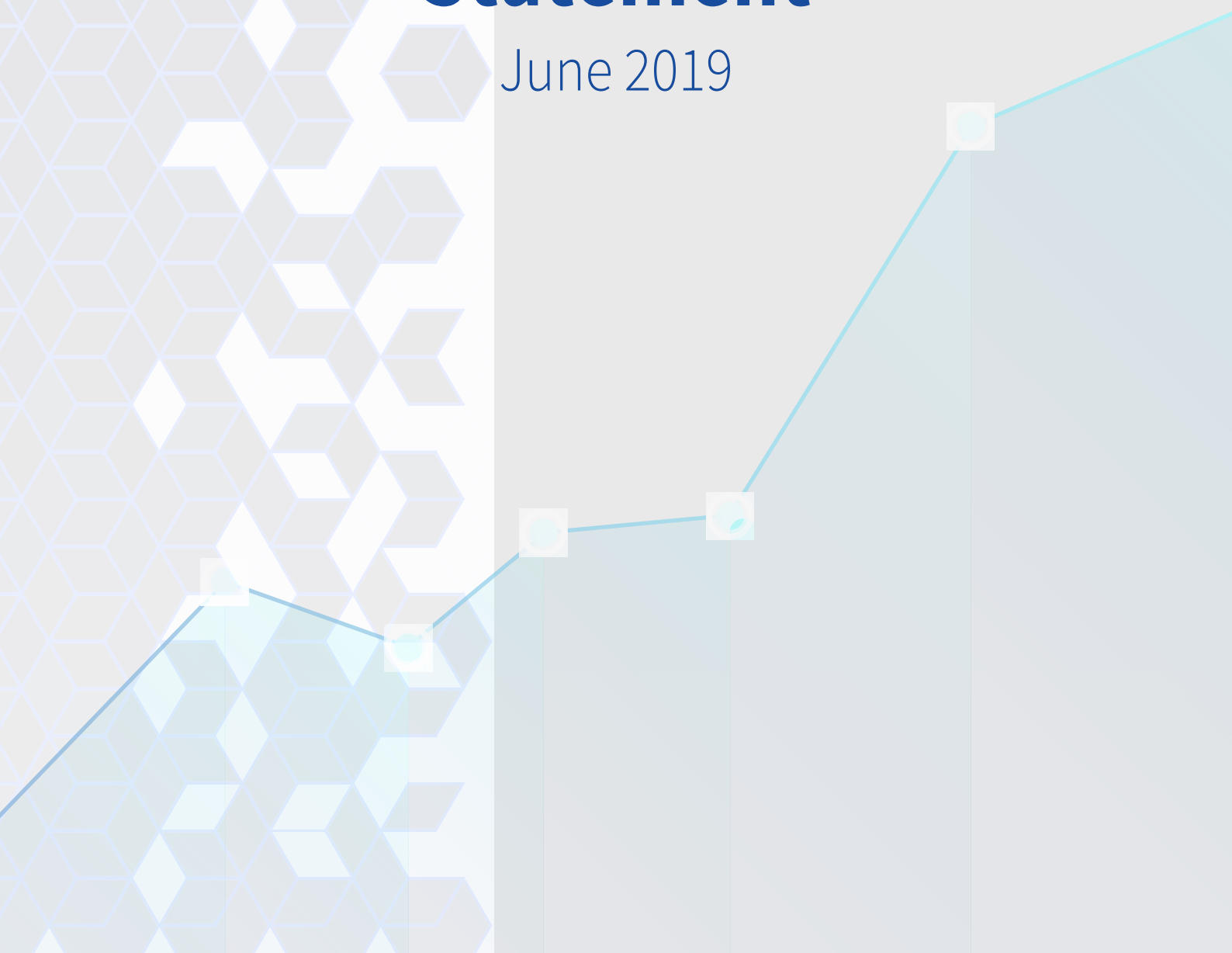


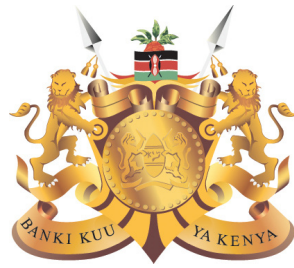
**Central Bank of Kenya**

# **Monetary Policy Statement**

June 2019







## LETTER OF TRANSMITTAL

In accordance with Section 4B 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 44<sup>th</sup> Monetary Policy Statement of the Central Bank of Kenya. It reviews and assesses the implementation of monetary policy during the first half of 2019 and outlines the direction of monetary policy for the next twelve months.

**Dr. Patrick Njoroge**

**Governor**

## CONTENTS

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LETTER OF TRANSMITTAL.....	I
THE PRINCIPAL OBJECTIVES OF THE CENTRAL BANK OF KENYA.....	III
INSTRUMENTS AND TRANSMISSION OF MONETARY POLICY.....	III
EXECUTIVE SUMMARY.....	V
1. INTRODUCTION.....	1
2. ACTIONS AND OUTCOMES OF THE POLICY STANCE IN THE FIRST HALF OF 2019.....	2
3. THE CURRENT ECONOMIC ENVIRONMENT AND OUTLOOK FOR FY 2019/20 .....	12
4. DIRECTION OF MONETARY POLICY IN THE FY 2019/20.....	14
ANNEX: EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (JANUARY-JUNE 2019).....	15
GLOSSARY OF KEY TERMS.....	16

## THE PRINCIPAL OBJECTIVES OF THE CENTRAL BANK OF KENYA

The role of the Central Bank of Kenya (CBK) is anchored in Section 231 of Kenya's Constitution and in the CBK Act. The CBK is responsible for formulating monetary policy to achieve and maintain price stability, and issuing currency.

The Bank also promotes financial stability through regulation, supervision and licensing of financial institutions under its mandate. It also provides oversight of the payments, clearing and settlement systems. Financial stability fosters liquidity, solvency and proper functioning of the financial system. The CBK formulates and implements the foreign exchange policy, and manages foreign exchange reserves. It is also the banker for, adviser to, and fiscal agent of the Government.

The CBK's monetary policy is designed to support the Government's objectives with respect to growth. The CBK formulates and conducts monetary policy with the aim of keeping overall inflation within the target prescribed by the National Treasury at the beginning of the financial year. Currently, this target is a range between 2.5 percent and 7.5 percent.

The achievement and maintenance of a low and stable inflation rate coupled with adequate liquidity in the market, facilitates higher levels of domestic savings and private investment. This leads to improved economic growth, higher real incomes and increased employment opportunities.

## INSTRUMENTS AND TRANSMISSION OF MONETARY POLICY

The CBK pursues its monetary policy objectives using the following instruments:

- **Open Market Operations (OMO):** This refers to actions by the CBK involving purchases and sales of eligible securities to regulate the money supply and the credit conditions in the economy. OMO can also be used to stabilise short-term interest rates. When the Central Bank buys securities on the open market, it increases the reserves of commercial banks, making it possible for them to expand their loans and hence increase the money supply. To achieve the desired level of money supply, OMO is conducted using:
  - i. **Repurchase Agreements (Repos):** A repo is a collateralized loan involving a contractual arrangement between two parties, in which one party sells a security at a specified price with a commitment to buy the security back at a later date. Both parties therefore, meet their investment goals of secured funding and liquidity. CBK Repos are conducted through auctions with tenors of 3 and 7 days and are for mopping up liquidity from the market. The Late Repo, sold in the afternoon, has a 4-day tenor and is issued at 100 basis points below the repo rate of the day. Reverse Repos, on the other hand, are for liquidity injections and involve purchase of securities from commercial banks. The current tenors for Reverse Repos are 7, 14, 21, and 28 days.
  - ii. **Term Auction Deposit (TAD):** The TAD is used 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. Currently, the tenors for such deposits at CBK are 14, 21, or 28 day periods. At maturity, the proceeds revert to the respective commercial banks.
  - iii. **Horizontal Repos:** Horizontal Repos are modes of improving liquidity distribution between commercial banks, and are conducted under CBK supervision. They are transacted between commercial banks on the basis of signed agreements using government securities as collateral, and have negotiated tenors

and yields. Commercial banks, short of deposits at the CBK, borrow from banks with excess deposits on the security of an appropriate asset, normally a government security. Horizontal Repos also help banks overcome the problem of limits to lines of credit, thus promoting more efficient management of interbank liquidity.

- **Central Bank Rate (CBR):** The CBR is reviewed and announced by the Monetary Policy Committee (MPC) at least every two months. Movements in the CBR, both in direction and magnitude, signal the monetary policy stance. In order to enhance clarity and certainty in monetary policy implementation, the CBR is the base for all monetary policy operations. Whenever the Central Bank is injecting liquidity through a Reverse Repo, the CBR is the lowest acceptable rate by law. Likewise, whenever the Bank wishes to withdraw liquidity through a Vertical Repo, the CBR is the highest rate that the CBK will pay on any bid received. However, to ensure flexibility and effectiveness of monetary policy operations in periods of volatility in the market, the CBK can raise the maximum acceptable interest rates on TAD to above the CBR. Movements in the CBR are transmitted to changes in short-term interest rates. A reduction of the CBR signals an easing of monetary policy and a desire for market interest rates to move downwards. Lower interest rates encourage economic activity and thus growth. When interest rates decline, the quantity of credit demanded should increase.

The efficiency in the Repo and interbank markets is crucial for the transmission of monetary policy decisions. The CBK monitors the overnight interbank money market. It responds to the tightness or slackness in the interbank market liquidity through OMO. Short-term international flows of capital are affected by short-term interest rates in the country. These are, in turn, affected by movements in the CBR and hence indirectly, the exchange rate could also be affected.

