper on *Modernization of the Monetary Policy Framework and Operations*, that was published by the MPC in July 2021. These reforms are aimed at enhancing the effectiveness of monetary policy formulation and implementation.

The MPC held virtual meetings with CEOs of banks and non-bank private sector firms after every meeting, to provide the 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 continued to enhance the understanding of monetary policy formulation and implementation by the public.

The Bank continued to monitor and remained vigilant to the risks posed by developments in the domestic and global environment, including the war in Ukraine, on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The outlook for global growth remained uncertain in the six months to April 2023, largely reflecting concerns about financial sector stability in the advanced economies, continued geopolitical tensions particularly the ongoing war in Ukraine, and the pace of monetary policy tightening in the advanced economies. According to the IMF World Economic Outlook (WEO) for April 2023, global growth was expected to slowdown from 3.4 percent in 2022 to 2.8 percent in 2023, before improving slightly to 3.0 percent in 2024. The outlook for global growth in the April WEO was 0.1 percentage points lower than the forecast in the January 2023 WEO Update.

Growth in the advanced economies was expected to slow down to 1.3 percent in 2023 from 2.7 percent in 2022, mainly reflecting reduced economic activity due to higher interest rates and financial markets volatility. This slowdown also reflects the adverse effects of the ongoing war in Ukraine, and growing geoeconomics fragmentation. The growth forecast was, however, slightly higher by 0.1 percentage points compared to that in the January 2023 WEO Update. Most of the advanced economies were projected to experience a decline in growth in 2023, including the US (1.6 percent), Euro Area (0.8 percent), UK (-0.3 percent), and Japan (1.3 percent).

In the emerging markets and developing economies (EMDEs), growth was on average stronger than for advanced economies, but these prospects varied across regions. Growth in EMDEs was projected to slow down slightly, from 4.0 percent in 2022 to 3.9 percent in 2023, before recovering slightly to 4.2 percent in 2024. Growth in Russia was expected at 0.7 percent in 2023 and 1.3 in 2024 due to the tight trade and financial sanctions. In the Asia region, China's economic growth was expected to improve to 5.2 percent in 2023 from 3.0 percent in 2022, following the lifting of the stringent COVID-19 protocols. Growth in India was expected at 5.9 percent in 2023 from 6.8 percent in 2022, mainly driven by private consumption and private investment on the back of government policies to improve transport infrastructure and the business environment. In Sub-Saharan Africa (SSA), growth was projected at 3.6 percent in 2023 and 4.2 percent in 2024. Nigeria, South Africa, and Kenya were expected to grow by 3.2 percent, 0.1 percent, and 5.3 percent in 2023, respectively. In 2024, Nigeria is expected to grow by 3.0 percent, South Africa by 1.8 percent, and Kenya by 5.4 percent.

Global financial conditions have tightened, reflecting rising interest rates in major economies as central banks of advanced economies continue to tighten monetary policy. Although global inflation remained high in the period, it declined partly due to easing commodity prices in the global markets, particularly of oil and food. Inflation in the major economies including the US, UK and Eurozone declined to 4.9 percent, 8.7 percent, and 7.0 percent in April 2023, from 7.7 percent, 11.1 percent, and 10.6 percent, respectively, in October 2022. Global inflation was expected to decline from 8.7 percent in 2022 to 7.0 percent in 2023.

According to the April 2023 IMF WEO and Global Financial Stability Report, the unexpected failures of two specialized regional banks in the US in mid-March 2023 and the collapse of confidence in Credit Suisse, shook financial markets with bank depositors and investors re-evaluating the safety of their holdings and shifting away from institutions and investments perceived as vulnerable.

The risks to the global economic outlook are tilted to the downside reflecting persistent and broad-based inflation pressures and increased concerns that financial sector stress could amplify, weakening the real economy through a sharp deterioration in financing conditions. Further escalation of the war in Ukraine could also lead to more spikes in food and energy prices, pushing inflation up. Further, fragmentation into geopolitical blocs has the scope to generate large output losses, including through its effects on foreign direct investment.

2. DEVELOPMENTS IN THE KENYAN ECONOMY

2.1 Overall Economy

Despite adverse effects of domestic and external shocks, the Kenyan economy remained resilient in 2022 supported by non-agriculture sectors. The economy expanded by 4.8 percent, compared to a revised growth of 7.6 percent in 2021. Growth of the economy was largely driven by robust performance of the services sector which expanded by 7.0 percent compared to 9.8 percent in 2021, and contributed 3.9 percentage points to real GDP growth. The strong performance was supported by robust activity in the finance and insurance, information and communication, transport and storage, and accommodation and food services sectors. Growth in the industrial sector slowed to 3.9 percent down from 7.5 percent in 2021, mainly due to a deceleration in growth of the manufacturing sector to 2.7 percent from 7.3 percent in 2021. The latter was largely on account of low agro-processing activity following subdued performance of the agriculture sector.

The performance of the agriculture sector remained subdued due to the unfavorable weather conditions experienced in the country. The sector contracted further by 1.6 percent in 2022 compared to a contraction of 0.4 percent in 2021. The poor performance was reflected in depressed crop and livestock production which were negatively affected by adverse weather conditions experienced during the period **(Table 1)**.

The main upside risks to growth are a faster than expected decline in international oil prices, better than expected improvement in weather conditions as well as faster than expected implementation of proposed Government projects which are expected to support growth prospects. Downside risks to growth remain significant and include escalation of the war in Ukraine which may further strain global supply chains, further acceleration of inflation and economic decline in advanced economies, and accelerated policy tightening in advanced economies which could lead to financial stress in emerging markets and developing economies.

Table 1: Real GDP growth (percent)

Growth Rates	2021				2021 Annual	2022				2022 Annual
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
1. Agriculture	**-0.6**	**-1.8**	**-0.6**	**2.1**	**-0.4**	**-1.7**	**-2.4**	**-1.3**	**-0.9**	**-1.6**
2. Non-Agriculture (o/w)	**3.1**	**14.0**	**11.4**	**10.0**	**9.5**	**8.2**	**7.1**	**5.3**	**4.7**	**6.3**
2.1 Industry	**4.1**	**9.2**	**9.0**	**7.7**	**7.5**	**5.6**	**5.0**	**2.6**	**2.4**	**3.9**
Mining & Quarrying	10.4	10.6	16.0	35.5	18.0	23.8	16.6	-4.5	1.6	9.3
Manufacturing	2.0	11.1	10.5	6.2	7.3	3.8	3.6	1.8	1.8	2.7
Electricity & water supply	3.9	7.7	7.1	3.8	5.6	3.2	5.6	6.0	4.9	4.9
Construction	6.2	6.9	6.7	7.0	6.7	6.0	4.5	3.5	2.4	4.1
2.2 Services	**2.9**	**14.9**	**12.0**	**10.1**	**9.8**	**8.9**	**8.0**	**5.9**	**5.3**	**7.0**
Wholesale & Retail Trade	8.8	10.3	6.6	6.7	8.0	4.9	4.1	3.6	2.7	3.8
Accommodation & Food Services	-28.3	69.7	145.1	120.8	52.6	40.1	44.0	16.9	14.9	26.2
Transport & Storage	-7.9	18.5	14.6	7.0	7.4	7.5	7.0	4.8	3.2	5.6
Information & Communication	5.1	11.8	1.4	6.9	6.1	9.0	11.2	11.8	8.0	9.9
Financial & Insurance	10.1	13.2	10.6	11.8	11.5	17.0	16.1	9.6	9.4	12.8
Public administration	7.2	8.2	5.3	3.6	6.0	6.2	3.8	3.4	4.7	4.5
Professional, Admin. & Support Services	-12.3	20.0	15.3	9.6	7.1	13.4	10.9	8.9	5.2	9.4
Real estate	6.0	6.8	7.1	6.8	6.7	6.0	5.0	4.0	2.9	4.5
Education	12.0	34.4	30.9	18.4	22.8	4.7	4.4	3.8	6.0	4.8
Health	7.9	9.5	7.1	10.8	8.9	5.7	4.4	3.7	4.3	4.5
Other services	-8.5	28.6	17.5	16.9	12.5	8.9	4.3	5.7	4.0	5.7
FISIM	5.9	3.6	5.0	6.5	5.3	0.7	1.3	2.3	1.6	1.5
2.3 Taxes on products	**2.4**	**19.2**	**12.5**	**14.6**	**11.9**	**9.5**	**6.1**	**7.1**	**5.4**	**7.0**
Real GDP Growth	**2.4**	**10.3**	**9.4**	**8.6**	**7.6**	**6.3**	**5.2**	**4.3**	**3.8**	**4.8**

