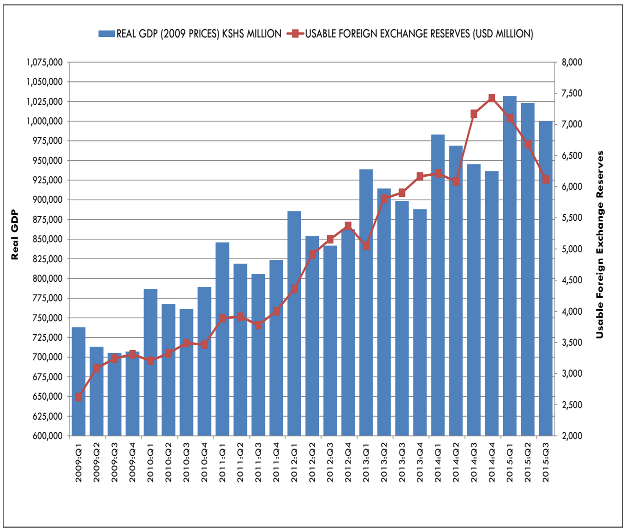


CENTRAL BANK OF KENYA

Monetary Policy Statement

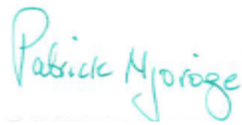
Issued pursuant to Section 4B of the Central Bank of Kenya Act, Cap 491

DECEMBER 2015

Letter of Transmittal to the Cabinet Secretary for the National Treasury

Dear Honourable Cabinet Secretary,

I have the pleasure of forwarding to you the 37th Monetary Policy Statement (MPS) of Central Bank of Kenya (CBK), pursuant to Section 4B of the Central Bank of Kenya Act. It reviews the outcome of the monetary policy stance during the second half of 2015, describes the current economic environment and outlook, and concludes with an outline of the direction of monetary policy in 2016.



Dr. Patrick Njoroge
Governor

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The Principal Objectives of the Central Bank of Kenya

The principal objectives of the Central Bank of Kenya (CBK) as established in the CBK Act are:

(1) To formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices;

(2) To foster the liquidity, solvency and proper functioning of a stable, market-based, financial system;

(3) Subject to (1) and (2) above, to support the economic policy of the Government, including its objectives for growth and employment.

Without prejudice to the generality of the above, the Bank shall:

- Formulate and implement foreign exchange policy;
- Hold and manage Government foreign exchange reserves;
- License and supervise authorised foreign exchange dealers;
- Formulate and implement such policies as best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems;
- Act as banker and adviser to, and fiscal agent of, the Government; and
- Issue currency notes and coins.

The CBK formulates and conducts monetary policy with the aim of keeping overall inflation within the allowable margin (currently 2.5 percent) on either side of the target prescribed by the National Treasury after the annual Budget Policy Statement. The achievement and maintenance of a low and stable inflation rate coupled with ensuring adequate liquidity in the market facilitates higher levels of domestic savings and private investment which leads to improved economic growth, higher real incomes and increased employment opportunities.

The Bank's monetary policy is therefore designed to support the Government's desired growth in the production of goods and services and employment creation through achieving and maintaining a low and stable rate of inflation.

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 through 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):** Repos entail the sale of eligible securities by the CBK to reduce commercial banks' deposits held at CBK. Repos (also called Vertical Repos) have fixed tenors of 3 and 7 working days. Reverse Repos are purchases of securities from commercial banks and hence, they are an injection of liquidity by the CBK during periods of tighter than desired liquidity in the market. The Late Repo, sold in the afternoon, has a 4-day tenor and is issued at an interest rate 100 basis points below the Repo on that day. When a weekend or public holiday coincide with the maturity date of the Repo, the tenor is extended to the next working day.
  - 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:** Although Horizontal Repos are not strictly monetary policy instruments, they 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, but does not intervene, in the overnight interbank money market which is conducted by the banking industry. 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.

- **Kenya Banks' Reference Rate (KBRR):** The KBRR is the base rate for all commercial and microfinance banks' lending. The level of the KBRR is reviewed by the CBK and announced through the Monetary Policy Committee press releases at least every six months.
- **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 15th of the previous month to the 14th of the current month and not to fall below a CRR of 3 percent on any day.
- **Foreign Exchange Market Operations:** The CBK can also inject or withdraw liquidity from the banking system by engaging in foreign exchange transactions. A sale of foreign exchange to banks withdraws liquidity from the system while the purchase of foreign exchange injects liquidity into the system. Participation by the CBK in the foreign exchange market is usually motivated by the need to acquire

foreign exchange to service official debt, and to build-up its foreign exchange reserves in line with the statutory requirement. The CBK uses its best endeavours to maintain foreign reserves equivalent to four months' imports as recorded and averaged for the last three preceding years. The CBK does not participate in the foreign exchange market to defend a particular value of the Kenya shilling but may intervene in the exchange market to stabilise it in the event of excess volatility. The following regulatory measures have been introduced, through Prudential Guidelines of banks, to support stability of the exchange rate:

i. Limiting the tenor of swaps and Kenya Shilling borrowing where offshore banks are involved to a tenor of not less than one year.
ii. Limiting the tenor of swaps between residents to not less than seven days.
iii. Reduction of the foreign exchange exposure ratio of core capital from 20 percent to 10 percent. The foreign exchange limits should not exceed the 10 percent overall limit at any time during any day.
iv. Requiring that local banks obtain supporting documents for all transactions in the Nostro accounts of offshore banks.

- **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 ensuring compliance with Prudential Guidelines, and vetting potential managers for suitability both with respect to qualifications and character.
- **The National Payments System:** The modernisation of the National Payments System has continued to lower transaction costs, and improve the effectiveness of monetary policy instruments.
- **Policy coordination in the region:** Price and financial stability are also supported by regional policy coordination through the regular meetings of the Governors of the Central Banks' of the East African Community partner states, consolidated supervision and regulation of banks with branches in the region to safeguard the banking system from risks associated with cross border banking activities and country risk, and maintaining efficient regional payments systems to facilitate timely and secure settlement of cross border transactions.
- **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 through the Kenya Bankers Association (KBA) has ensured that monetary policy decisions are transmitted to the banking sector. 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. The CBK also participates in the regional and National Agricultural Society of Kenya Shows in order to sensitise the public on its functions.