- **Standing Facilities:** The CBK does not have automatic standing facilities with respect to overnight lending. The CBK, as lender of last resort, provides secured loans to commercial banks on an overnight basis at a penal rate that is over the CBR. This facility is referred to as the Discount Window. Access to the Window is governed by rules and guidelines which are reviewed from time to time by the CBK. Banks making use of this facility more than twice in a week are scrutinised closely, and supervisory action taken.
- **The Cash Reserves Ratio (CRR):** In accordance with the law, the CRR is the proportion of a commercial bank's total deposit liabilities which must be held as deposits at CBK. These deposits are held in the CRR Account at no interest. The ratio is currently 5.25 percent of the total of a bank's domestic and foreign currency deposit liabilities. To facilitate commercial banks' liquidity management, commercial banks are currently required to maintain their CRR based on a daily average level from the 15<sup>th</sup> of the previous month to the 14<sup>th</sup> of the current month and not to fall below a CRR of 3 percent on any day.
- **Licensing and Supervision of Financial Institutions:** The CBK uses the licensing and supervision tools to ensure stability and efficiency of the banking system; this includes vetting potential managers for suitability.
- **The National Payments System:** The modernisation of the National Payments System has continued to lower transaction costs and enhanced the efficiency of the payments systems. This has ensured the effectiveness of monetary policy instruments.
- **Communication:** The increasing use of communication media ensures a wider dissemination of monetary policy decisions and background data thereby increasing the efficiency of information transmission and managing expectations. The regular interaction between the MPC and the Chief Executive Officers of banks has ensured that monetary policy decisions are transmitted to the banking sector. The regular Governor's Press Conferences have also enhanced the media understanding of monetary policy decisions. The CBK website is an important source of up-to-date data on all aspects of the financial market including interest rates, exchange rates, results of auctions of government securities, and the MPC releases.

## EXECUTIVE SUMMARY

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This Monetary Policy Statement (MPS) provides the direction of monetary policy for the financial year (FY) 2019/20. It also reviews the outcome of the monetary policy stance adopted in the first half of 2019. During the period, the CBK conducted monetary policy with the aim of keeping overall inflation within the target range of between 2.5 and 7.5 percent. The 12-month overall inflation remained within the target range supported by lower food prices despite effects of delayed onset of rains, declining domestic energy prices and prudent monetary policy. The inflation rate stood at 5.7 percent in June 2019, the same level as that in December 2018. Non-food-non-fuel (NFF) inflation remained below 5 percent, indicating muted demand pressures in the economy.

During the Monetary Policy Committee (MPC) meetings in January, March and May 2019, the Committee retained the Central Bank Rate (CBR) at 9.00 percent, noting that inflation expectations remained well anchored within the target range, and that the economy was operating close to its potential. The liquidity management operations by the CBK were undertaken to support liquidity distribution in the interbank market and ensured stability in the interbank market during the period. The CBK continued to monitor the impact of interest rate caps on lending to the private sector and monetary policy effectiveness.

The foreign exchange market remained stable supported by the narrowing of the current account deficit, balanced flows and an adequate reserve buffer. The current account deficit narrowed to 4.9 percent of GDP in the 12 months to June 2019 from 6.4 percent in June 2018, . This narrowing was supported by higher foreign exchange receipts from agriculture exports particularly horticulture, travel and remittance inflows, and a lower import bill. The CBK usable foreign exchange reserves stood at USD 9.1 billion (equivalent to 5.8 months of import cover) at the end of June and continued to provide adequate buffer against short-term shocks in the foreign exchange market.

The banking sector remained resilient and stable during the period with strong liquidity and capital adequacy ratios. Growth in private sector credit picked up gradually to 5.2 percent in the 12 months to June 2019 from 2.4 percent in December 2018. Notable growth in credit was recorded in the manufacturing, consumer durables and private households sectors. The CBK continued to strengthen the sector to ensure greater transparency, to promote stronger governance and to improve consumer protection.

Monetary policy in the FY 2019/20 will aim at maintaining overall inflation rate within the target range. The foreign exchange market is expected to remain stable supported by expected narrowing of the current account deficit supported by the continued resilience in agricultural exports, service receipts and remittance inflows, as well as a moderate growth of imports. Overall, macroeconomic stability will be supported by continued coordination of monetary and fiscal policies. This will support the achievement of the Government's *Big 4* development priorities of food security and agricultural productivity, affordable housing, increased share of manufacturing, and universal health coverage.

Consistent with inflation and growth objectives stipulated in the Government Medium Budget Policy Statement for 2019, monetary policy will aim at containing annual growth in broad money (M3) at about 12.2 percent by June 2020, while the recovery in private sector credit growth is expected to gain momentum. Monetary policy will aim at ensuring that movements in the short-term interest rates support the Bank's primary objective of price stability. The Bank will continue to review and enhance the effectiveness of its monetary policy instruments in order to maintain price stability. In addition, the CBK will continue to strengthen the banking sector to ensure greater transparency, and to promote stronger governance, effective business models, and innovation leveraging on information technology.

The Bank will continue to monitor the impact of interest rate caps on lending and monetary policy effectiveness. It will also continue to monitor the risks posed by developments in the domestic and global economies on the overall price stability objective. The Bank will closely monitor risks associated with weaker than anticipated global growth, further escalation of trade tensions, concerns with Brexit resolution, and volatility in international oil prices.

# 1. INTRODUCTION

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This Monetary Policy Statement (MPS) provides the direction of monetary policy for the financial year 2019/20. It also presents the outcome of the monetary policy stance adopted in the first half of 2019.

Price stability remains the primary objective of monetary policy formulation and implementation. The Central Bank Rate (CBR) signals the monetary policy stance, and is the base for all monetary policy operations. The Bank monitors targets of key monetary aggregates such as broad money (M3) and credit to the private sector. The bank maintains a flexible exchange rate regime. The Bank's participation in the foreign exchange market is guided by the need to maintain adequate level of foreign exchange reserves, meeting the Government's external obligations, and ensuring stability in the foreign exchange market. The CBK foreign exchange reserves provide a buffer against short-term shocks.

During the first half of 2019, overall inflation remained anchored within the medium term target range despite the delayed onset of the long rains.

Price stability was supported by lower food prices, declining domestic energy prices and prudent monetary policy. The exchange rate also remained stable and this dampened any threat of imported inflation, despite the rise in international oil prices.

On the global scene, the global economic activity softened on the back of escalation of trade tensions, reduced trade and investment, and weak consumer and business confidence.

The rest of this Policy Statement is organized as follows. Section 2 reviews the outcome of the monetary policy stance implemented in the first half of 2019 while Section 3 describes the economic environment and outlook for the financial year 2019/20. Section 4 concludes by outlining the monetary policy path for FY 2019/20.



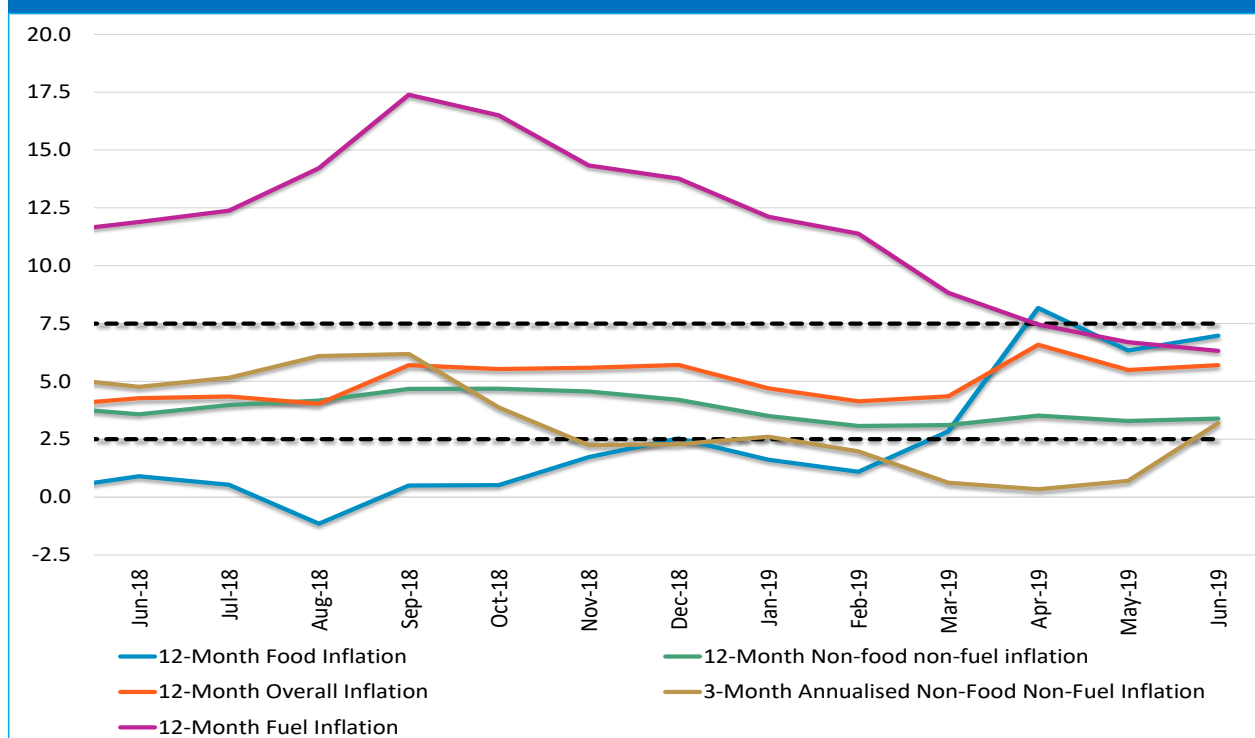
## 2. ACTIONS AND OUTCOMES OF THE POLICY STANCE IN THE FIRST HALF OF 2019