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

2.2 Financial Market Developments

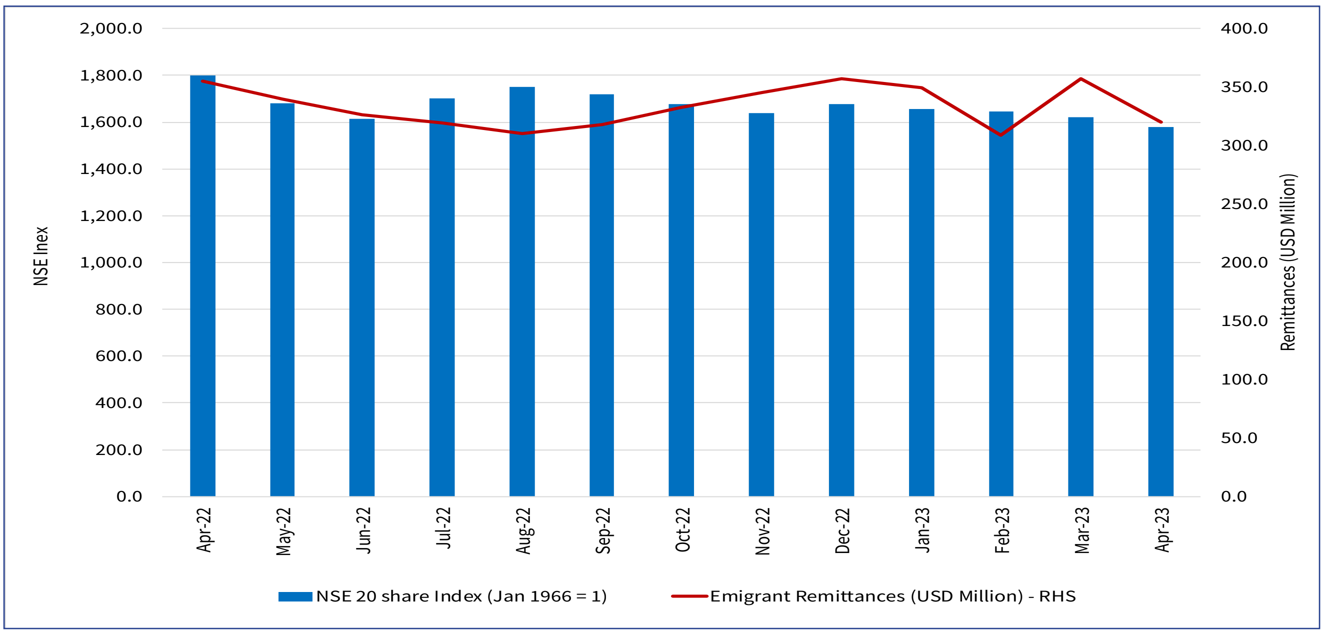
According to the IMF WEO April 2023, signs that global economic recovery was on an upward trajectory have receded amid persistent inflation and recent financial sector turmoil in advanced economies. Although inflation has declined as central banks have raised interest rates and food and energy prices have come down, underlying price pressures are proving sticky, with labor markets tight in a number of economies. Side effects from the fast rise in policy rates have become apparent, as banking sector vulnerabilities come into focus and fears of contagion rising across the broader financial sector, including nonbank financial institutions.

During the six months to April, financial stability risks rose significantly as the resilience of the global financial system faced a number of tests. The collapse of Silicon Valley Bank and Signature Bank in the United States, and the loss of market confidence in Credit Suisse, a global systemically important bank (GSIB) in Europe, brought to the fore the challenges posed by the interaction between tighter monetary and financial conditions and the buildup in vulnerabilities. The US dollar continued to appreciate, spurred by stronger-than-expected U.S. economic data and a corresponding change to expectations of interest rate hikes by the Federal Reserve Bank.

Having fallen below parity with the U.S. dollar in the second half of 2022, the Euro recovered in 2023. With the potential reduction of rate hikes by the US Fed, the interest rate spreads is expected to narrow in 2023. The Sterling Pound appreciated during the period, fueled primarily by better-than-expected economic data and a weakened U.S dollar.

In the domestic economy, diaspora remittances remained strong over the period **(Chart 1a)**. Neverthless, activity at the Nairobi Securities Exchange (NSE) remained subdued amidst a challenging in economic environment with the NSE 20-Share index declining from 1,866.6 points in April 2021 to 1,604.74 in April 2023.

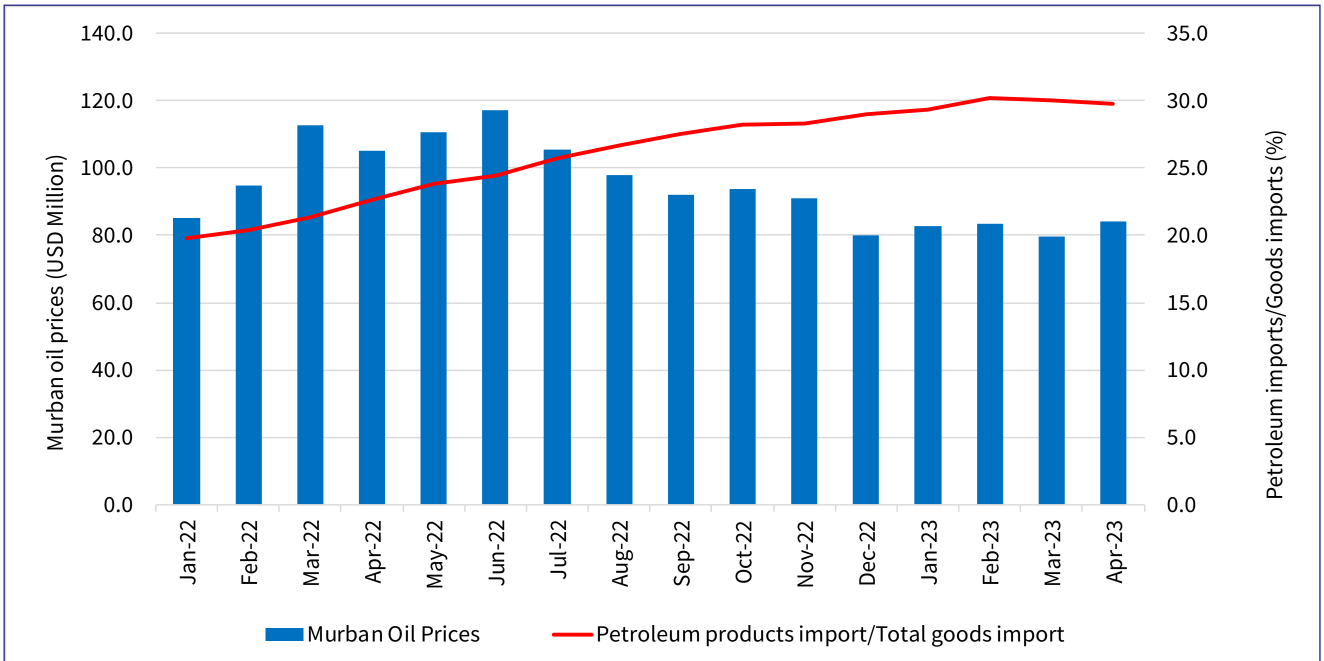
Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE 20 share Index (Jan 1966=100)



Source: Central Bank of Kenya and Nairobi Securities Exchange

Developments in international oil prices have implications on the balance of payments position, particularly when the proportion of imports of petroleum products in total imports is high. International oil prices declined in the six months to April 2023 owing to reduced demand from China amidst concerns over potential global recession. China's lower-than-expected 5.2 percent GDP growth target for 2023, remained an overhang on oil prices. **(Chart 1b)**.