Legal Status of the Monetary Policy Statement

1. Section 4B (1) of the CBK Act requires the Bank to submit to the Cabinet Secretary for The National Treasury, at intervals of not more than six months, a Monetary Policy Statement for the next twelve months which shall:
    i. Specify policies and the means by which the Bank intends to achieve its policy targets;
    ii. State reasons for adopting such monetary policies and means; and
    iii. Contain a review and assessment of the progress made in the implementation of monetary policy by the Bank during the period to which the preceding Monetary Policy Statement relates.

2. The Cabinet Secretary shall – by law – lay every Statement submitted under subsection (1) before the appropriate committee of the National Assembly not later than the end of the subsequent session of Parliament after the Statement is so submitted.

3a. The Bank shall – by law – publish in the Kenya Gazette:
    i) Its Monetary Policy Statement; and
    ii) Its Monthly Balance Sheet.

3b. The Bank is further required to disseminate key financial data and information on monetary policy to the public.

4. In subsection (2) of section 4B, the expression "appropriate committee" means the committee of the National Assembly appointed to investigate and inquire into matters relating to monetary policy.

Executive Summary

This Monetary Policy Statement provides the direction of monetary policy in 2016. It also reviews the outcome of the monetary policy stance adopted in the second half of 2015.

Overall month-on-month inflation remained within the Government target range from July to November, but exceeded the 7.5 percent upper bound of the target range in December 2015 largely due to high food prices, and the impact of the revised Excise taxes implemented from 1st December, 2015. It rose gradually from 7.0 percent in June 2015 to 8.0 percent in December 2015. The 12-month non-food-non-fuel inflation rose to 5.6 percent in December from 4.6 percent in June, largely due to the revised Excise taxes. However, there were no evident adverse demand pressures in the economy reflecting the impact of the monetary policy measures. The decline in international oil prices coupled with the stability of the Kenya Shilling mitigated any risks of imported inflation.

Most currencies were volatile against the U.S. Dollar in July and August, 2015 largely due to the impact of the volatility in China's financial markets, continued strengthening of the U.S. Dollar, and capital outflows from emerging markets reflecting weaker growth prospects and expectations of higher interest rates in the U.S. The Kenya Shilling has remained stable against the U.S. Dollar since September supported by a narrowing current account deficit due to a lower import bill for petroleum products and consumer goods, improved tea and horticulture exports, strong diaspora remittances, and improved market discipline. In addition, the Kenya Shilling strengthened, on average, against the Sterling Pound, Euro, and the major regional currencies. The CBK monetary policy operations ensured stability in the foreign exchange market during periods of short-term volatility.

The Monetary Policy Committee (MPC) tightened the policy stance by raising the Central Bank Rate (CBR) to 11.50 percent in July 2015 from 10.0 percent in order to anchor inflationary expectations which were attributed largely to exchange rate depreciation. In addition, the Kenya Banks' Reference Rate (KBRR) was raised to 9.87 percent in July, from 8.54 percent. The effectiveness of liquidity management instruments was enhanced through the introduction of a 3-day Repo, and by raising the maximum acceptable rate on the Term Auction Deposits (TAD) instrument to 250 basis points above the CBR. The money market was turbulent in September and October 2015 following pressures on the Government borrowing programme, and the placement of Imperial Bank Limited into receivership. The CBK used Reverse Repos to address the resultant temporary liquidity shortages in segments of the market.

The monetary policy stance in 2016 will aim at maintaining overall month-on-month inflation rate within the Government's target range of 2.5 percent on either side of the 5 percent target. The price stability objective aims at supporting a strong and sustainable growth in the medium-term. The level of foreign exchange reserves together with the Precautionary Arrangements with the International Monetary Fund (IMF) will continue to provide an adequate buffer against short-term shocks. Overall macroeconomic stability and sustainability of public debt will be supported by continued coordination of monetary and fiscal policies.

Considering the inflation and growth objectives in the Government Budget Policy Statement in 2016, monetary policy will aim at ensuring that annual growth in broad money (M3) is 17.2 percent by March 2016, 14.6 percent by June, 19.5 percent by September and 17.4 percent by December. Net Domestic Asset (NDA) of the CBK is projected at Ksh. -272 billion in March 2016, Ksh. -251 billion in June, Ksh. -240 billion in September and Ksh. -270 billion in December. The annual growth in credit to the private sector is projected at 17.5 percent in March 2016, 15.3 percent in June, 15.4 percent in September and 16.4 percent in December. The Net International Reserves (NIR) targets of the CBK are USD 5,784 million in March 2016, USD 5,900 million in June, USD 5,852 million in September and USD 6,283 million in December. Monetary policy will aim at ensuring that movements in the short-term interest rates support the Bank's primary objective of price stability. The planned reduction of Government domestic borrowing during the period is expected to ease pressure on interest rates. The Bank will also continue to review and enhance the effectiveness and efficiency of its monetary policy instruments in order to maintain price stability while ensuring financial sector stability.

Global economic growth recovery in 2016 is expected to be uneven across the advanced and emerging market economies. The slower growth prospects in China and other emerging markets, lower commodity prices, as well as the possibility of tight financing conditions following commencement of tightening of U.S. monetary policy remains the main risks to global growth outlook.

The CBK will continue to work closely with the National Treasury and regional Central Banks in order to ensure the effectiveness of monetary policy through policy coordination. The Bank will also continue its regular interactions with stakeholders in the financial and real sectors to obtain feedback, and ensure the timely release of relevant monetary and financial data. The Kenya Banks' Reference Rate (KBRR) framework will be reviewed to improve it as a transmission mechanism, while providing transparency in credit pricing to consumers.