During the first half of 2019, monetary policy formulation and implementation was aimed at maintaining overall inflation at the target of 5.0 percent with a flexible margin of 2.5 percent on either side. The policy stance was also aimed at encouraging growth and supporting stable interest rates. During the Monetary Policy Committee (MPC) meetings in January, March and May 2019, the Committee retained the Central Bank Rate (CBR) at 9.00 percent, noting that inflation expectations remained well anchored within the target range, and that the economy was operating close to its potential. The following are the specific outcomes of the policy stance:

### i. Inflation

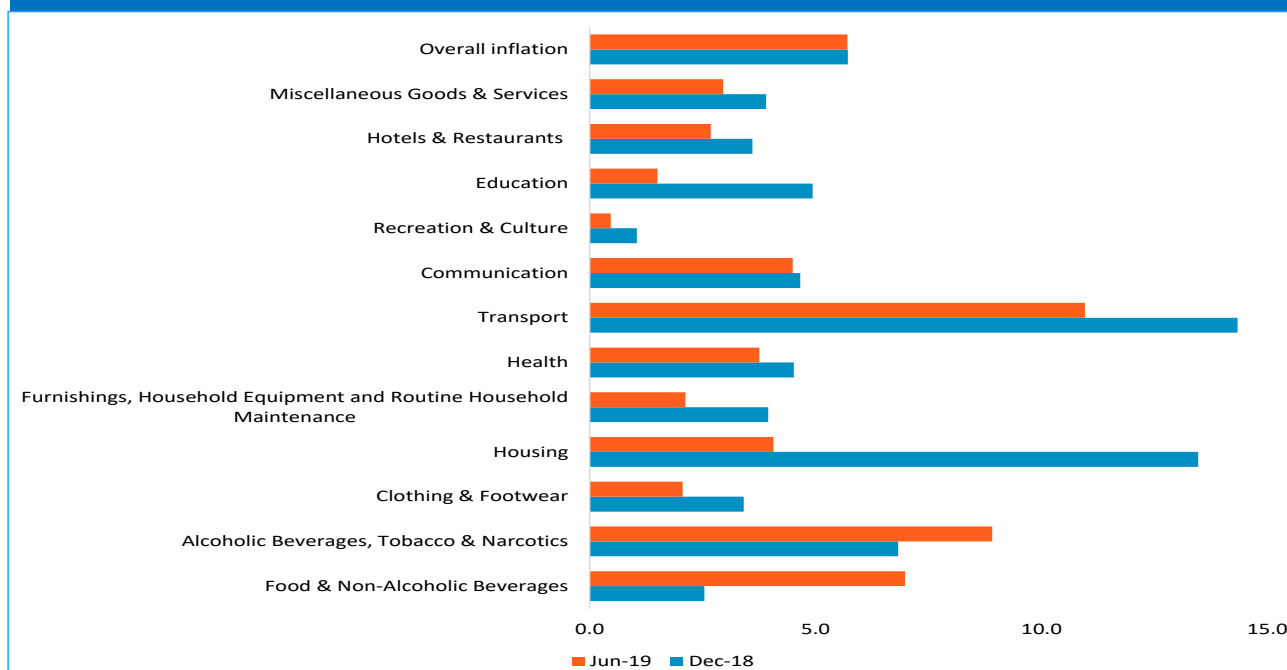
Overall inflation remained well anchored within the medium term target range in the first half of 2019 (**Chart 1a and 1b**). The inflation rate stood at 5.7 percent in June, the same level as that in December 2018. The inflation rate rose in the first quarter of 2019, reflecting increases in food prices due to effects of delayed onset of rains in the first quarter. Food inflation rose from 1.7 percent in January to 7.7 percent in April, before declining to 6.6 percent in June following improved supply of fast growing foodstuff especially vegetables.

**Chart 1a: Inflation in Broad Measures (Percent)**



Source: Kenya National Bureau of Statistics and CBK

**Chart 1b: 12-Month Inflation by CPI Category (Percent)**



Source: Kenya National Bureau of Statistics

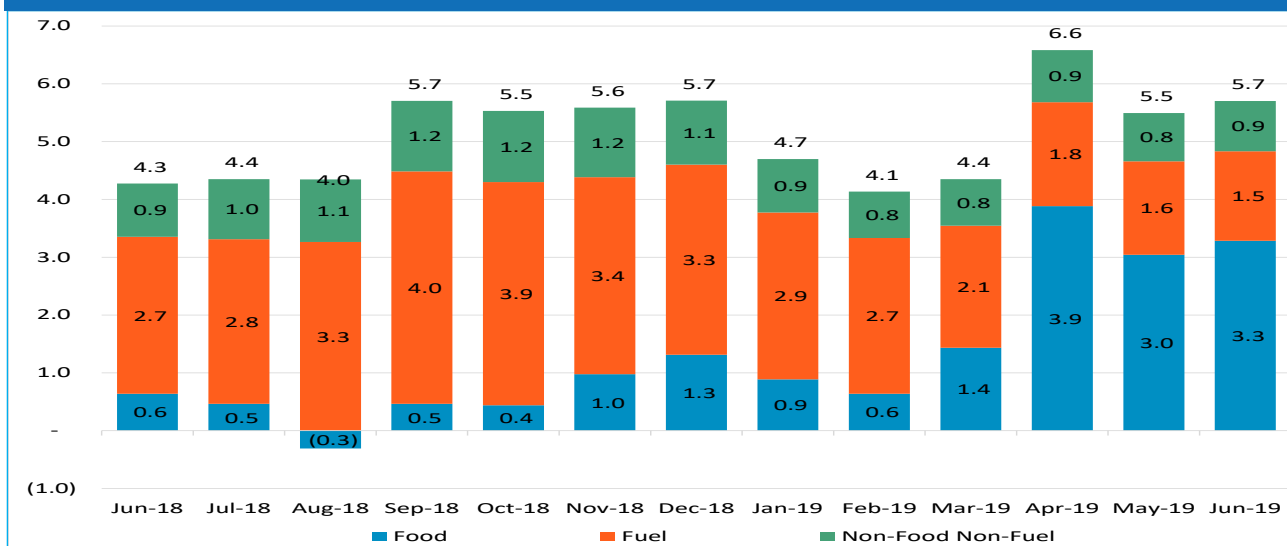
Consequently, the contribution of food to overall inflation rose significantly from 0.6 percentage points in February to a high of 3.9 percentage points in April and 3.3 percentage points in June (**Chart 1c**).

The main food items with significant price increases were Irish potatoes, cabbages, maize flour (sifted), kale (sukuma wiki), maize grain (loose), and fresh packeted milk (**Chart 1d**). Over the same period, fuel inflation decelerated due to declining impact of high charcoal prices following a ban on logging and

restrictions in charcoal trade imposed in March 2018.

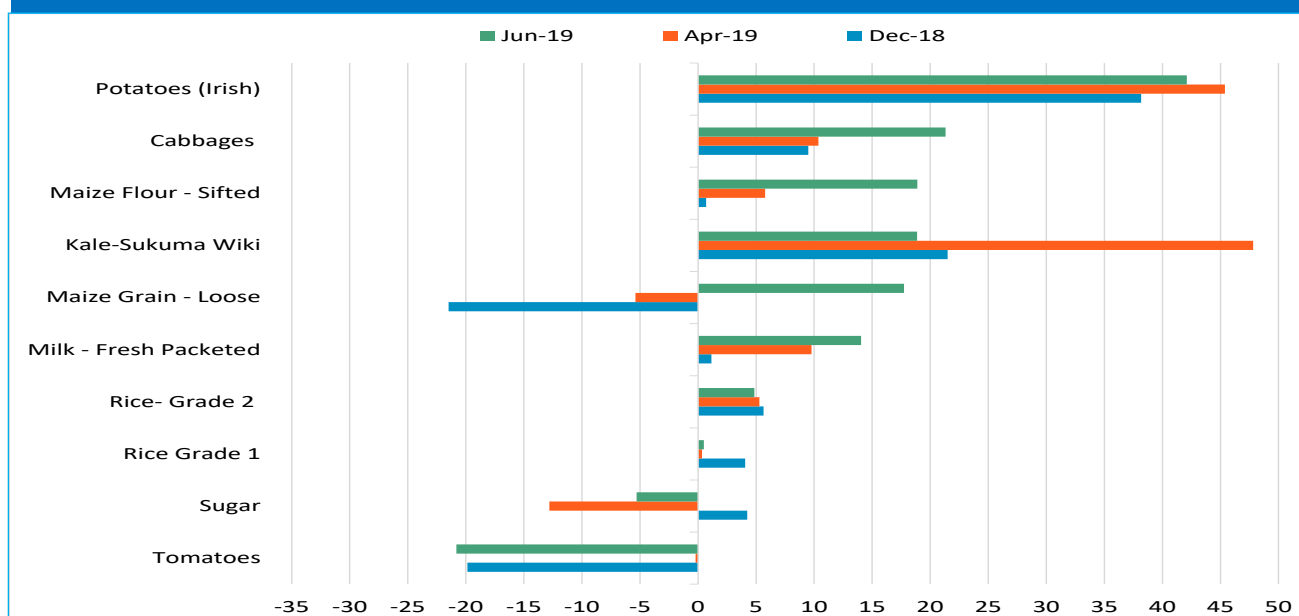
The 12-month and 3-month annualised non-food non-fuel (NFnF) inflation remained below 5 percent, indicating that demand pressures in the economy were muted (**Chart 1a**). The NFnF inflation stood at 3.4 percent in June compared to 4.2 percent in December 2018. The stability of the exchange rate continued to moderate the impact of import costs on consumer prices.