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



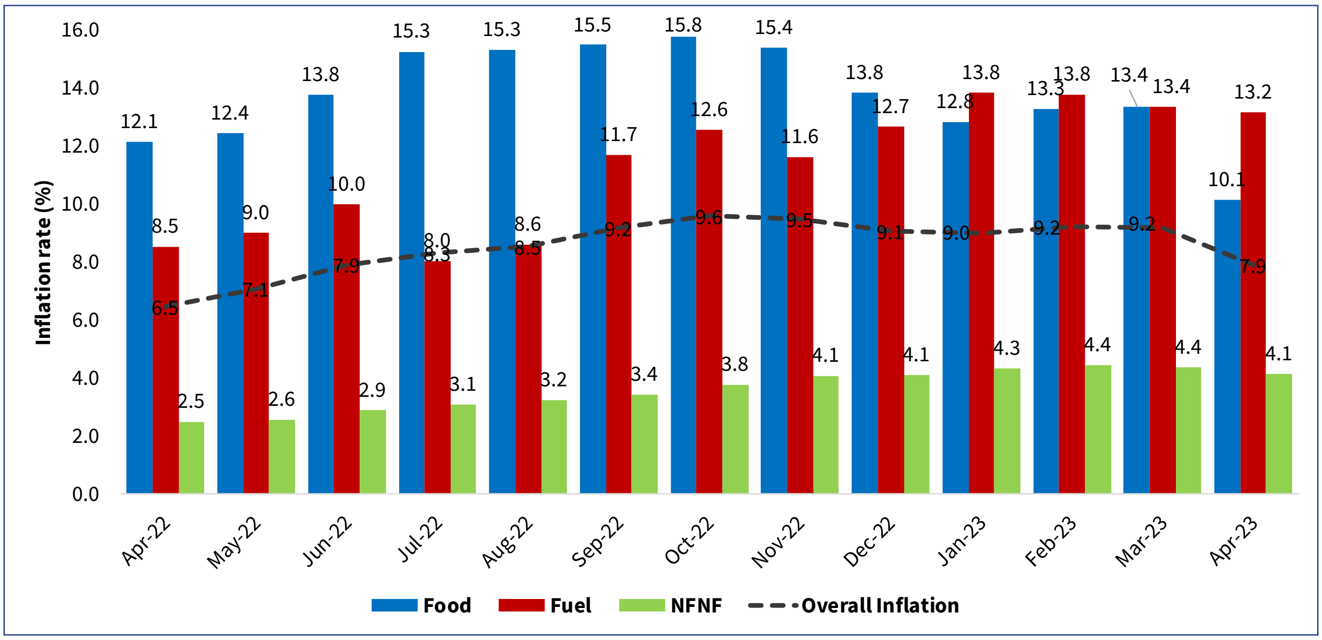
Source: Oil price.com and Kenya Revenue Authority

2.3 Developments in Key Economic Indicators

2.3.1 Inflation

Overall inflation during the six months to April 2023 was mainly driven by supply side factors. The inflation rate declined to 7.9 percent in April 2023 from 9.6 percent in October 2022 following improved weather conditions that resulted in enhanced supply of vegetables. Food inflation declined to 10.1 percent from 15.8 percent due to lower food prices, supported by the onset of long rains, increased imports of key food items such as maize, wheat and edible oils, and easing international food prices. Fuel inflation remained elevated during the period reflecting the impact of the unwinding of the fuel subsidy programme and upward review of electricity tariffs. It increased to 13.2 percent in April 2023 from 12.6 percent in October 2022. Non-Food-Non-Fuel (NFNF) inflation remained low reflecting muted demand pressures and the impact of monetary policy actions. It increased modestly to 4.1 percent in April 2023 from 3.8 percent in October 2022, partly on account of the second order effects of rising energy and transport costs **(Chart 2a)**.

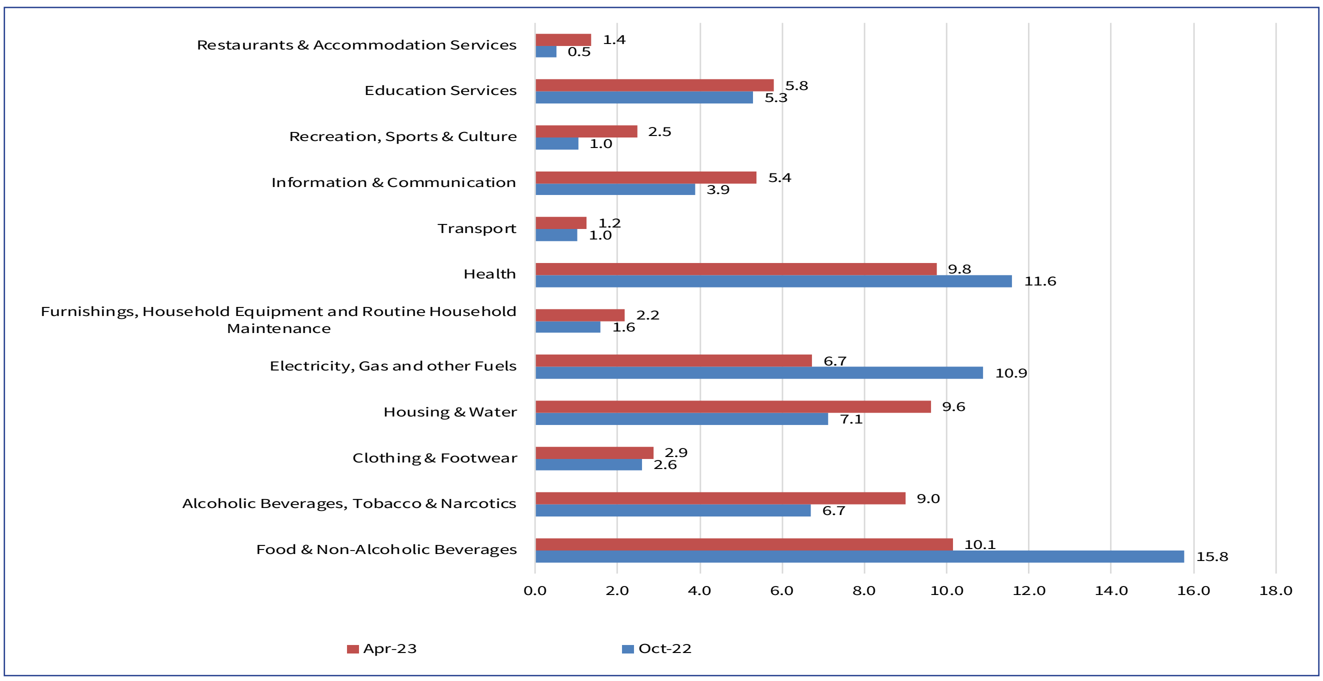
Chart 2a: Inflation by broad category (y/y, percent)



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

The inflation rates across the broad CPI categories declined except those of housing and water, information and communication, education services, and alcoholic beverages, tobacco and narcotics category **(Chart 2b)**.