1. Introduction

This Monetary Policy Statement (MPS) provides the direction of monetary policy for the year 2016. It also presents the outcome of the monetary policy stance adopted in the second half of 2015.

Price stability remains the primary objective of monetary policy formulation and implementation. The CBK targets for Net Domestic Assets (NDA) and Net International Reserves (NIR) are the operational parameters. The Bank also monitors targets for key monetary aggregates such as broad money (M3) and credit to the private sector. The Central Bank Rate (CBR) signals the monetary policy stance, and is the base for all monetary policy operations. 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 of the value of the Kenya Shilling. The CBK foreign exchange reserves and the Precautionary Arrangements with the International Monetary Fund (IMF) provide an adequate buffer against short-term shocks.

On the domestic scene, high food prices and the revised Excise taxes have exerted significant upward pressure on prices and, consequently, overall inflation. The revised Excise taxes contributed to the significant rise in the prices of alcoholic beverages and tobacco products. However, a stable exchange rate of the Kenya Shilling and lower prices of petroleum products reduced the risk of imported inflation. On the global scene, a modest but uneven recovery of the global economy is expected in 2016 across the advanced and emerging market economies.

The rest of this Policy Statement is organized as follows. Section 2 reviews the outcome of the monetary policy stance proposed in the June 2015 MPS while Section 3 describes the current economic environment and outlook for 2016. Section 4 concludes by outlining the specific monetary policy path for the period January to December 2016.

2. Outcomes of the Policies in the June 2015 Monetary Policy Statement

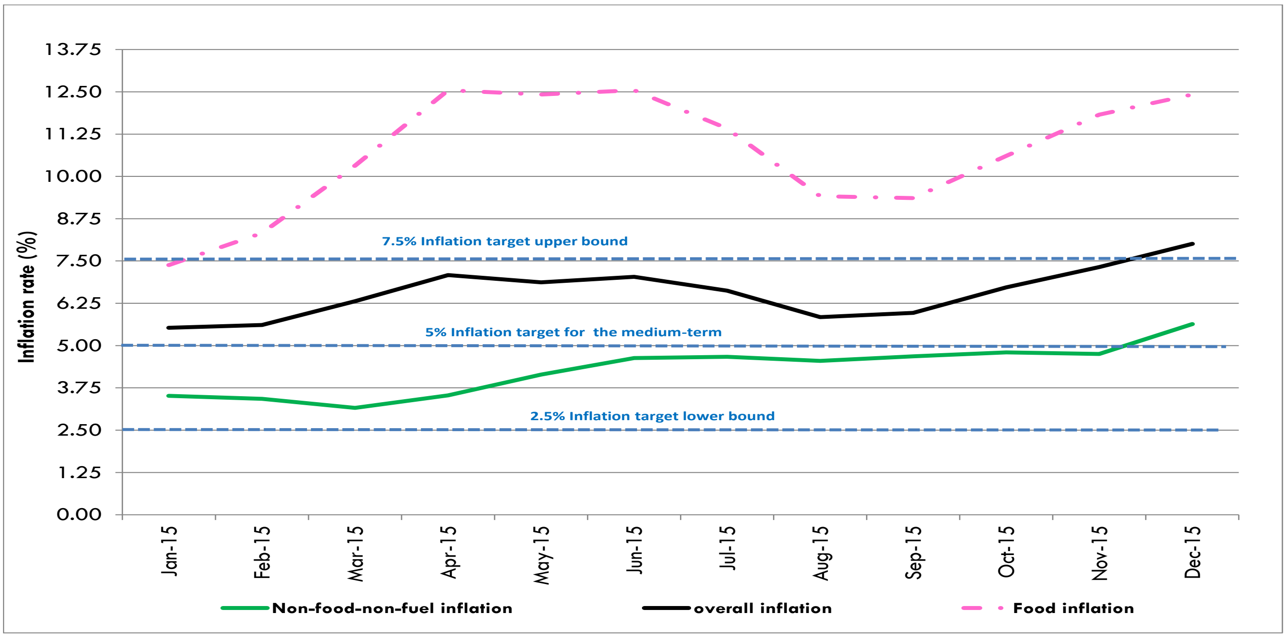
The overall aim of the Monetary Policy Statement for June 2015 (36^{th} MPS) was to set monetary policy targets that would ensure low and stable inflation, encourage growth, support long-term sustainability of public debt through stable interest rates and, by enhancing financial access within the economy, contribute to lowering the cost of doing business in Kenya. The specific outcomes of the policy proposals in the 36^{th} MPS are described below.

a. Inflation

The Monetary Policy Committee (MPC) has been pursuing a policy stance aimed at anchoring inflation expectations since June 2015. The CBR was raised to 11.5 percent in July 2015, from 10.0 percent in June. Overall month-on-month inflation remained within the Government target range from July to November, but exceeded the 7.5 percent upper bound of the target range in December 2015 (Chart 1a). It rose gradually from 7.0 percent in June to 8.0 percent in December 2015 largely reflecting increases in the prices of food, and the impact of the revised Excise taxes which came into effect on 1st December, 2015. Notably, the contribution of food inflation to overall inflation rose from 4.1 percentage points in August to 5.4 percentage points in December. The main food items with increased prices were Irish potatoes, tomatoes, kales (Sukuma wiki), carrots, cabbages, onions, beef with bones, and avocados, which contributed 2.3 percentage points to the overall inflation in December (Table 1). These items account for about 8.0 percent of the total Consumer Price Index (CPI) basket, and 22.3 percent of the food basket. Price increases for most of these items were largely due to high transport costs during the rainy season, and lower production in some of the key production regions following pest infestation.