**Chart 1c: Contributions to 12-Month Overall Inflation (Percent)**



Source: Kenya National Bureau of Statistics

**Chart 1d: 12-Month Change of Selected Food Commodity Price Indices (Percent)**



Source: Kenya National Bureau of Statistics

## ii. Bank Credit to the Private Sector

Private sector credit grew by 5.2 percent in the 12 months to June, compared to 2.4 percent in December 2018 (**Table 1**). Strong credit growth was observed in the following sectors: manufacturing (11.4 percent); consumer durables (21.3 percent); transport and communication (5.8 percent); and private households (7.6 percent). Lending to manufacturing sector was mainly channeled to the food and beverage sub-sector. The household sector, which comprises private households and consumer

durables, recorded strong credit reflecting increased marketing efforts by banks including rollout of new innovative credit products.

## iii. Developments in the other Monetary Aggregates

The 12-month growth of broad money, M3, slowed to 9.2 percent in June from 10.1 percent in December 2018 largely due to a slowdown in net domestic assets (NDA) of the banking system.

**Table 1: 12-Month Growth in Private Sector Credit across Sectors (Percent)**

Main sectors	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
Agriculture	-2.0	-0.2	-2.6	0.2	2.5	2.7	3.9
Manufacturing	6.5	6.5	7.7	7.2	7.9	6.5	11.4
Trade	2.9	6.6	6.4	8.7	8.4	7.6	5.5
Building and construction	1.8	1.4	2.6	-7.0	-6.5	-4.1	-6.3
Transport and communication	-9.4	-6.5	-0.7	5.7	6.4	6.2	5.8
Finance and insurance	17.5	15.4	13.1	10.2	13.3	6.7	4.7
Real estate	-0.5	-2.6	-2.9	-0.1	-0.7	-0.5	1.0
Mining and quarrying	-10.7	-14.5	-13.4	-11.4	-12.5	-7.9	-4.3
Private households	6.8	5.6	6.6	8.0	7.9	7.8	7.6
Consumer durables	11.0	15.4	16.1	13.9	16.4	18.0	21.3
Business services	8.0	0.0	0.3	-0.4	1.1	-1.2	-3.2
Other activities	-34.8	-27.2	-33.1	-31.7	-29.6	-32.0	-22.6
<b>Total private sector credit</b>	<b>2.4</b>	<b>3.0</b>	<b>3.4</b>	<b>4.3</b>	<b>4.9</b>	<b>4.4</b>	<b>5.2</b>

Source: Central Bank of Kenya

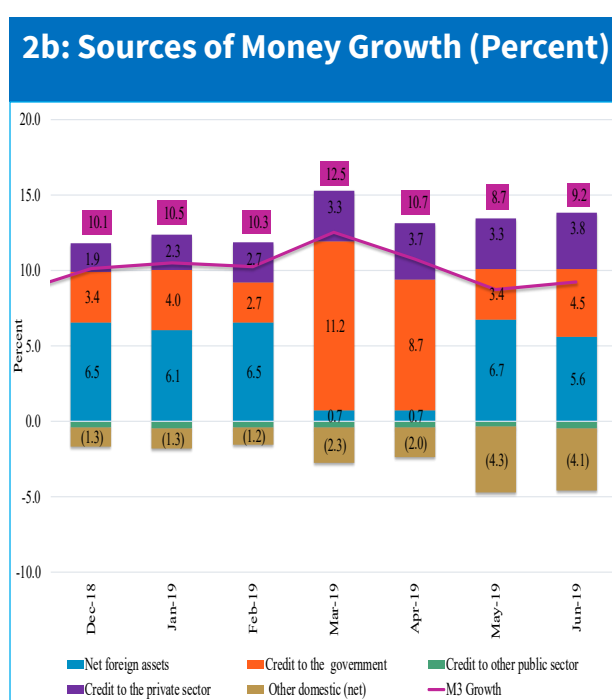
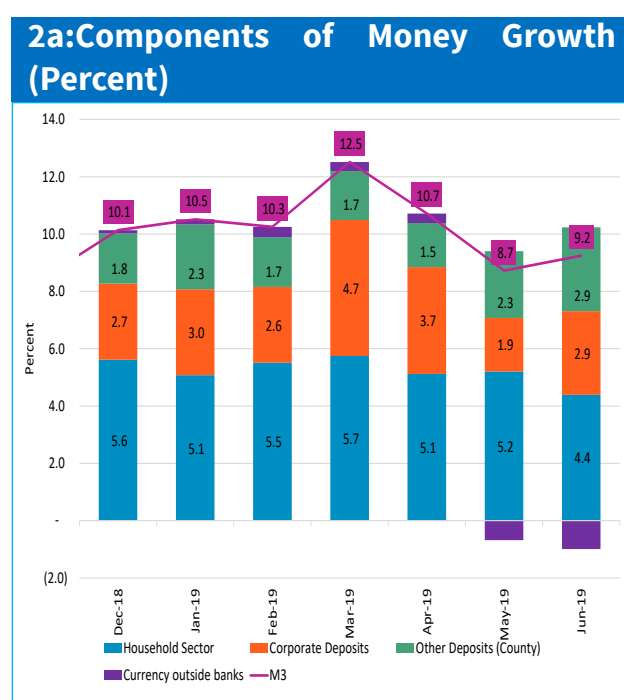
The contraction in NDA of the banking system was attributed to net lending to other public sector, and other items net, in part reflecting an increase in capital and reserves. On the liabilities side, the decline in growth of money supply was reflected in slower growth in deposits and currency outside banks (**Chart 2**). Overall, all the monetary aggregates grew at a slower pace compared to their respective targets (**Table 2**).

## iv. Interest Rates Developments

### a. Central Bank Rate (CBR)

The MPC retained the CBR at 9.00 percent between January and June noting that inflation expectations were well anchored within the target range and the economy was operating around its potential.

**Chart 2: The 12-Month Growth in Broad Money Supply (M3) (Percent)**



Source: Central Bank of Kenya

**Table 2: Actual and Targeted Growth in Key Monetary Aggregates**

	Dec-18	Mar-19	Jun-19
Actual Broad Money, M3 (Ksh Billion)	3,337.8	3,415.3	3,564.2
Target (Ksh Billion)	3,331.8	3,379.1	3,512.0
Actual Reserve Money (Ksh Billion)	492.0	456.5	439.8
Target (Ksh Billion)	470.2	454.5	455.5
Actual Net Foreign Assets of CBK (Ksh Billion)	739.5	747.5	941.0
Target (Ksh Billion)	745.5	757.6	864.3
Actual Net Domestic Assets of CBK (Ksh Billion)	-247.5	-291.0	-501.2
Target (Ksh Billion)	-275.2	-303.1	-408.7
Actual Credit to private sector (Ksh Billion)	2,422.0	2,444.2	2,503.0
Target (Ksh Billion)	2,448.4	2,440.4	2,506.6
Memorandum Items			
12-month growth in actual Reserve Money (Percent)	12.1	9.1	2.5
12-month growth in actual Broad Money, M3 (Percent)	10.1	12.5	9.2

Source: Central Bank of Kenya

The MPC continued to closely monitor economic developments in both external and domestic fronts, as well as any possible perverse response to its previous decisions due to the interest rate caps.

## b. Short Term Rates

Short-term interest rates declined between December 2018 and June 2019, supported by improved liquidity conditions in the market (**Table 3**). The average interbank interest rate fell to 2.98 percent in June from 8.15 percent in December, partly reflecting increased liquidity following increased government spending especially towards the end of the FY 2018/2019, and payment of pending bills.

However, the average interbank rate remained below the CBR, and was relatively volatile partly reflecting market segmentation along bank tiers.

Similarly, interest rates on government securities declined, partly reflecting ample liquidity conditions. The average 91-day Treasury bill rate declined to 6.90 percent from 7.34 percent, while the average 182-day Treasury bill rate decreased to 7.64 percent from 8.40 percent.

## c. Commercial Bank Rates

Commercial banks' average interest rates remained stable within the interest rate caps. The average commercial bank lending rate declined to 12.47 percent in June from 12.51 percent in December while the average deposit rate declined to 7.19 percent from 7.41 percent. The interest spread remained relatively stable in the period.

## v. Banking Sector Developments

The banking sector remained stable and resilient. The average commercial banks' liquidity and capital adequacy ratios stood at 50.6 percent and 18.2 percent, respectively, in June compared to 48.2 percent and 18.7 percent, respectively in December 2018. The ratio of gross non-performing loans (NPLs) to gross loans increased from 12.0 percent in December 2018 to 12.7 percent in June 2019, partly reflecting delayed payments by the public and private sectors, slow uptake of developed housing and commercial units in the real estate sector, delays in cash inflows attributed to low business turnover, and cash flow constraints.