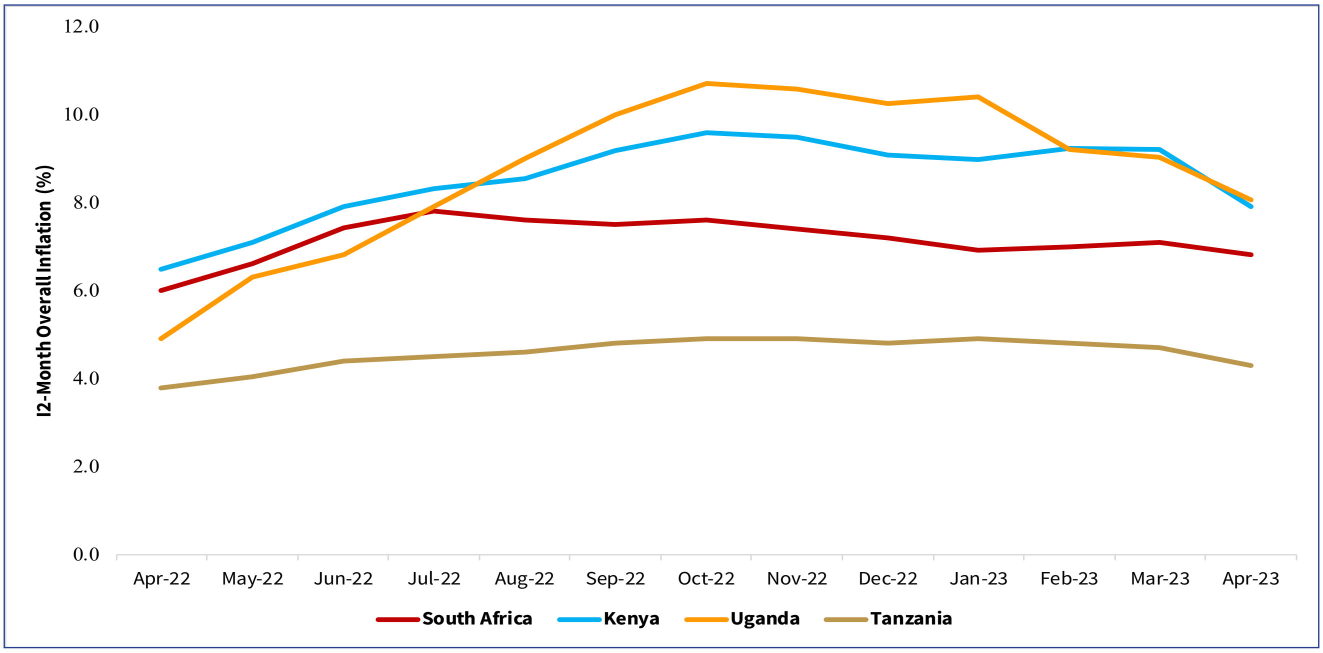
Chart 2b: Inflation by CPI basket categories (y/y, percent)



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

During the six months to April 2023, overall inflation rates of major East African Community (EAC) countries, and South Africa declined. Food and energy prices were the main drivers of inflation in these countries in the period **(Chart 2c)**.

Chart 2c: 12-Month Inflation in the region



Source:Respective country central bank websites

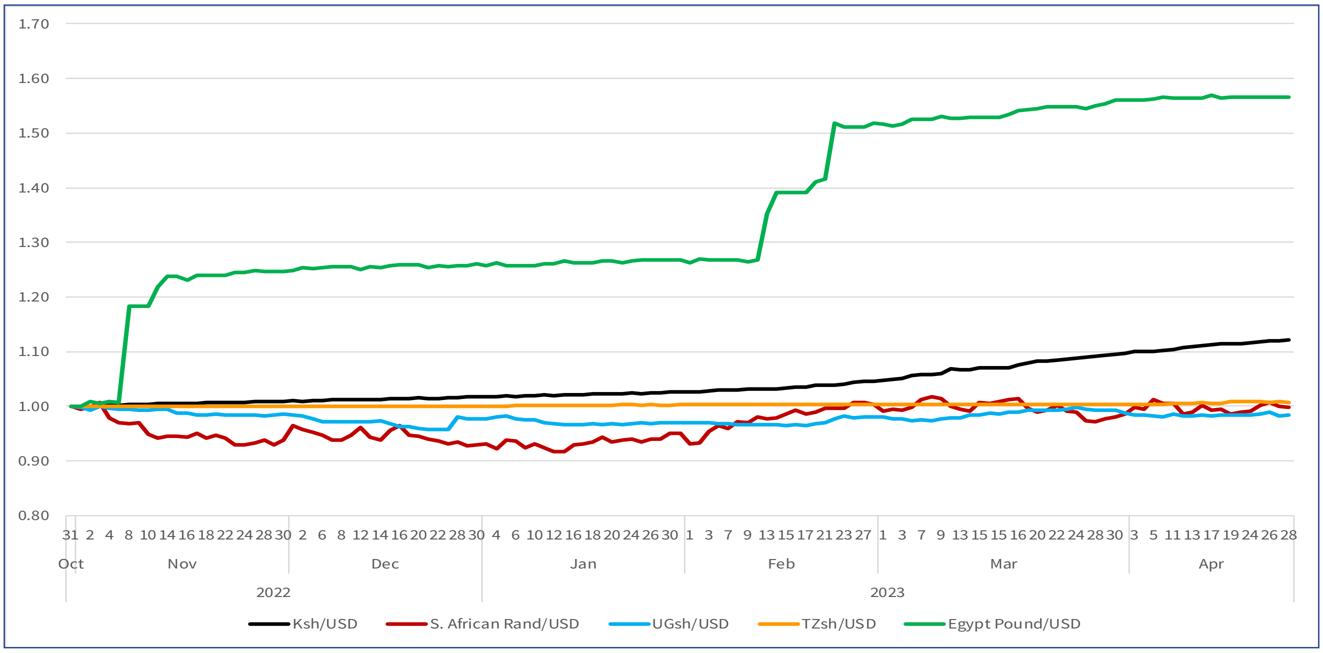
2.3.2 Foreign Exchange Market Developments

The foreign exchange market remained relatively stable in the six months to April 2023, supported by improvement in receipts from exports of goods and services as well as resilient remittances. However, there was some pressure from the strengthening of the U.S dollar against major currencies in the international market as well as rapid changes in interest rates of advanced economies in response to inflationary pressures. Diaspora remittances totaled USD 398.5 million in April 2023 compared to USD 355.0 million in April 2022.

The CBK foreign exchange reserves, which stood at USD 6,508 million (3.62 months of import cover) as at end April, continued to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market.

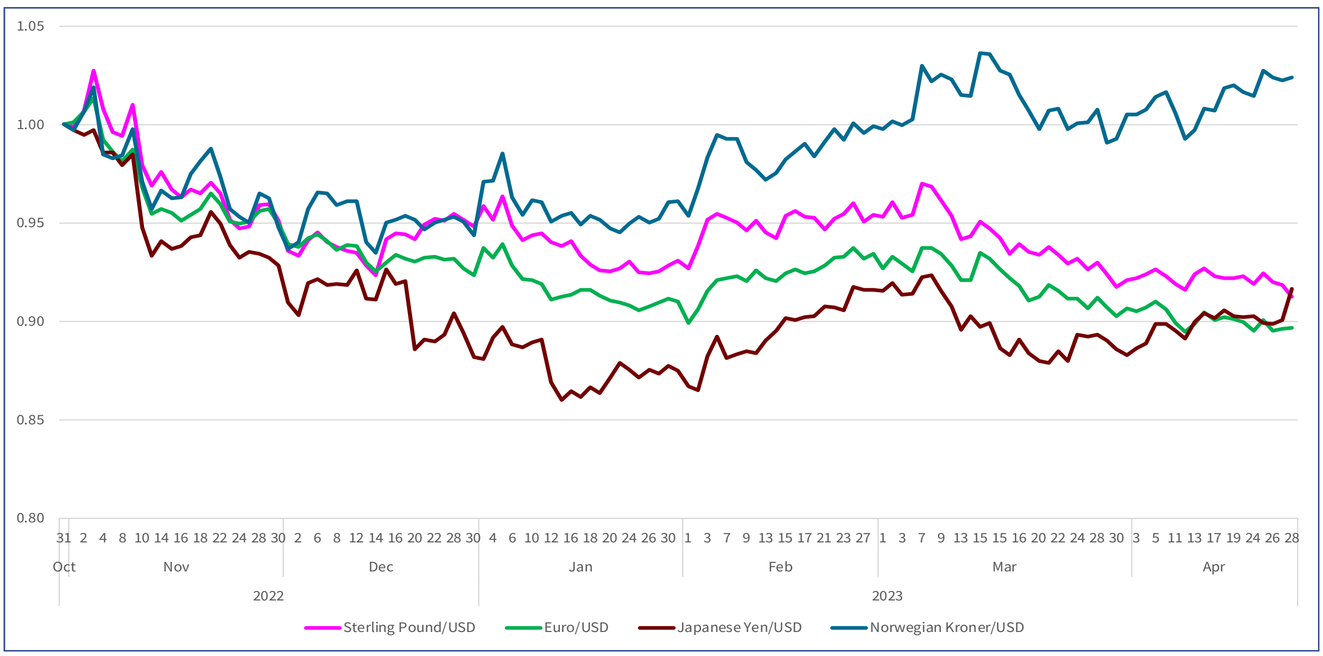
Global financial markets remained volatile during the period under review due to uncertainities from the ongoing war in Ukraine and tightening of monetary policy to contain inflation in the advanced economies **(Charts 3a and 3b)**. Kenya's external balance continued to support the stability of the Kenya Shilling. Most currencies in the region weakened against the U.S dollar in the period.