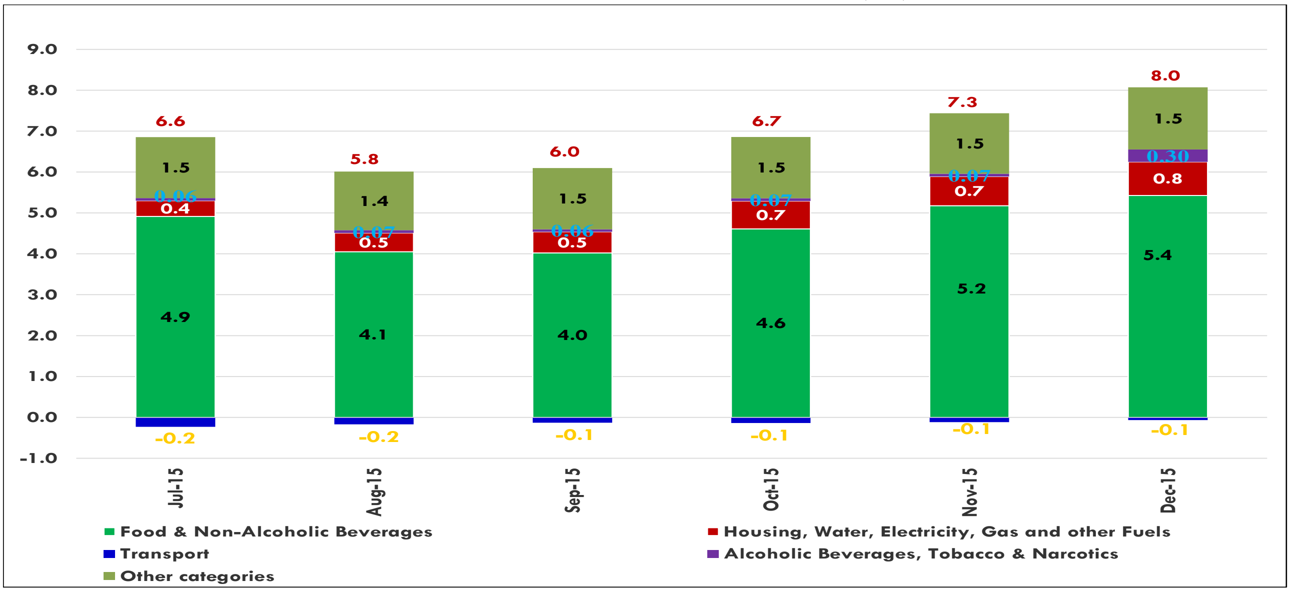
The alcoholic beverages and tobacco products contributed 0.3 percentage points to overall inflation and 1.2 percentage points to the non-food-non-fuel (NFNF) inflation (Chart 1b). Consequently, the NFNF inflation increased to 5.6 percent in December from 4.7 percent in July. However, there were no evident adverse demand pressures in the economy since growth in credit to private sector was consistent with the projected growth path. The decline in the prices of petroleum prices coupled with stability of the exchange rate of the Kenya Shilling moderated any risks of imported inflation.

Chart 1a: 12-Month Inflation in Broad Measures (%)



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

Chart 1b: Contributions to 12-Month Overall Inflation (%)



Source: Kenya National Bureau of Statistics

Table 1: Prices of Key food items driving inflation (Ksh/Kg)

	Jan-15	Apr-15	Jul-15	Oct-15	Nov-15	Dec-15	Change in Price (%)	
							(Nov-15/Dec-15)	(Dec-14/Dec-15)
Spinach	41.1	47.7	46.5	46.4	45.5	**44.0**	**-3.3**	**10.5**
Kale-*Sukuma Wiki*	33.0	42.8	37.7	38.8	37.5	**37.1**	**-1.1**	**18.7**
Tomatoes	90.1	112.9	111.3	100.7	107.6	**125.6**	**16.8**	**49.7**
Cabbages	32.6	49.3	42.0	43.7	43.4	**43.3**	**-0.2**	**48.6**
Carrots	55.3	72.8	85.0	78.3	77.2	**80.4**	**4.2**	**49.6**
Onions	94.2	104.4	119.6	121.6	124.3	**134.3**	**8.1**	**46.3**
Potatoes (Irish)	46.3	63.6	63.2	73.8	78.1	**76.4**	**-2.2**	**64.7**

Source: Kenya National Bureau of Statistics

i. Credit to Private Sector

The growth in credit to private sector remained strong in the second half of 2015 (Table 2). The 12-month growth in credit declined gradually from 20.5 percent in June to 18.0 percent in December 2015, and was consistent with the monetary policy stance and desired inflation profile. Credit growth in the period was largely towards the key sectors of the economy including: agriculture, manufacturing, trade, transport and communication, building and construction, business services, real estate, and finance and insurance. The deceleration in credit growth to the mining and quarrying sector was attributed largely to the delayed regulatory framework for the sector.

Table 2: Annual Growth in Private Sector Credit across Sectors (%)

	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15
Agriculture	24.0	28.5	28.7	21.4	17.2	12.5	14.6
Manufacturing	20.0	22.3	25.3	19.3	20.2	20.8	22.2
Trade	25.9	26.7	25.9	29.7	23.6	22.2	23.2
Building & construction	15.5	19.8	22.1	27.9	37.6	34.0	32.2
Transport & communication	33.8	33.4	30.0	29.0	32.1	32.3	31.7
Finance and insurance	43.3	46.8	50.5	45.7	26.4	28.5	21.2
Real estate	19.4	15.5	15.0	12.5	9.8	10.6	7.6
Mining & quarrying	-22.1	-17.9	-18.0	-5.4	-15.5	-22.8	-11.3
Private households	31.2	28.6	28.5	26.6	18.2	16.7	13.8
Consumer durables	21.6	21.5	21.0	19.0	18.0	15.3	14.3
Business services	15.8	25.3	22.5	15.9	24.1	19.3	20.9
Other activities	-11.1	-12.6	-14.2	-0.9	8.6	14.6	11.9
Total	**20.5**	**21.2**	**21.0**	**20.8**	**19.5**	**18.7**	**18.0**

Source: Central Bank of Kenya

ii. Developments in the Monetary Aggregates and Impact of Financial Innovations

Broad money (M3) was within the target throughout the second half of 2015, while the private sector credit was closely aligned to the projected path (Table 3). The CBR signalled the monetary policy stance and formed the base for all subsequent monetary policy operations. The conduct of monetary policy by CBK in order to achieve its price stability target was on the basis of the monetary aggregate targeting framework. The NDA and NIR indicative targets for December 2015, and the Monetary Policy Consultative Clause (MPCC) on inflation under the Precautionary Arrangements with the IMF were met. Under the MPCC, overall month-on-month averaged over three months should be within the Government target range.