**Table 3: Interest Rates (Percent)**

	2018						2019			
	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun
Central Bank Rate	9.50	9.50	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00
Interbank	4.90	5.03	4.28	8.15	3.32	2.51	3.72	4.12	5.61	2.98
Repo	-	6.16	4.77	7.72	3.70	3.15	3.49	3.03	-	4.23
Reverse Repo	9.95	9.56	9.03	11.34	-	9.03	-	9.13	9.18	-
91-Tbill	8.02	7.87	7.64	7.34	7.19	7.02	7.08	7.41	7.17	6.90
182-Tbill	10.39	9.99	8.82	8.40	8.92	8.55	8.28	8.11	7.85	7.64
<b>Average Lending Rate (1)</b>	<b>13.49</b>	<b>13.22</b>	<b>12.66</b>	<b>12.51</b>	<b>12.50</b>	<b>12.47</b>	<b>12.51</b>	<b>12.50</b>	<b>12.47</b>	<b>12.47</b>
Overdraft/loan	13.40	13.23	12.52	12.17	12.15	12.13	12.13	12.15	12.13	12.12
1-5years	13.67	13.39	12.85	12.70	12.68	12.62	12.70	12.68	12.62	12.64
Over 5years	13.31	13.00	12.51	12.47	12.47	12.48	12.49	12.48	12.47	12.46
<b>Average Deposit Rate (2)</b>	<b>8.16</b>	<b>8.04</b>	<b>7.76</b>	<b>7.41</b>	<b>7.34</b>	<b>7.28</b>	<b>7.22</b>	<b>7.17</b>	<b>7.20</b>	<b>7.19</b>
Demand	1.25	1.08	1.55	1.61	1.72	1.68	1.58	1.56	1.62	1.43
0-3months	8.48	8.41	8.22	7.83	7.73	7.69	7.62	7.56	7.58	7.55
Over 3months	8.26	8.14	7.64	7.67	7.58	7.49	7.43	7.48	7.50	7.53
Savings	6.85	6.60	6.33	5.13	5.14	5.16	5.05	4.75	4.71	4.77
<b>Spread (1-2)</b>	<b>5.33</b>	<b>5.18</b>	<b>4.91</b>	<b>5.09</b>	<b>5.16</b>	<b>5.19</b>	<b>5.29</b>	<b>5.34</b>	<b>5.27</b>	<b>5.28</b>

Source: Central Bank of Kenya

The CBK continued to strengthen the sector to ensure greater transparency, and to promote stronger governance, effective business models, and innovation leveraging on ICT. To address increased consumer protection concerns, the CBK issued the Kenya Banking Sector Charter in February 2019.

The Charter applies to all institutions carrying out banking, financial, mortgage finance and microfinance businesses under the Banking and Microfinance Acts. Banks were required to develop and submit to CBK time bound plans approved by their respective Boards, for implementation of the Charter and thereafter submit quarterly progress reports within 10 days after the end of every quarter.

## vi. Exchange Rates and Foreign Exchange Reserves

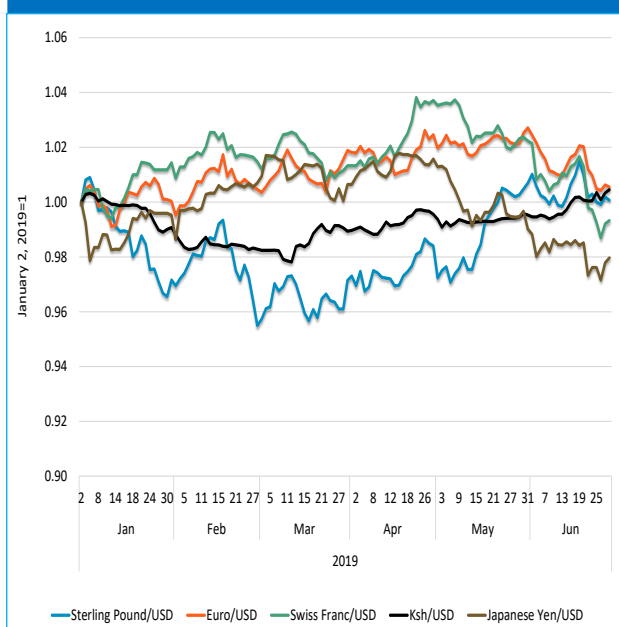
Kenya's foreign exchange market remained relatively stable in the first half of 2019 mainly supported by the narrowing of the current account deficit and an adequate reserve buffer (**Charts 3a and 3b**). The narrowing of the current account was due to higher foreign exchange receipts from agriculture exports particularly horticulture, travel and remittance

inflows, and lower foreign exchange demand for food imports.

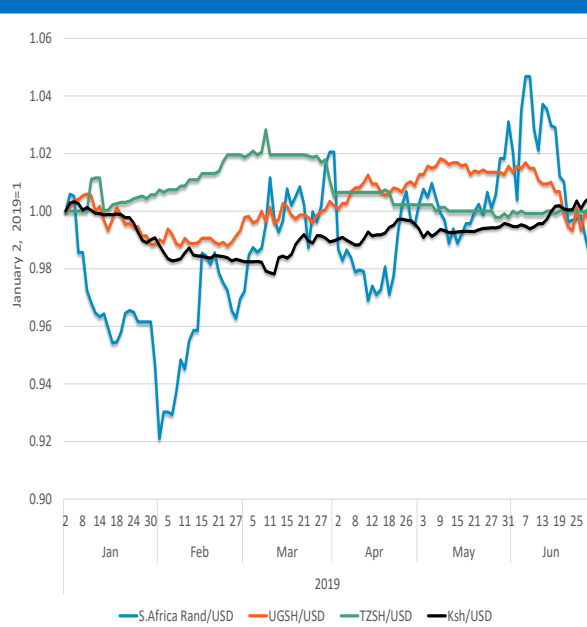
Most international currencies depicted some volatility against the U.S. dollar due to increased uncertainties associated with weaker global growth prospects, escalation of trade tensions between the U.S. and China, protracted resolution of Brexit, and heightened geo-political tensions. Regional currencies depicted mixed trends against the U.S. dollar (**Chart 3b**). Regional currencies in Kenya, Uganda, and Tanzania were relatively stable against the U.S. dollar, while the South African Rand was relatively volatile reflecting political developments and slower growth.

The CBK usable foreign exchange reserves were USD 9.1 billion (equivalent to 5.8 months of import cover) at the end of June (**Chart 3c**). These reserves continued to provide an adequate buffer against short-term shocks in the foreign exchange market.

**Chart 3a: Rate of Depreciation/ Appreciation of the Kenya Shilling and Major International Currencies against the U.S. Dollar**

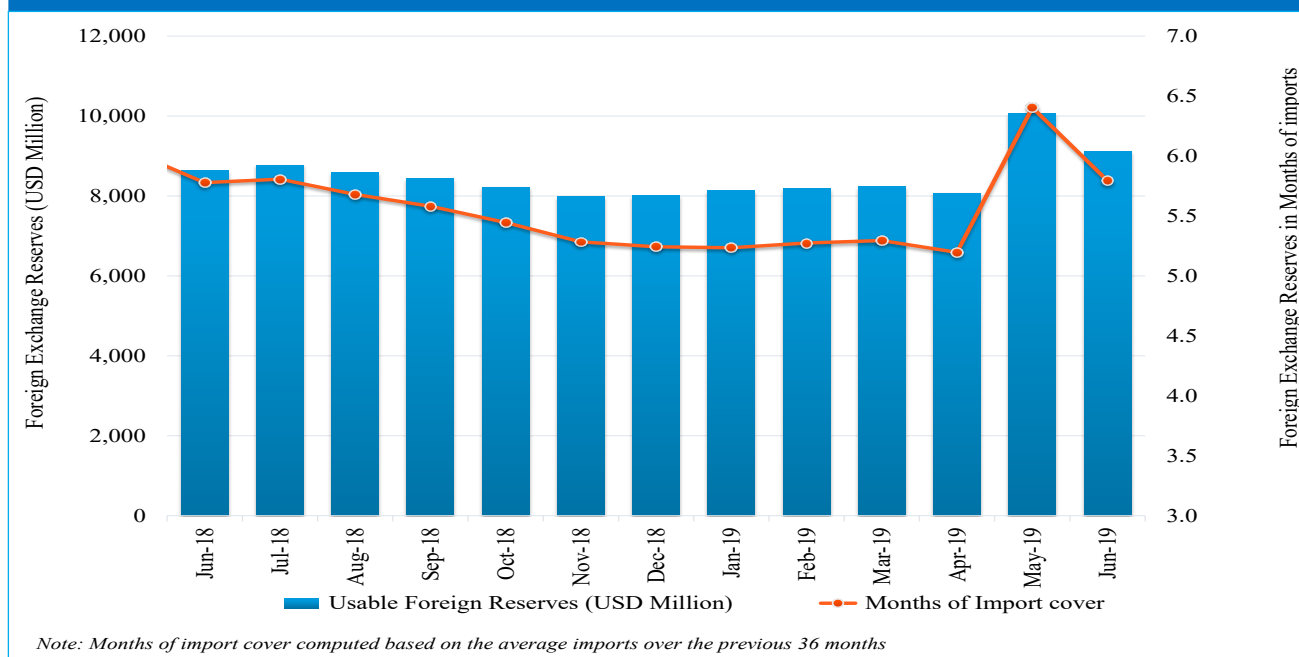


**Chart 3b: Rate of Depreciation/ Appreciation of the Kenya Shilling and Regional Currencies against the U.S. Dollar**



Source: Central Bank of Kenya

**Chart 3c: CBK Usable Foreign Exchange Reserves**



Source: Central Bank of Kenya

Note: The CBK usable foreign exchange reserves refer to reserves available for use without any restrictions. They exclude reserves held by CBK on behalf of the Government or commercial banks.