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar(October 31, 2022, = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of Major Currencies against the US Dollar (October 31, 2022, = 1)



Source: Central Bank of Kenya

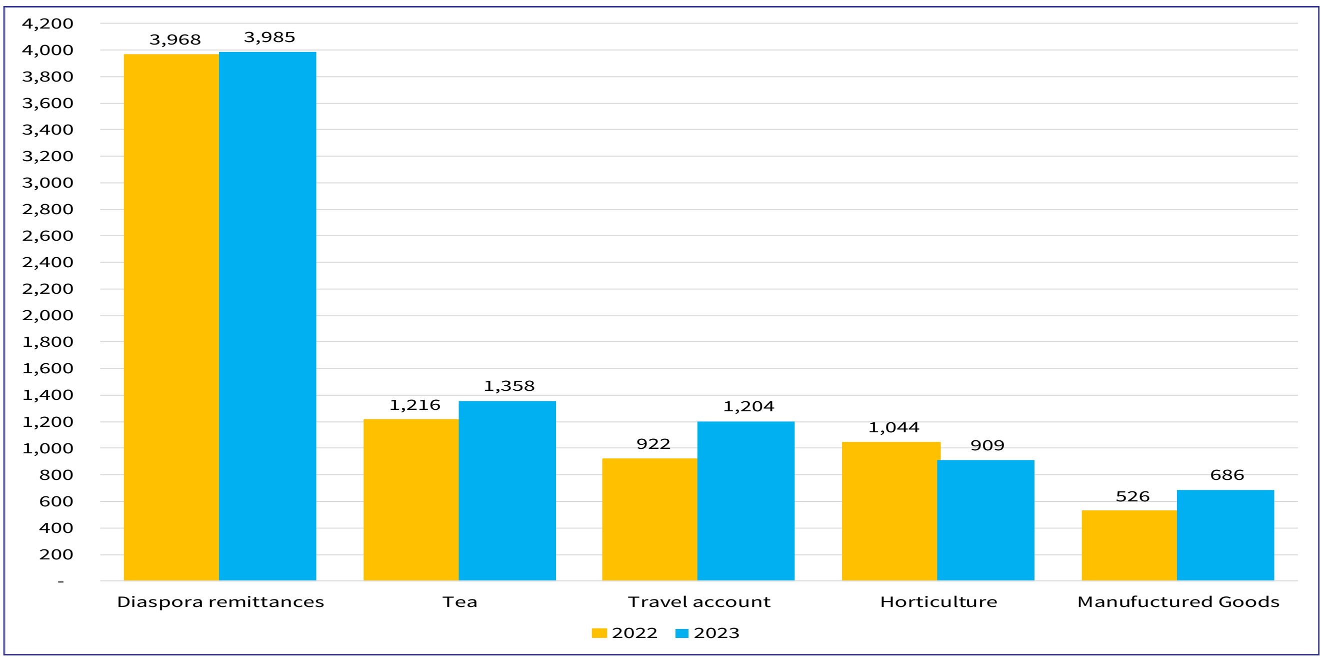
2.3.3 Balance of Payments Developments

In the 12-months to April 2023, the current account balance was a deficit of USD 5,812 million (5.2 percent of GDP), compared to a deficit of USD 5,420.8 million (4.9 percent of GDP) in a similar period in 2022. The current account deficit in percent of GDP narrowed due to a slower growth of imports amid increased receipts from agricultural and services exports as well as resilient remittances.

The deficit in the goods account narrowed to USD 11,229 million in the 12 months to April 2023, largely reflecting lower imports of infrastructure related equipment due to completed projects. The performance of exports improved by 6.6 percent to USD 7,376 million in the 12 months to April 2023, reflecting improved tea receipts as a result of increased demand from traditional partners. Receipts from tea and manufactured goods exports increased by 12 percent and 30 percent, respectively during the period. However, horticulture receipts fell by 13 percent due to a drop in earnings in 2022. Imports grew by 1.2 percent in the 12 months to April 2023 compared to 21.3 percent in a similar period in 2022. Imports of chemicals increased while those of machinery and manufactured goods decreased. Receipts from service exports increased reflecting sustained improvements in international travel and transport **(Chart 4a and Chart 4b)**.

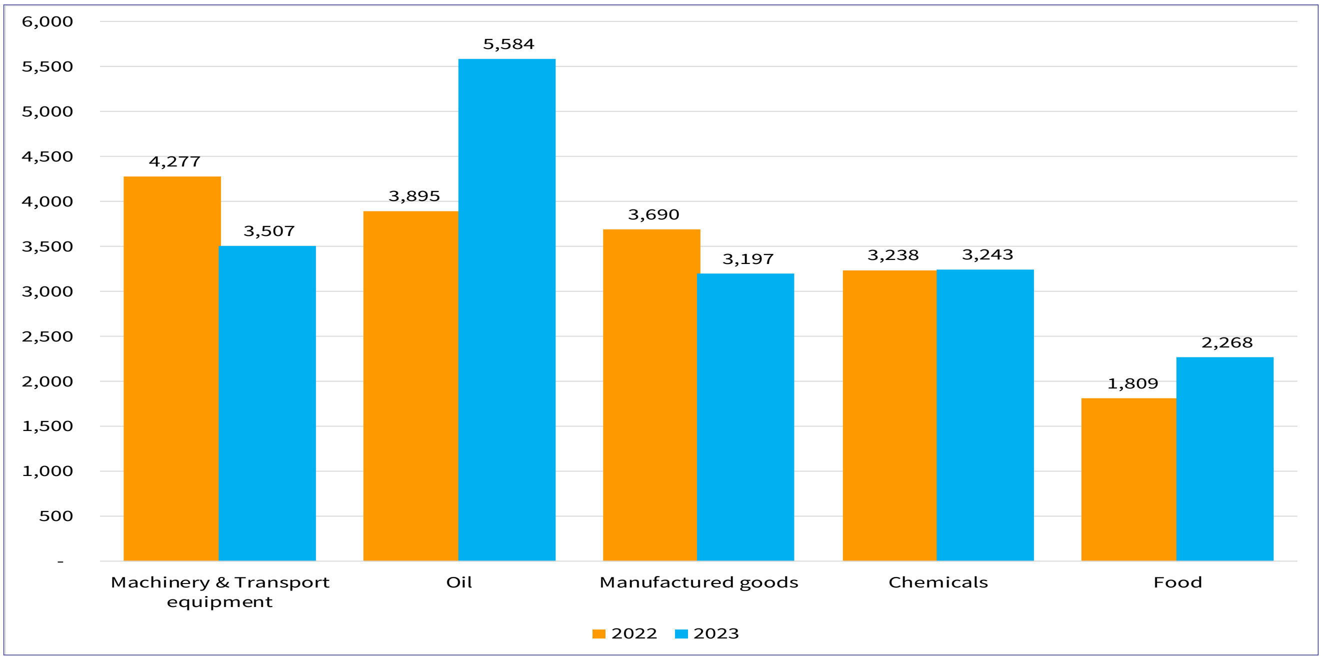
Financial account net inflows totaled USD 3,221 million in the 12-months to April 2023 from USD 5,462 million over a similar period in 2022. This largely reflected a decline in other investment inflows. The capital account on the other hand, recorded a surplus of USD 217.0 million in the 12-months to April 2023. Imports from China accounted for 19.1 percent of the total imports in the 12 months to April 2023, while United Arabs Emirates, India, the United States, and the United Kingdom accounted for 18.1 percent, 10.9 percent, 4.0 percent, and 1.7 percent, respectively.

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



Source: Central Bank of Kenya

Chart 4b: Imports by Major Categories in the 12-Months to April (USD Million)



Source: Central Bank of Kenya

The U.K. and U.S. accounted for 5.0 percent and 8.5 percent, respectively, of Kenya's total exports in the 12-months to April 2023. Exports to other trading blocs such as the EAC, COMESA and the EU accounted for 26.6 percent, 27.9 percent, and 19.7 percent, respectively, of total exports over the period, compared to 24.1 percent, 25.2 percent and 20.4 percent of total exports in the 12-months to April 2022 respectively.