Table 3: Actual and Targeted Growth in Key Monetary Aggregates

	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15
Actual Broad Money,M3 (Ksh Billion)	2,553.0	2,549.0	2,569.9	2,556.0	2,574.7	2,604.5	2,658.2
Target Broad Money,M3 (Ksh Billion)	2,457.2	2,582.5	2,611.9	2,641.5	2,671.0	2,700.5	2,730.1
Actual Reserve Money (Ksh Billion)	372.0	383.3	367.4	376.7	433.9	391.1	392.4
Target Reserve Money (Ksh Billion)	354.6	353.6	364.5	353.4	360.9	373.3	400.1
Actual Net Foreign Assets of CBK (Ksh Billion)	565.2	558.0	557.7	529.3	590.5	580.6	621.4
Targets for Net Foreign Assets of CBK (Ksh Billion)	575.0	527.3	523.9	520.5	517.7	514.7	587.3
Actual Net Domestic Assets of CBK (Ksh Billion)	-193.2	-174.6	-190.3	-152.6	-156.6	-189.5	-229.0
Target Net Domestic Assets of CBK (Ksh Billion)	-220.4	-173.7	-159.4	-167.1	-156.7	-141.5	-187.2
Actual Credit to private sector (Ksh Billion)	2,072.2	2,113.8	2,149.8	2,184.0	2,186.6	2,204.4	2,223.6
Target Credit to private sector (Ksh Billion)	2,028.1	2,096.5	2,123.3	2,150.1	2,173.2	2,198.3	2,227.1
Memorandum Items							
12-month growth in actual Reserve Money (Percent)	14.9	25.8	2.9	16.7	24.5	19.8	3.4
12-month growth in Broad Money, M3 (Percent)	18.6	16.4	14.0	13.5	13.9	13.5	14.1

Source: Central Bank of Kenya

The predictability of money demand continued to be affected by an unstable money multiplier and the long-term decline in the velocity of money in circulation. The money multiplier remained unstable in the period, fluctuating between 5.9 and 7.0 while the velocity of money declined from 2.3 in December 2014 to 2.2 in September 2015. These outcomes on velocity of money and money multiplier are associated largely with financial innovations such as the mobile phone platforms which have continued to affect the design and conduct of monetary policy.

The CBK continued to implement measures aimed at improving the efficiency of the banking sector as well as financial inclusion in order to enhance the monetary policy transmission mechanism. The commercial banks' branch network increased from 1,476 in June 2015 to 1,508 in December 2015; this increase was distributed across all the counties in the country. Similarly, the Agency Banking model continued to expand; a total of 17 commercial banks had been licensed by the CBK to undertake Agency banking by December 2015. The banks have contracted 39,754 active agents which had facilitated 221.6 million cumulative transactions valued at Ksh. 1.2 trillion by December 2015. This was a notable increase from September 2015 when the number of Agents stood at 38,871, and the cumulative transactions at 193.4 million valued at Ksh. 1.0 trillion.

The mobile phone continued to be an important platform for financial services thereby reducing transaction costs. Mobile phone money transactions were estimated at Ksh. 8.6 billion per day in December 2015 compared with Ksh. 6.5 billion in June 2015. This points to the potential of technology-led delivery channels in increasing access to financial services.

iii. Interest Rates and Liquidity

Overall liquidity conditions were tight between July and October 2015 with the interbank interest rate remaining above the CBR. This was consistent with the monetary policy tightening bias stance adopted by the MPC, with the CBR having been raised to 11.5 percent in July 2015 from 10.0 percent in order to anchor inflationary expectations. The money market was turbulent in September and October 2015 following pressures on the Government borrowing programme and the placement of Imperial Bank Limited into receivership. Following the action taken by the CBK on Imperial Bank in October, there were immediate misrepresentations in the social media with regard to the viability of some banks. This resulted in the loss of deposits in some of these banks due to biased expectations. These developments tightened further the liquidity conditions and exerted upward pressure on short-term interest rates partly due to skewed distribution of liquidity. The temporary pressure on the Government borrowing programme coupled with the policy measures adopted to anchor inflation expectations following exchange rate pressures contributed to a significant rise in Treasury bill rates in October. The 91-day Treasury bill rate rose sharply from an average of 8.3 percent in June to an average of 21.7 percent in October.