## vii. Balance of Payments Developments

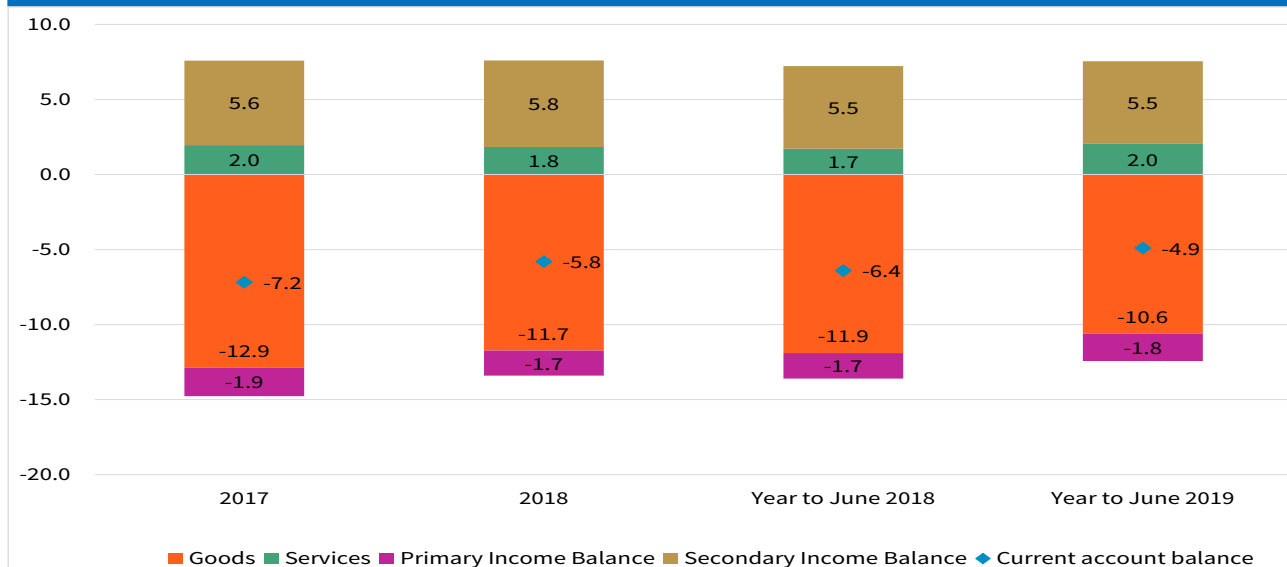
The current account deficit narrowed to 4.9 percent of GDP in the 12-months to June from 6.4 percent in June 2018. This improvement was recorded in the goods and services accounts and resilient remittance inflows (**Chart 4 and Table 4**).

The balance in the goods account improved to a deficit of 11.0 percent of GDP, attributed to lower merchandise imports, which more than offset the reduction in merchandise exports. The lower imports were mainly in food, machinery and transport equipment. Analysis by direction of trade shows that the lower imports were from Africa mainly the EAC and COMESA regions, and China (**Table 5**). The lower imports from China reflected reduced importation of machinery and transport equipment following the near completion of the Nairobi-Naivasha standard gauge railway line. However, oil import bill increased during the period under review, following higher oil prices.

The decline in merchandise exports was mainly attributed to lower receipts from tea exports following lower tea prices in the second half of 2018 and lower tea production caused by dry weather in the first half of 2019. Exports by destination shows that Kenya's exports to Africa were lower in the year to June 2019, following reduced exports to Egypt, South Sudan and Somalia (**Table 5**). Exports to Pakistan also declined, with its share dropping to 8.2 percent from 10.2 percent in June 2018. However, exports to the EAC region and European Union increased.

The narrowing of the current account deficit was also supported by improvement in the services balance and remittances. This reflected higher receipts from freight and air transport, increased cross border financial services and increased tourist arrivals. However, the primary income balance worsened due to higher foreign interest payments.

**Chart 4: Components of the Current Account Balance (Percent of GDP)**



Source: Central Bank of Kenya

**Table 4: Annual Balance of Payments (Percent of GDP)**

	2017	2018	Year to June 2018	Year to June 2019
	Act.	Act.	Prov.	Prov.
<b>1. Current account balance</b>	<b>-7.2</b>	<b>-5.8</b>	<b>-6.4</b>	<b>-4.9</b>
<b>1.1 Goods balance</b>	<b>-12.9</b>	<b>-11.7</b>	<b>-11.9</b>	<b>-10.6</b>
Goods: Exports (fob)	7.3	7.0	6.9	6.2
o/w: Tea	1.8	1.6	1.7	1.3
Horticulture	1.0	1.1	1.1	1.1
Coffee	0.3	0.3	0.3	0.2
Other exports and re-exports	4.2	4.1	4.1	3.8
Goods: Imports (fob)	20.2	18.7	18.8	16.9
o/w: Oil	3.4	3.9	3.6	3.6
Machinery & transport equipment	5.9	5.2	5.1	3.6
Other imports	10.8	9.6	10.1	9.6
<b>1.2 Services balance</b>	<b>2.0</b>	<b>1.8</b>	<b>1.7</b>	<b>2.0</b>
Credit	5.9	6.3	5.7	6.0
o/w: Transportation	2.0	2.3	2.0	2.3
Travel	1.2	1.2	1.2	1.1
Debit	3.9	4.5	4.0	4.0
<b>1.3 Primary Income, balance</b>	<b>-1.9</b>	<b>-1.7</b>	<b>-1.7</b>	<b>-1.8</b>
Credit	0.2	0.2	0.2	0.2
Debit	2.1	1.9	1.9	2.0
<b>1.4 Secondary Income, balance</b>	<b>5.6</b>	<b>5.8</b>	<b>5.5</b>	<b>5.5</b>
Credit	5.7	5.8	5.6	5.1
o/w: Remittances	2.5	3.1	2.8	2.9
Debit	0.1	0.1	0.1	0.1
<b>2. Capital Account balance</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.2</b>
<b>3. Financial Account balance</b>	<b>-7.0</b>	<b>-7.5</b>	<b>-6.2</b>	<b>-6.9</b>
3.1 Foreign direct investment, balance	-0.5	-1.3	-1.3	-1.5
3.2 Portfolio investment, balance	0.7	1.4	-1.0	-1.0
3.3 Other investment, balance	-5.8	-5.3	-3.8	-4.4

Source: Central Bank of Kenya



**Table 5: Kenya's Direction Trade**

IMPORTS	(in millions of US dollars)			Share of Imports (%)			EXPORTS	(in millions of US dollars)			Share of Exports (%)		
	Year to June			Year to June				Year to June			Year to June		
Region/Country	2017	2018	2019	2017	2018	2019	Region/Country	2017	2018	2019	2017	2018	2019
Africa	1,632	2,136	2,029	11.0	14.4	13.7	Africa	2,199	2,169	2,116	38.5	35.8	35.5
Of which							Of which						
South Africa	567	637	676	3.8	3.9	4.2	Uganda	611	601	609	10.7	9.9	10.2
Egypt	332	359	369	2.2	2.2	2.3	Tanzania	281	294	304	4.9	4.9	5.1
Others	732	1,140	984	4.9	6.9	6.1	Egypt	170	213	192	3.0	3.5	3.2
							Sudan	54	67	62	0.9	1.1	1.0
EAC	417	743	564	2.8	4.5	3.5	South Sudan	157	152	114	2.8	2.5	1.9
COMESA	854	1,258	1,066	5.8	7.6	6.6	Somalia	201	167	133	3.5	2.8	2.2
Rest of the World	13,178	14,381	14,034	89.0	87.1	87.4	DRC	197	167	141	3.4	2.8	2.4
Of which							Rwanda	167	176	185	2.9	2.9	3.1
India	1,826	1,627	1,779	12.3	9.9	11.1	Others	362	333	377	6.3	5.5	6.3
United Arab Emirates	1,029	1,029	1,635	6.9	6.2	10.2							
China	3,904	3,904	3,720	26.4	23.6	23.2	EAC	1,135	1,129	1,172	19.9	18.7	19.7
Japan	809	809	819	5.5	4.9	5.1	COMESA	1,470	1,460	1,455	25.8	24.1	24.4
USA	515	515	568	3.5	3.1	3.5	Rest of the World	3,505	3,885	3,837	61.5	64.2	64.5
United Kingdom	312	299	328	2.1	1.8	2.0	Of which						
Singapore	65	43	56	0.4	0.3	0.3	United Kingdom	357	397	389	6.3	6.6	6.5
Germany	385	460	447	2.6	2.8	2.8	Netherlands	418	447	467	7.3	7.4	7.8
Saudi Arabia	964	1,315	1,587	6.5	8.0	9.9	USA	463	446	511	8.1	7.4	8.6
Indonesia	506	481	508	3.4	2.9	3.2	Pakistan	516	644	490	9.0	10.6	8.2
Netherlands	163	219	309	1.1	1.3	1.9	United Arab Emirates	273	307	367	4.8	5.1	6.2
France	246	224	246	1.7	1.4	1.5	Germany	123	109	112	2.2	1.8	1.9
Bahrain	117	46	51	0.8	0.3	0.3	India	81	76	72	1.4	1.3	1.2
Italy	241	238	217	1.6	1.4	1.3	Afghanistan	36	29	38	0.6	0.5	0.6
Others	2,094	3,172	1,765	14.1	19.2	11.0	Others	1,238	1,428	1,392	21.7	23.6	23.4
Total	14,810	16,517	16,063	100	100	100	Total	5,704	6,054	5,953	100	100	100
EU	1,947	2,088	2,214	13.1	12.6	13.8	EU	1,184	1,183	1,273	20.8	19.5	21.4
China	3,904	3,904	3,720	26.4	23.6	23.2	China	122	75	141	2.1	1.2	2.4

Source: Kenya Revenue Authority and Central Bank of Kenya

### viii. Economic Growth

The Kenyan economy remained resilient in the first half of 2019. Real GDP grew by 5.1 percent, supported by strong performance of the services sector and resilience in industry and agriculture (**Table 6 and Chart 5**). The services sector was the main driver of growth and contributed 3.2 percentage points to real GDP growth. This reflected strong and resilient performance of Wholesale and Retail, Transport and Storage, Information and Communication, Real estate, Financial and Insurance and Accommodation and Restaurant sectors.