2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the period ended April 2023, with strong liquidity and capital adequacy ratios. The average commercial banks liquidity and capital adequacy ratios stood at 48.6 percent and 18.9 percent respectively in April 2023. These were above the minimum statutory limits of 20.0 percent and 14.5 percent respectively.

Credit risk was elevated, with the ratio of gross non-performing loans (NPLs) to gross loans standing at 14.6 percent in April 2023, an increase from 13.8 percent in October 2022. Gross NPLs increased by 13.2 percent from Ksh.504.2 billion in October 2022, to Ksh.570.6 billion in April 2023 mainly due to adverse business conditions. The main sectors with increased NPLs are Manufacturing, Trade, Financial Services, Personal and Household, and Building and Construction.

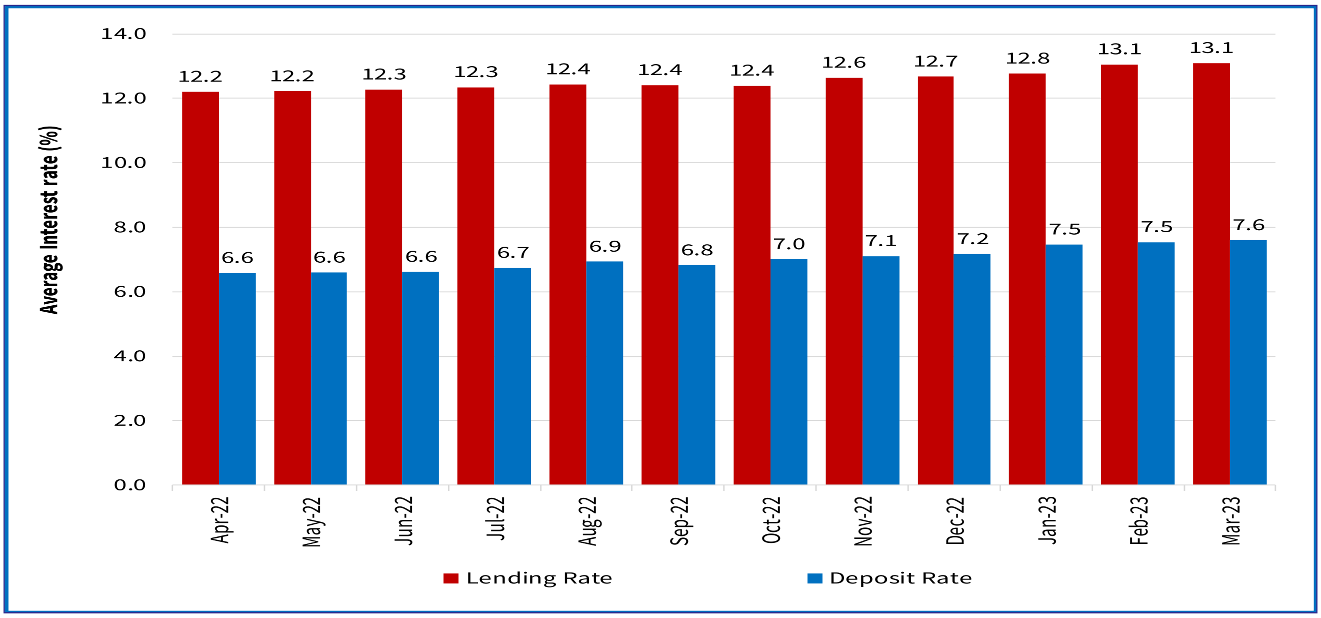
The total banking sector lending increased by 7.6 percent to Ksh.3,924.5 billion in April 2023, from Ksh.3,647.9 billion in October 2022. This was mainly driven by increased demand for loans in the Manufacturing, Real Estate, Building and Construction, Personal and Household, and Energy and Water sectors.

Customer deposits remained the main source of funding to the banks accounting for 71.7 percent of the banking sector's total liabilities and shareholders' funds as at April 2023. This was a slight decrease from 72.3 percent in October 2022. Customer deposits increased by 4.6 percent to Ksh.4,832.2 billion in April 2023, from Ksh.4,620.0 billion in October 2022.

Going forward, the banking sector is projected to remain resilient and stable. Credit risk is expected to remain elevated in the short to medium term. Liquidity risk is expected to remain stable while Operational risk is expected to remain elevated. Interest rate risk is expected to remain elevated.

Commercial banks' average lending rates increased during the review period, partly reflecting the tight monetary policy stance. The weighted average lending rate increased to 13.1 percent in March 2023 from 12.4 percent in October 2022, while the weighted average deposit rate increased to 7.6 percent from 7.0 percent **(Chart 5)**.

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



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Private sector credit growth remained resilient in the period, partly reflecting increased demand for working capital and resilience in economic activities. The 12-month growth in private sector credit was relatively unchanged at 13.2 percent in April 2023 compared to 13.3 percent in October 2022. Strong credit growth was observed in manufacturing, transport and communications, trade, business services, and consumer durables **(Table 2)**. Growth in private sector credit is expected to remain robust, supported by, among other factors, resilient economic activity, and the implementation of the Credit Guarantee Scheme for the vulnerable MSMEs.

Table 2: 12-Month Growth in Private Sector Credit (%)

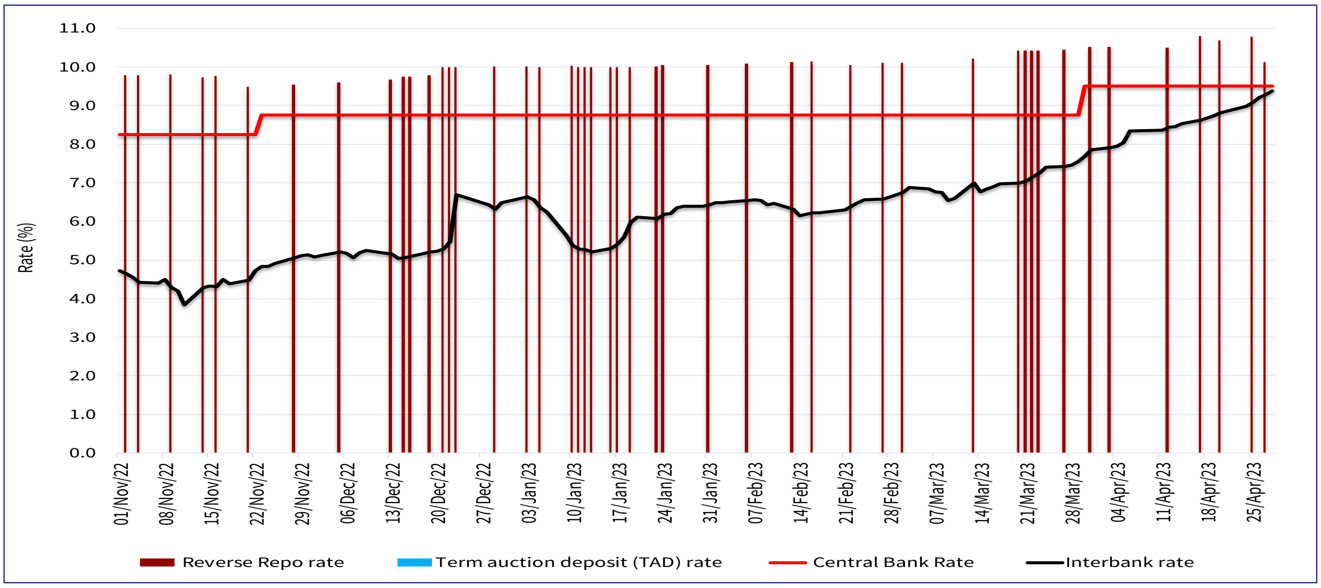
	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23
Total Credit to Private Sector	**11.5**	**11.9**	**12.3**	**14.2**	**12.5**	**12.9**	**13.3**	**12.5**	**12.5**	**11.5**	**11.7**	**11.6**	**13.2**
Agriculture	6.4	11.6	12.5	10.8	19.2	17.0	21.7	20.3	22.3	20.7	18.0	14.9	16.9
Manufacturing	12.0	15.5	15.2	16.1	15.2	14.2	17.5	14.9	13.8	13.8	15.2	15.8	21.7
Trade	10.7	9.1	11.6	15.2	13.3	16.4	15.3	14.3	11.4	11.1	11.8	11.9	13.7
Building & construction	8.2	9.0	13.9	14.1	11.5	12.5	8.0	6.0	8.2	5.8	3.0	5.8	4.2
Transport & communication	28.9	26.5	22.2	27.0	13.5	21.6	22.8	21.8	23.5	16.6	16.5	17.4	18.0
Finance and insurance	5.8	5.3	6.5	2.8	1.2	0.2	5.4	4.4	7.6	6.7	21.1	28.4	32.3
Real estate	0.8	0.8	0.5	1.7	1.0	0.1	1.6	2.8	3.2	3.3	2.9	2.3	2.4
Mining & quarrying	28.3	47.9	28.5	78.6	97.2	57.4	53.5	58.3	31.3	54.2	97.7	83.2	55.6
Private households	6.7	7.5	6.1	7.6	7.8	7.8	5.9	6.0	8.2	7.8	7.8	7.2	5.0
Consumer durables	16.1	15.1	14.7	14.8	14.3	14.4	14.0	12.6	12.9	12.5	12.4	12.7	13.3
Business services	12.2	11.3	15.2	16.9	16.1	12.5	13.2	14.5	13.7	13.7	13.5	9.3	12.5
Other activities	53.6	57.5	57.2	69.8	60.8	53.8	49.8	44.8	41.8	33.3	15.3	11.9	20.6