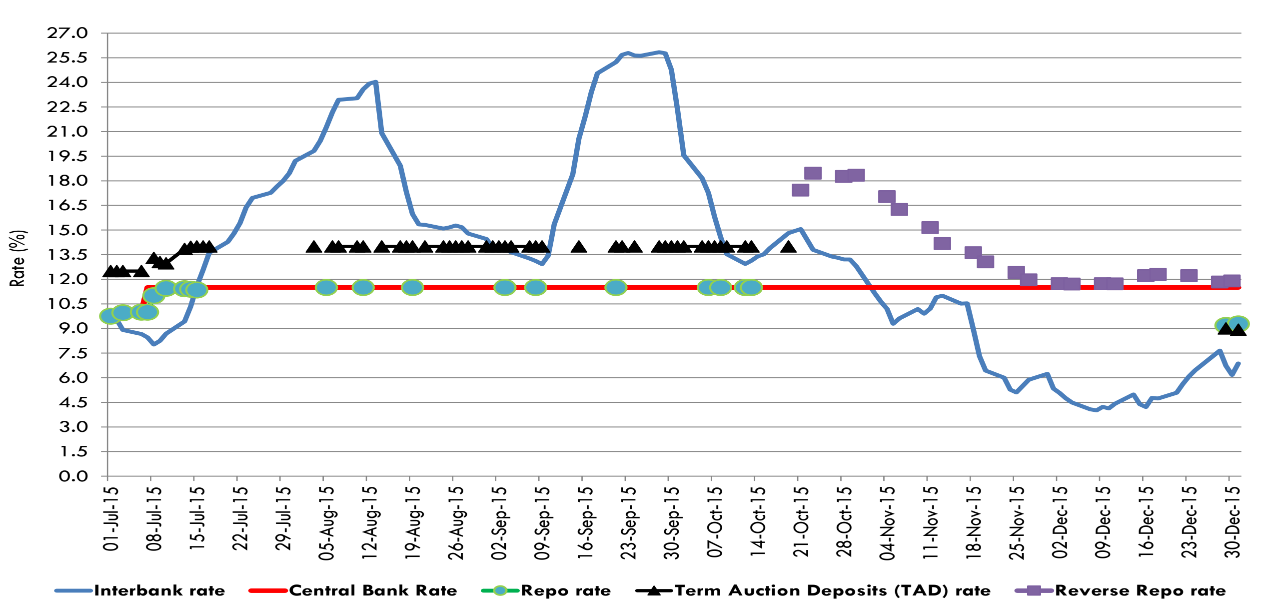
The CBK used Reverse Repos to address the temporary liquidity shortages in segments of the market. In addition, the Government issuance of a Syndicated Loan in November dampened pressure on domestic borrowing. The tight liquidity conditions eased in October with the interbank rate declining to below the CBR (Chart 2). The liquidity distribution in the interbank market have improved as evidenced by the decline, and subsequent stability, in the interbank rate in November and December. The 91-day Treasury bill rate declined to an average of 9.8 percent in December. The CBK is working with stakeholders in the banking sector to explore strategies for enhancing redistribution of liquidity through development of Horizontal Repo market.

The CBK continued to work with the Kenya Bankers Association (KBA) and banks to implement initiatives in the banking sector aimed at reducing the cost of doing business and promoting transparency in the banking sector. These initiatives include: innovation by banks; improving transparency in pricing credit through publication of individual commercial banks' lending rates on the CBK website; strengthening the Kenya Bank Reference Rate (KBRR) framework; strengthening collateral ownership; supporting modernization of the Lands and Companies Registries, and development of an electronic registry for moveable assets; reducing time costs in realizing collateral; Currency Centres and Agency Banking; Credit Reference Bureaus; and strengthening the National Payment System.

The CBK revised the KBRR to 9.87 percent in July 2015 from 8.54 percent. The average commercial banks' lending rates increased to 18.3 percent in December 2015 from a revised rate of 16.1 percent in June 2015, partly reflecting increased cost of funds (Table 4). The increase in lending rates was reflected across all the bank sizes, but was more pronounced in the small bank category reflecting competition for funds. The average deposit rate increased from 6.6 percent to 8.0 percent during the period reflecting increased banks' competition for deposits. The spread between the average commercial banks' lending rate and deposit rate increased from 9.4 percent to 10.3 percent in the period. Large banks had the highest spread on average during the second half of 2015 due to comparably lower deposit rates.

The MPC continued to engage the Chief Executive Officers of banks on various issues through regular forums after MPC meetings. This has facilitated a platform for moral suasion and provided a regular feedback mechanism.

Chart 2: Trends in Short-Term Interest Rates (%)



Source: Central Bank of Kenya

Table 4: Trends in Commercial Bank Interest Rates and Spreads (%)

	Average Lending rates (%)				Average Deposit rates (%)				Average Spread (%)			
	Small	Medium	Large	Overall	Small	Medium	Large	Overall	Small	Medium	Large	Overall
Jun-15	16.5	16.0	16.0	16.1	6.8	8.0	5.1	6.6	9.7	8.0	10.9	9.4
Jul-15	16.4	15.8	15.9	16.0	7.0	7.7	5.3	6.3	9.3	8.1	10.6	9.7
Aug-15	17.0	15.8	15.8	15.9	7.5	7.7	5.7	6.9	9.5	8.0	10.1	9.0
Sep-15	17.7	17.0	16.5	16.8	7.5	7.9	6.5	7.3	10.1	9.2	10.0	9.5
Oct-15	17.8	16.3	16.5	16.6	9.1	8.0	6.5	7.5	8.7	8.3	10.0	9.0
Nov-15	18.7	17.2	16.9	17.2	9.4	8.2	6.4	7.4	9.3	9.1	10.5	9.8
Dec-15	19.0	18.6	18.0	18.3	9.4	8.0	7.4	8.0	9.6	10.6	10.6	10.3

Source: Central Bank of Kenya

b. Exchange Rates and Foreign Exchange Reserve Developments

i) Exchange Rates and External Sector Developments

Most currencies were volatile against the U.S. Dollar in July and August, 2015 largely due to the impact of the volatility in China's financial markets, continued strengthening of the U.S. Dollar, and capital outflows from emerging markets reflecting weaker growth prospects and expectations of higher interest rates in the U.S. Consequently, the major international and regional currencies depreciated against the U.S. Dollar in the period (Charts 3a and 3b). The global strengthening of the U.S. Dollar reflected the strong recovery in the US economy, and uncertainty in the financial markets attributed to the timing of the increase in U.S. interest rates. The Kenya Shilling strengthened, on average, against the Sterling Pound, Euro, South African Rand, and the major regional currencies from September. This reflected the resilience and diversified nature of the Kenyan economy relative to its peers. In the region, the South African Rand weakened significantly against most currencies largely due to the drop in commodity prices, widening trade deficit attributed to weak growth in its main trading partners including China, and labour unrests in the mining sector which have affected growth.