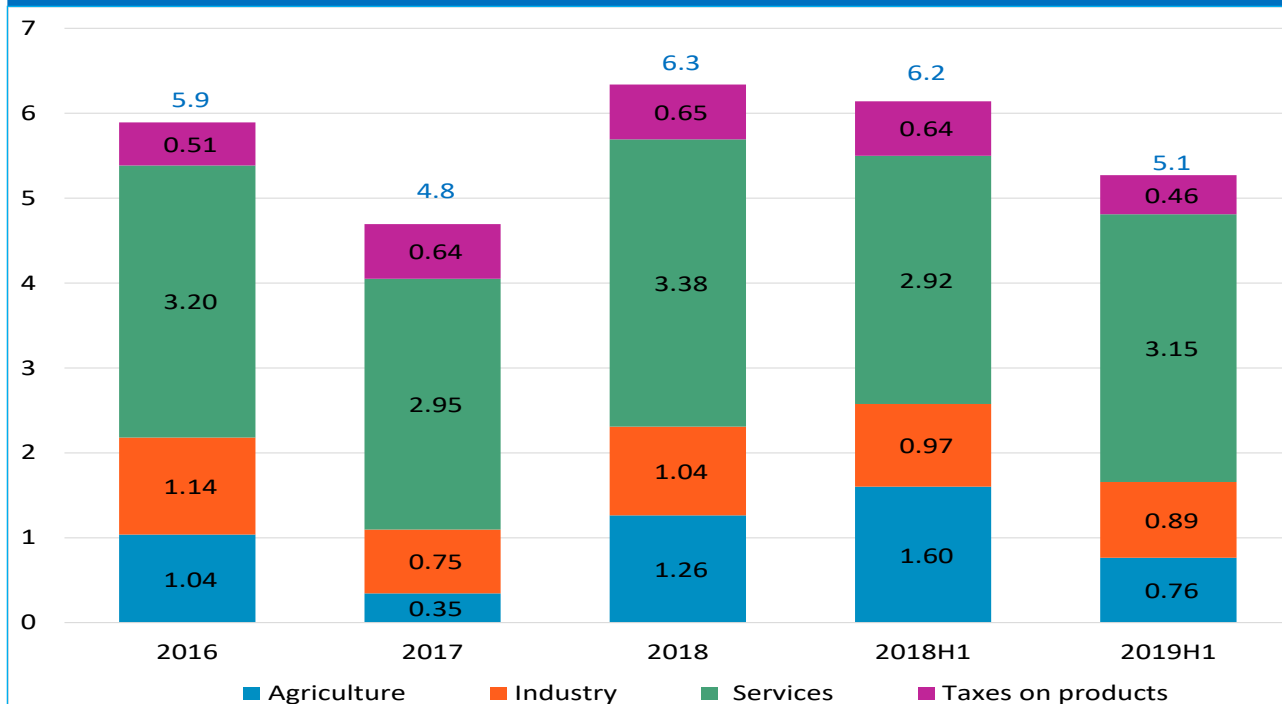
Agriculture sector performance was subdued due to effects of delayed onset of rains in the first quarter. The sector expanded by 3.1 percent in the first half of 2019 compared to 6.5 percent in a similar period of 2018. The growth of industry moderated to 4.8 percent from 5.2 percent reflecting slower growth of the Manufacturing sector. Increased government and private sector activity to support the *Big 4* Agenda supported growth of the Construction and Electricity and Water Supply sectors.

**Table 6: Kenya's Real GDP Growth across the Main Sectors (Percent)**

Main Sectors	2016	2017	2018	2018H1	2019H1
1. Agriculture	4.7	1.6	6.0	6.5	3.1
2. Non-Agriculture (o/w)	6.2	5.7	6.4	6.1	5.8
2.1 Industry	5.9	3.9	5.5	5.2	4.8
Manufacturing	3.1	0.7	4.3	4.3	3.2
Electricity & water supply	8.4	7.0	8.0	7.2	7.5
Construction	9.9	8.4	6.9	6.1	6.6
2.2 Services	6.4	5.9	6.7	6.1	6.6
2.3 Taxes on products	4.4	5.7	5.6	6.0	4.3
<b>Real GDP</b>	<b>5.9</b>	<b>4.8</b>	<b>6.3</b>	<b>6.2</b>	<b>5.1</b>

Source: Kenya National Bureau of Statistics

**Chart 5: Contributions to Real GDP Growth (percent)**



Source: Kenya National Bureau of Statistics

## ix. Domestic Government Borrowing

The coordination between monetary and fiscal policies continued to support macroeconomic stability. The Government's borrowing plan in the second half of the FY2018/19 ensured that the build-up in domestic debt was consistent with the thresholds set in the Medium-Term Debt Management Strategy. The Government continued to review its borrowing plan in line with market conditions and prudent budget management that focused on rationalisation of expenditures and strengthening of revenue collection measures.

## x. Stakeholder Forums, MPC Market Perception Surveys, and Communication

The MPC held forums with Chief Executive Officers of commercial banks after every meeting. The Committee also continued to improve and expand

its information gathering processes through the Market Perception Surveys and communication with key stakeholders on the MPC decisions to obtain feedback. The MPC Press Releases were continuously reviewed to make them better focused to the public, media, financial sector and other stakeholders.

The Chairman of the MPC also held press conferences after each MPC meeting to brief the media on measures undertaken by the CBK to support macroeconomic and financial stability. As a result, the media and public understanding of monetary policy decisions and their expected impact on the economy continued to be enhanced. The Chairman and MPC members also held meetings with investors during the period in order to appraise them on economic developments in the country.

### 3. THE CURRENT ECONOMIC ENVIRONMENT AND OUTLOOK FOR FY 2019/20

#### i. International Economic Environment

Economic growth momentum slowed down in the advanced economies and emerging markets amid intensified trade tensions, geopolitics and policy uncertainties (**Table 7**). Global growth was projected at 3.2 percent in 2019 and 3.5 percent in 2020 compared to 3.6 percent in 2018 (IMF World Economic Outlook). Growth in advanced economies was projected at 1.9 percent in 2019 down from 2.2 percent in 2018, while in emerging and developing economies, growth was projected at 4.1 percent, which was 0.4 percentage points lower than in 2018, with the effects of trade tensions and weakening external demand dampening growth to varying magnitudes across countries. However, economic activity in sub-Saharan Africa (SSA) was expected to remain strong, with growth rising from 3.1 percent in 2018 to 3.4 percent in 2019 and 3.6 percent in 2020. The higher growth was expected in major oil exporting countries like Angola and Nigeria. On the other hand, economic activity in South Africa was expected to slow down reflecting a larger-than-anticipated impact of strike, energy supply issues and weak agricultural production.

Nevertheless, global inflationary pressures remained contained in both advanced and emerging markets and developing economies. In advanced economies annual headline consumer price inflation was expected to average 1.6 percent, while that of emerging markets and developing economies, 4.8 percent in 2019, owing to the expected slowdown in the contribution of both fuel and nonfuel inflation.

Downside risks to global activity have intensified. The escalation of trade disputes among major economies and a further escalation of geopolitical tensions could lead to increase in trade barriers and may pose risks to global trade and increase the probability of a marked global downturn. In addition, the prolonged uncertainty surrounding the UK's withdrawal from the European Union was expected to continue undermining intra-Euro trade and investment.