Source: Central Bank of Kenya

2.3.6 Interest rates

Short-term money market interest rates increased in the six months to April 2023, partly reflecting the monetary policy stance and tight liquidity conditions in the interbank market. The interbank interest rates increased, trending close to the CBR in April 2023. Open market operations remained active **(Chart 6a)**.

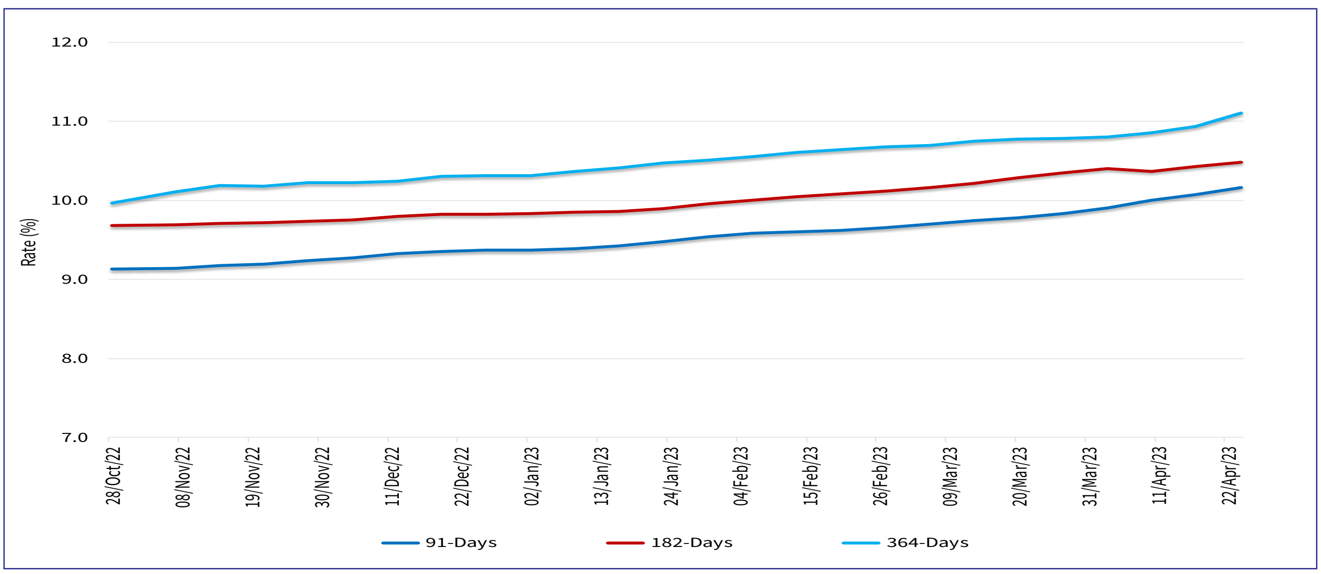
Chart 6a: Trends in Short Term Interest Rates (%)



Source: Central Bank of Kenya

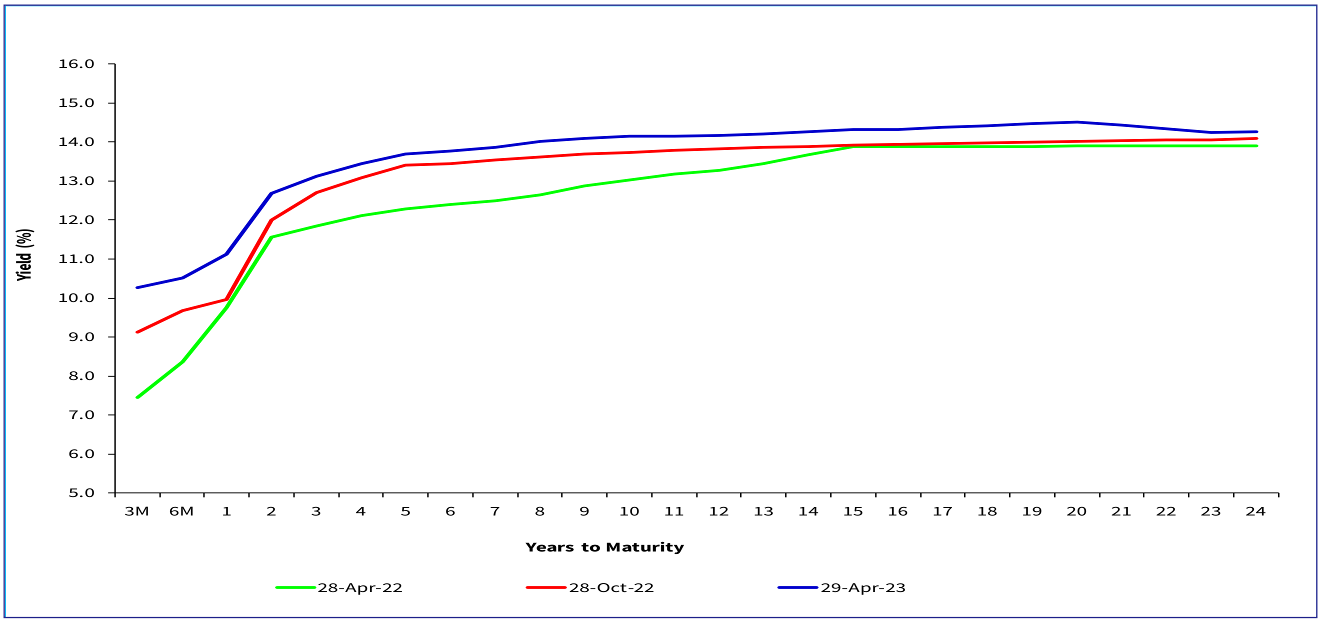
Interest rates on Government securities increased, with a stable normal yield curve during the period. This partly reflected effective coordination of monetary and fiscal policies, particularly in the implementation of the Government domestic borrowing programme **(Chart 6b and 6c)**.

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



Source: Central Bank of Kenya

Chart 6c: Government Securities Yield Curve



Source: Central Bank of Kenya

3.1 Attainment of Monetary Policy Objectives and Targets

During the six months to April 2023, 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 FY2022/23 was 5 percent with an allowable margin of 2.5 percent on either side. The CBK provided a letter to the National Treasury and Parliament explaining the factors which contributed to overall inflation remaining outside the target range in the period.

The CBR remained the base for monetary policy operations and its adjustments both in direction and magnitude signaled the stance of monetary policy. The monetary policy stance was 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). Monetary policy was conducted in the context of a flexible exchange rate regime.

The annual growth in the broad money (M3) and private sector credit remained optimal during the period under review. The 12-month growth in M3 and credit to the private sector stood at 9.4 percent and 13.2 percent respectively, in April 2023. The growth in M3 was largely supported by resilient growth in private sector credit during the period.