The foreign exchange market has remained stable since September 2015 supported by a narrowing current account deficit largely due to a lower import bill for petroleum products, recovery in tourism, tea and horticulture exports, strong diaspora remittances, and improved market discipline. The 12-month cumulative current account deficit was estimated at about 8.2 percent of GDP in December 2015 down from 10.4 percent of GDP in December 2014. In particular, the annual growth in earnings from tea exports rose from -1.1 percent in June 2015 to 16.6 percent in December. The CBK's foreign exchange reserves together with the Precautionary Arrangements with the International Monetary Fund (IMF) provided an adequate buffer against short-term shocks.

The lower petroleum products import bill eased the demand for foreign exchange following the sustained decline in the international crude oil prices in the second half of 2015. The decline in international oil prices reflected increased production from the United States and Libya, reduced demand particularly from China following dimmed growth prospects, a stronger U.S. Dollar in the global markets, and sustained production by the Organization of Petroleum Exporting Countries (OPEC). Subsequently, Murban crude oil prices declined from USD 63.7 per barrel in June 2015 to USD 37.3 per barrel in December 2015 (Chart 3c). Consequently, the proportion of oil imports in total merchandise imports declined from 21.3 percent in 2014 to 15.5 percent in 2015.

The 12-month cumulative proportion of imports of goods and services financed by exports of goods and services increased from 54.7 percent in June 2015 to 60.9 percent in December 2015. Although the value of imports of machinery and transport equipment declined by 11.4 percent in 2015, its share in total imports rose slightly to 33.4 percent from 32.4 percent in 2014. This partly reflected imports of equipment towards construction of the Standard Gauge Railway.

Chart 3a: Movements of Exchange Rates of the Kenya Shilling and Major International Currencies against the U.S. Dollar (2nd January 2015 = 1)

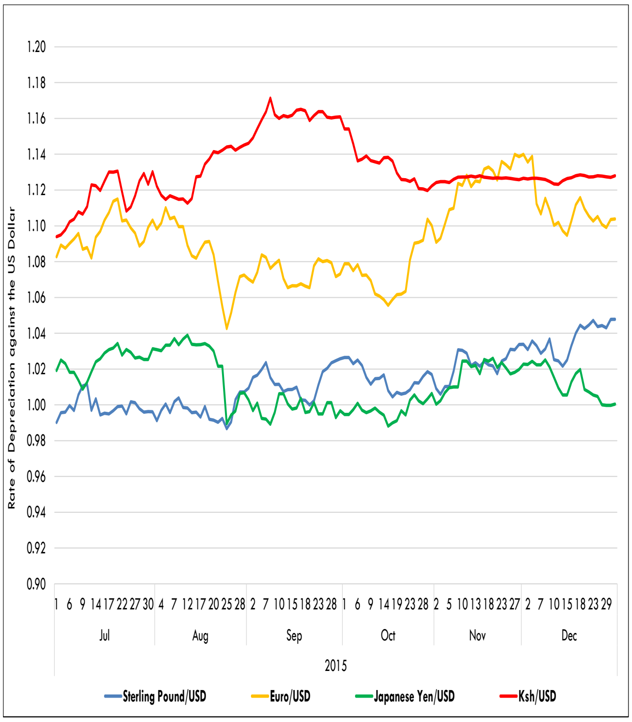
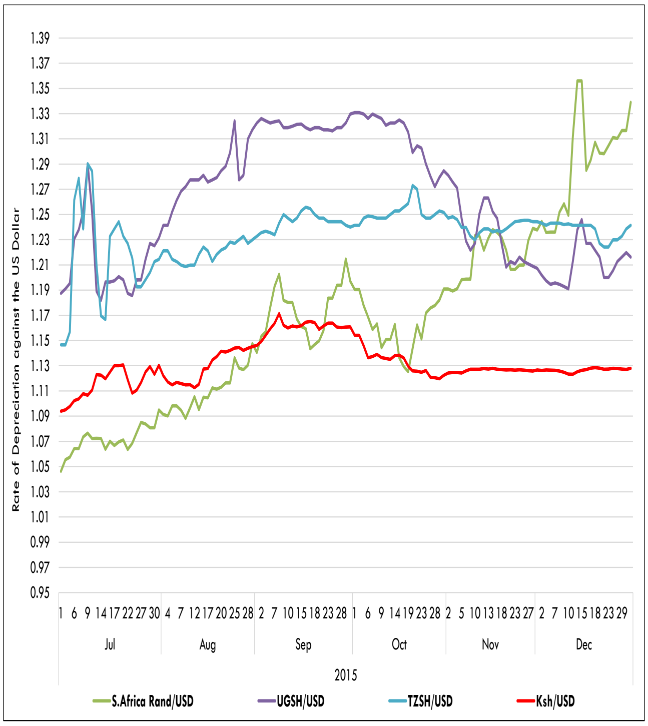
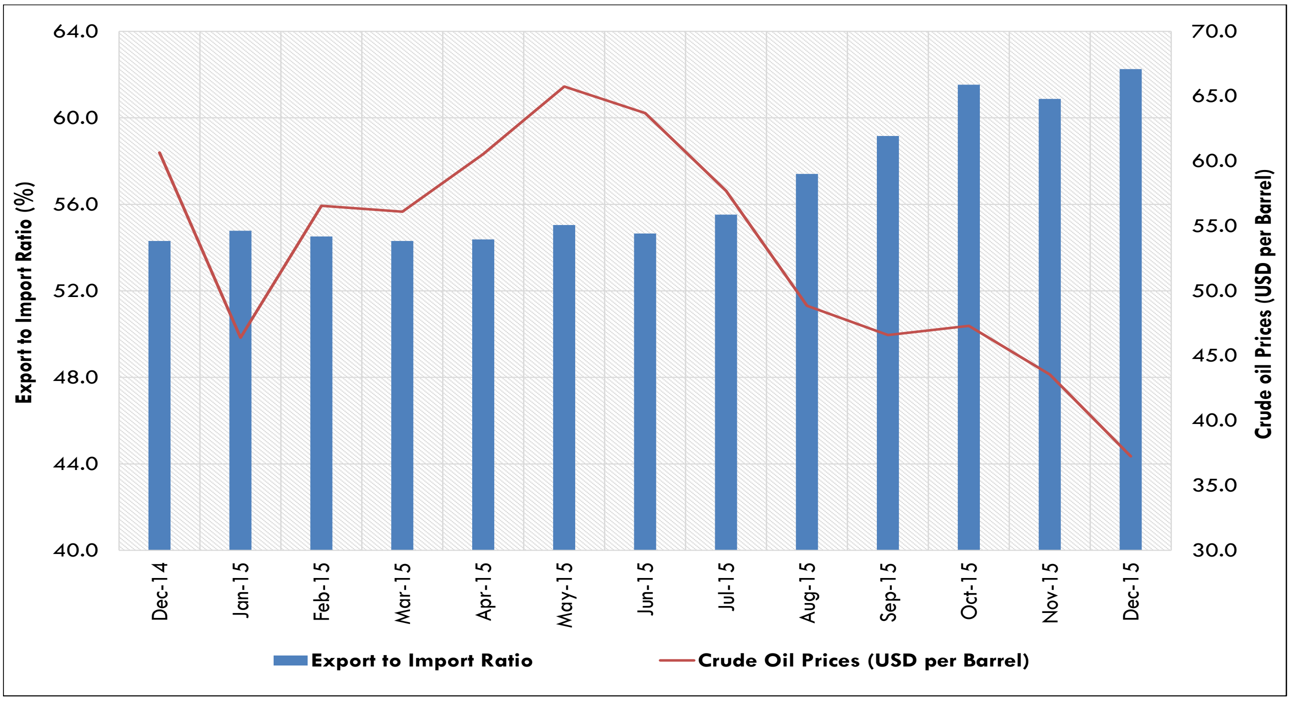