**Table 7: Growth Performance and Outlook for the Global Economy (Percent)**

Region/Country	2016	2017	2018	2019	2020
	Act.	Act.	Act.	Proj.	Proj.
<b>World Output</b>	<b>3.2</b>	<b>3.8</b>	<b>3.6</b>	<b>3.2</b>	<b>3.5</b>
<b>Advanced Economies</b>	<b>1.7</b>	<b>2.4</b>	<b>2.2</b>	<b>1.9</b>	<b>1.7</b>
United States	1.5	2.2	2.9	2.6	1.9
Euro area	1.8	2.4	1.9	1.3	1.6
Japan	1.0	1.9	0.8	0.9	0.4
United Kingdom	1.8	1.8	1.4	1.3	1.4
<b>Emerging Market and Developing Economies</b>	<b>4.4</b>	<b>4.8</b>	<b>4.5</b>	<b>4.1</b>	<b>4.7</b>
Emerging and Developing Asia	6.5	6.6	6.4	6.2	6.2
China	6.7	6.8	6.6	6.2	6.0
India	7.1	7.2	6.8	7.0	7.2
Latin America and the Caribbean	-0.6	1.2	1.0	0.6	2.3
Brazil	-3.5	1.1	1.1	0.8	2.4
Sub-Saharan Africa	1.5	2.9	3.1	3.4	3.6
South Africa	0.6	1.4	0.8	0.7	1.1
Nigeria	-1.6	0.8	1.9	2.3	2.6
Middle East, North Africa, Afghanistan and Pakistan	5.0	2.1	1.6	1.0	3.0

Source: IMF, World Economic Outlook, April 2019

## ii. Domestic Economic Environment

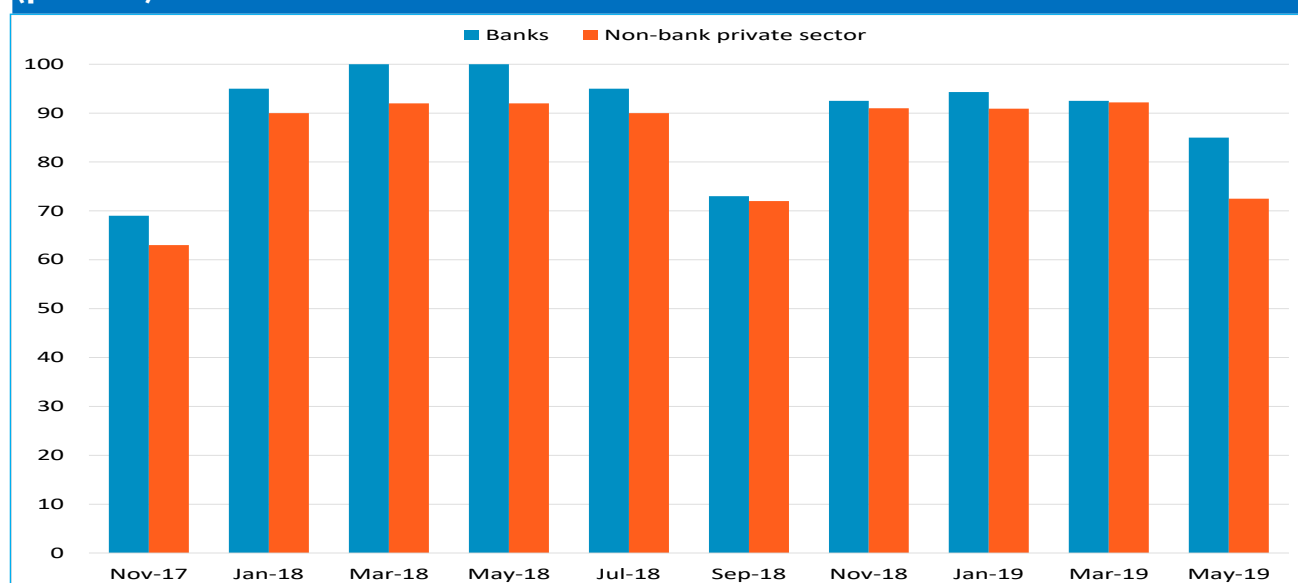
The outlook for domestic economy was expected to remain favourable, with GDP growth projected at 6.0 percent and 6.3 percent in 2019 compared to 6.3 percent in 2018. The growth outlook was expected to be supported by a stable macroeconomic environment, continued improvement in business environment, recovery of credit to the private sector and payment of pending bills by both the national and county governments. The Government's strategic focus on the *Big 4* development priorities in food security and agricultural productivity, affordable housing, increased share of manufacturing, and universal health coverage is expected to provide an additional stimulus to growth.

The outlook for the domestic economy was corroborated by the MPC Private Sector Market Perceptions Surveys, which showed continued optimism by the private sector on Kenya's economic prospects (**Chart 6**). Most of the respondents attributed their optimism to payments of pending bills by the national and county governments, increased focus by the Government on the *Big 4* Agenda, ongoing infrastructure development projects, a likely rebound of the manufacturing sector, and improved tourism boosted by direct flights to the US and France. Other reasons included

improved ease of doing business, improved private sector credit growth, the stable macroeconomic conditions, political stability and the fight against corruption.

The macroeconomic environment was expected to remain stable, with overall inflation remaining within the target range. The exchange rate is expected to be relatively stable, reflecting further improvement in the current account and adequate foreign reserves. The 12-month current account deficit was projected at 4.6 percent of GDP by June 2020 compared to 5.1 percent in June 2019 on the back of lower imports growth, resilient tea and horticulture exports, continued growth in tourism receipts, and strong diaspora remittances.

**Chart 6: Optimism by Private Sector on Economic Prospects, Going Forward (percent)**



Source: Central Bank of Kenya

## 4. DIRECTION OF MONETARY POLICY IN THE FY 2019/20

Monetary policy continues to be directed at achieving the Bank's principal objective of low and stable inflation. Thus, price stability will be the overriding objective of monetary policy during the FY 2019/20. In addition, monetary policy will support the growth and employment creation objectives of the Government particularly implementation of the *Big 4* Agenda. The monetary targets for the FY 2019/20 are consistent with the Medium-Term Government Budget Policy Statement for 2019 published by the National Treasury.

The monetary targets for the period are presented in **Table 8**. Monetary policy will aim at containing the annual growth in broad money (M3) at about 12 percent by June 2020. Growth in private sector credit is expected to pick up gradually to 8.2 percent by December 2019 and 10.1 percent by June 2020. Growth in reserve money is projected to decline by 4.8 percent by December 2019, before rising to 4.7 percent by June 2020. The reduction in the monetary base (reserve money) partly reflects the effect of the ongoing demonetisation of old KSh 1000 notes, which aims to curb illicit financial flows (IFF) and eliminate counterfeits. The pick up in credit will be supported by the continued rollout of innovative bank-initiated credit products targeting Micro Small and Medium Enterprises (MSMEs) as well as the recent payments of pending bills by the Government, which are expected to moderate the credit risks.

The CBK foreign exchange reserves are projected to rise to US\$ 10,020 million (about 6.0 months of import cover) by June 2020, consistent with the positive outlook of the Balance of Payments. This level of reserves will continue to provide a buffer against

short-term shocks in the foreign exchange market. Monetary policy will aim at ensuring that short-term interest rates are consistent with the CBK's price stability objective. The coordination of monetary and fiscal policies will support macroeconomic stability. In this regard, the monetary outlook has taken into account net domestic financing amounting to KSh 289.2 billion (2.7 percent of GDP) and external commercial borrowing of KSh 213 billion (about US\$ 2 billion).

The monetary projections are subject to risks emanating from both the domestic and global fronts. Domestically, risks include public expenditure pressures that may result in Government temporarily operating outside the domestic borrowing target, the predictability of money demand that continues to be affected by continued innovation in the financial sector as well as any unforeseen impact of the ongoing demonetisation.

On the external front, a weaker than anticipated global growth, further escalation of trade tensions, concerns with Brexit resolution, and volatility in international oil prices may lead to global recession and instability in the global financial markets. These have implications for emerging and developing economies. Consequently, developments in the monetary targets will be closely monitored in light of these risks, in order to provide necessary reviews to inform the decision making process in the Bank. Additionally, the CBK will continue to monitor the impact of the interest rate capping on lending and effectiveness of monetary policy transmission.

**Table 8: Monetary Targets for the FY 2019/20**

	Sep-19	Dec-19	Mar-20	Jun-20
Broad Money, M3 (Ksh Billion)	3,652.7	3,748.9	3,868.6	3,998.2
Reserve Money, RM (Ksh Billion)	447.3	469.1	462.1	461.8
Credit to Private Sector (Ksh Billion)	2,556.6	2,620.2	2,675.4	2,757.7
NFA of CBK (Ksh Billion)	856.2	824.6	784.9	948.8
NDA of CBK (Ksh Billion)	-408.9	-355.6	-322.8	-487.0
12-month growth in RM (Percent)	-0.8	-4.8	1.0	4.7
12-month growth in M3 (Percent)	12.0	12.3	13.3	12.2
12-month growth in Credit to Private Sector (Percent)	6.3	8.2	9.5	10.1
Medium-Term 12-month overall Inflation (Percent)	5.0	5.0	5.0	5.0

Source: Central Bank of Kenya

**EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (JANUARY – JUNE 2019)**

January 2019	The MPC retained the CBR at 9.0 percent to continue anchoring inflation expectations.
March 2019	The MPC retained the CBR at 9.0 percent to continue anchoring inflation expectations.
May 2019	The MPC retained the CBR at 9.0 percent to continue anchoring inflation expectations. Launch of the pilot phase of a mobile loan product ‘Stawi’ targeting micro, small and medium scale enterprises (MSMEs).
June 2019	Issuance and launch of the New Generation banknotes including gradual withdrawal (demonetization) of older 1,000 shillings banknotes to address emerging concerns about illicit financial flows and counterfeits.

## GLOSSARY OF KEY TERMS

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### OVERALL INFLATION

Overall inflation is a measure of price change in the economy calculated as the weighted year-on-year movement of the indices of the prices charged to consumers of the goods and services in a representative basket established in a base year. The indices are derived from data collected monthly by the Kenya National Bureau of Statistics.

### RESERVE MONEY

Reserve Money is computed as the 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 (NBFIs) held by 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 senses as follows: narrow money (M1); broad money (M2); and extended broad money (M3). These aggregates are computed as follows:

#### Narrow Money

M0: Currency outside the banking system

M1: M0 + demand deposits of banks (or depository corporations).

#### Broad Money

M2: M1 + quasi (long term) money deposits i.e. time and savings deposits of banks and non-bank financial institutions.

#### Extended Broad Money

M3: M2 + residents' foreign currency deposits.

#### Overall Liquidity

L: M3 + non-bank holdings of Government Paper. This however, is not a monetary aggregate.



**Central Bank of Kenya**

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