3.2 Implementation of Monetary Policy Reforms

The CBK continued to provide updates to the MPC regarding the status of implementation of the White Paper on Modernization of the Monetary Policy Framework and Operations, that was published in July 2021. The updates were provided in November 2022 and January 2023. The reforms will enhance the effectiveness of monetary policy and support anchoring of inflation expectations. These reforms focus on refining macroeconomic modelling and forecasting frameworks in line with changing structure of the economy, improving the functioning of the interbank market to strengthen monetary policy transmission and operations, and continued improvement of communication of monetary policy decisions.

3.3 Monetary PolicyCommittee Meetings and Decisions

Over the six months to April, the MPC held meetings on November 23, 2022, January 30, 2023, and March 29, 2023. These meetings were held against a backdrop of a weaker global growth outlook, decline in global commodity prices, easing inflationary pressures, geopolitical tensions, persistent uncertainties, and measures taken by authorities around the world in response to these developments. The meetings reviewed the outcomes of the MPC's previous decisions and measures implemented to mitigate the adverse economic impact and financial disruptions.

In the November meeting, the MPC noted that the global economic outlook had weakened further, reflecting the impact of the rapid tightening of monetary policy in advanced economies particularly the U.S., the ongoing war in Ukraine, and the lingering pandemic-related disruptions particularly in China. Inflation pressures showed signs of abating in some major economies but remained elevated mainly reflecting high energy prices and persistent supply chain challenges. Further, the Committee noted that volatility in global financial markets remained elevated amid significant U.S. dollar strength against major currencies and the rapid changes in policy stance in advanced economies in response to inflationary pressures. Inflation increased to 9.6 percent in October 2022 from 9.2 percent in September, mainly due to food and fuel prices. Food inflation rose to 15.8 percent in October from 15.5 percent in September, largely due to prices of maize and milk following reduced supply attributed to depressed rains, and edible oils and wheat products due to the impact of international supply chain disruptions.

Additionally, fuel inflation increased to 12.6 percent in October from 11.7 percent in September, mainly due to scaling down of the fuel subsidy, increases in electricity prices due to higher tariffs, and increases in transport costs. The MPC noted the GDP data for the second quarter of 2022 which indicated continued strong performance of the Kenyan economy, with real GDP growing by 5.2 percent. This performance reflected robust activity in transport and storage, wholesale and retail trade, information and communication, real estate, and financial and insurance. Leading economic indicators showed continued strong performance in the third quarter of 2022, supported by robust activity in a wide range of sectors. The economy was expected to remain strong in the last quarter of 2022, supported by the services sector despite subdued performance in agriculture and weaker global growth. The Committee noted the sustained inflationary pressures, the elevated global risks and their potential impact on the domestic economy and concluded that there was scope for a further tightening of the monetary policy in order to anchor inflation expectations. In view of these developments, the MPC decided to raise the CBR from 8.25 percent to 8.75 percent.

The January 2023 meeting was held against the backdrop of a weaker global growth outlook, decline in global commodity prices, easing inflationary pressures, geopolitical tensions, persistent uncertainties, and measures taken by authorities around the world in response to these developments. The global economic outlook improved with easing inflation pressures in major economies particularly in the U.S., as well as China's lifting of COVID-19 restrictions. Additionally, volatility in global financial markets moderated amid expectations of a slower pace of monetary policy tightening. Nevertheless, risks remained mainly reflecting geopolitical tensions particularly the ongoing war in Ukraine, and the pace of the monetary policy response in the advanced economies. GDP data for the third quarter of 2022 together with leading indicators showed that the Kenyan economy registered strong growth in 2022. Real GDP grew by 4.7 percent in the third quarter of 2022, mainly driven by robust activity in wholesale and retail trade, education, electricity and water, and real estate sectors. Based on available economic indicators, GDP was estimated to have grown by 5.6 percent in 2022. The economy was expected to remain resilient in 2023, supported by continued strong performance of the services sector and expected recovery in agriculture, despite the global uncertainties. The Committee noted that the impact of the further tightening of monetary policy in November 2022 to anchor inflationary pressures was still transmitting in the economy. Additionally, the MPC noted that this action would be complemented by Government measures to allow limited duty-free imports on specific food items, which were expected to moderate prices and further ease domestic inflationary pressures. The MPC concluded that the prevailing monetary policy stance remained appropriate, and therefore decided to retain the Central Bank Rate (CBR) at 8.75 percent.

The March 2023 meeting was held against a backdrop of continued global uncertainties, a weak global growth outlook, easing inflationary pressures, geopolitical tensions, and measures taken by authorities around the world in response to these developments. The MPC noted that domestic inflation pressures were expected to remain elevated in the near term, partly reflecting further increases in electricity prices. Nonetheless, the long rains were expected to moderate food inflation. Uncertainties in the global economic outlook had increased, reflecting concerns about financial sector stability in the advanced economies, continuing geopolitical tensions particularly the ongoing war in Ukraine, and the pace of monetary policy tightening in the advanced economies. Nevertheless, commodity prices in the global markets, particularly of oil and food, had been easing. Leading indicators of economic activity for the Kenyan economy showed strong performance of the Kenyan economy in the first quarter of 2023, reflecting robust activity in the services sector particularly wholesale and retail trade, accommodation and food services, education, and information and communication. The economy was expected to remain resilient in 2023 despite the global uncertainties, supported by continued strong performance of the services sector and expected recovery in agriculture. The Committee noted the sustained inflationary pressures, the elevated global risks and their potential impact on the domestic economy and concluded that there was scope for a further tightening of the monetary policy in order to anchor inflation expectations. In view of these developments, the MPC decided to raise the Central Bank Rate (CBR) from 8.75 percent to 9.50 percent.

4. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC Surveys conducted 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's Private Sector Market Perceptions Survey and CEOs Survey, revealed continuing optimism about economic growth prospects for 2023. Respondents attributed this optimism to firm and sector-specific growth opportunities, the onset of the long rains which was expected to boost agricultural activity and lower food prices in the near term, Government measures to strengthen agricultural production, support for businesses through the Hustler Fund, and the resilience of the private sector. The Agriculture Sector Survey revealed that high input costs, unpredictable weather conditions, as well as transport costs were the major factors constraining agricultural production.

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 background to MPC decisions and measures undertaken by the CBK to support macroeconomic stability.

The Governor also held virtual meetings with various potential investors and representative from the private sector 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 Bureau of Statistics (KNBS) on various data issues.

5. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to April 2023 continued to support price stability. 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 transmission of the monetary policy and other measures previously taken, and their effects on price stability. The CBK will also continue to implement the reforms outlined in the White Paper on *Modernization of The Monetary Policy Framework and Operations*, in order to enhance the effectiveness of monetary policy and support anchoring of inflation expectations.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2022 – APRIL 2023)

Date	Event of Relevance to Monetary Policy
November 2022	CBR raised from 8.25 percent to 8.75 percent.
December 2022	Reintroduction of charges for transactions between mobile money wallets and bank accounts, effective January 1, 2023. The charges were waived on March 16, 2020, as part of the emergency measures to facilitate use of mobile money in the context of the COVID-19 (Coronavirus) pandemic.
January 2023	Release of January 2023 IMF World Economic Outlook (WEO) Report showing that global growth was expected to fall to 2.9 percent in 2023 but rise to 3.1 percent in 2024. The 2023 forecast was 0.2 percentage point higher than predicted in the October 2022 WEO but below the historical average of 3.8 percent. Rising interest rates and the war in Ukraine continued to weigh on economic activity.
	CBR retained at 8.75 percent.
March 2023	Appointment of Dr. Susan J. Koech, as Deputy Governor by His Excellency President William S. Ruto, PhD., C.G.H.
	CBR raised from 8.75 percent to 9.50 percent.
April 2023	Release of April 2023 IMF World Economic Outlook (WEO) Report showing that growth was expected to fall from 3.4 percent in 2022 to 2.8 percent in 2023, before rising slowly and settling at 3.0 percent –– the lowest medium-term forecast in decades. The outlook reflected the tight policy stances needed to bring down inflation, the fallout from the deterioration in financial conditions, the continuing war in Ukraine, and growing geoeconomic fragmentation.

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the year-on-year 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 Reserves Ratio(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.

BANKI KUU YA KENYA
Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi |Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000

www.centralbank.go.ke | www.facebook.com/CentralBankKenya | @CbkKenya