Chart 3b: Movements of Exchange Rates of the Kenya Shilling and Regional Currencies against the U.S. Dollar (2nd January 2015 = 1)



Source: Central Bank of Kenya

Chart 3c: 12-Month Cumulative Exports/12-Month Cumulative Imports (%)



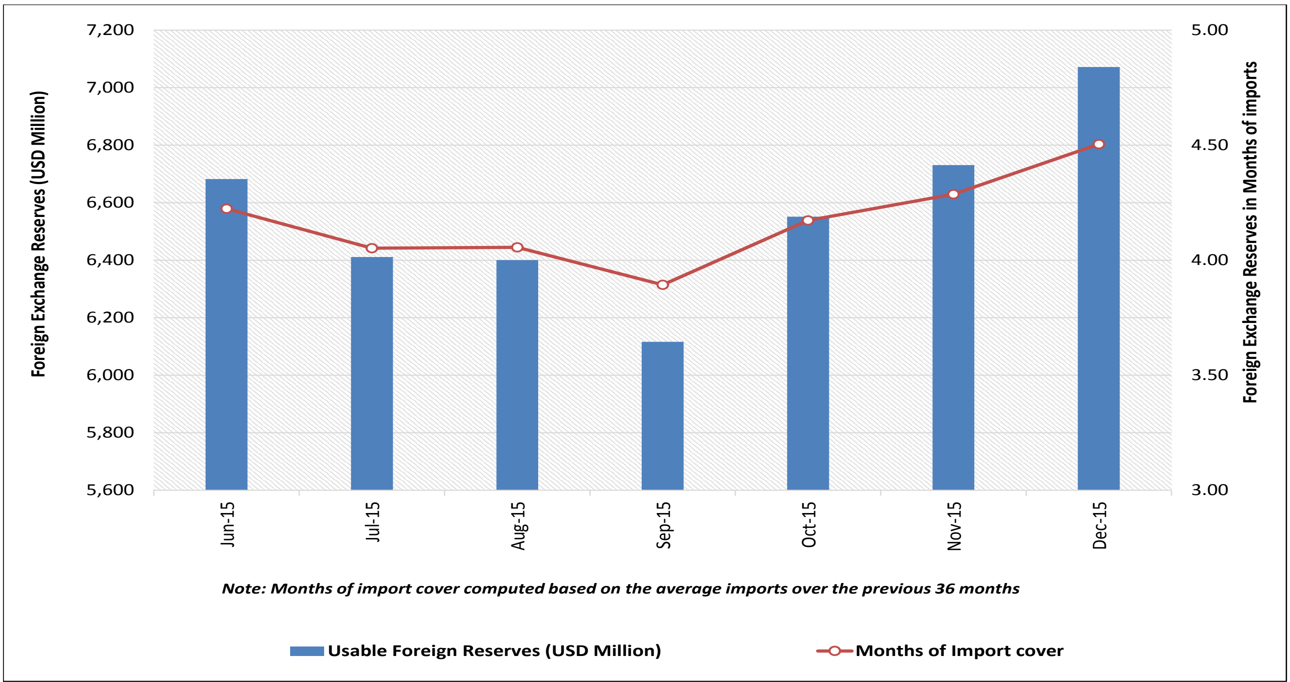
Note: Exports and imports comprise goods and services

Source: Central Bank of Kenya and Kenya Revenue Authority

ii) Foreign Exchange Reserves

The CBK level of usable foreign exchange reserves rose to USD 7,071.7 million (equivalent to 4.5 months of import cover) at the end of December 2015 from USD 6,682.5 million (equivalent to 4.2 months of import cover) at the end of June (Chart 4). The build-up in foreign exchange reserves was due to purchases from the market and the proceeds of the Government Syndicated Loan contracted in November. This level of reserves together with the Precautionary Arrangements with the IMF provided an adequate buffer against short term shocks. The IMF's Executive Board completed the first review of Kenya's performance under the programme in September 2015, and made available an additional SDR 54.3 million, bringing the cumulative amount available under the arrangements to SDR 434.2 million (about USD 610.7 million). This boosted the Bank's capacity to respond to short-term volatility in the foreign exchange market.

Chart 4: CBK Usable Foreign Exchange Reserves



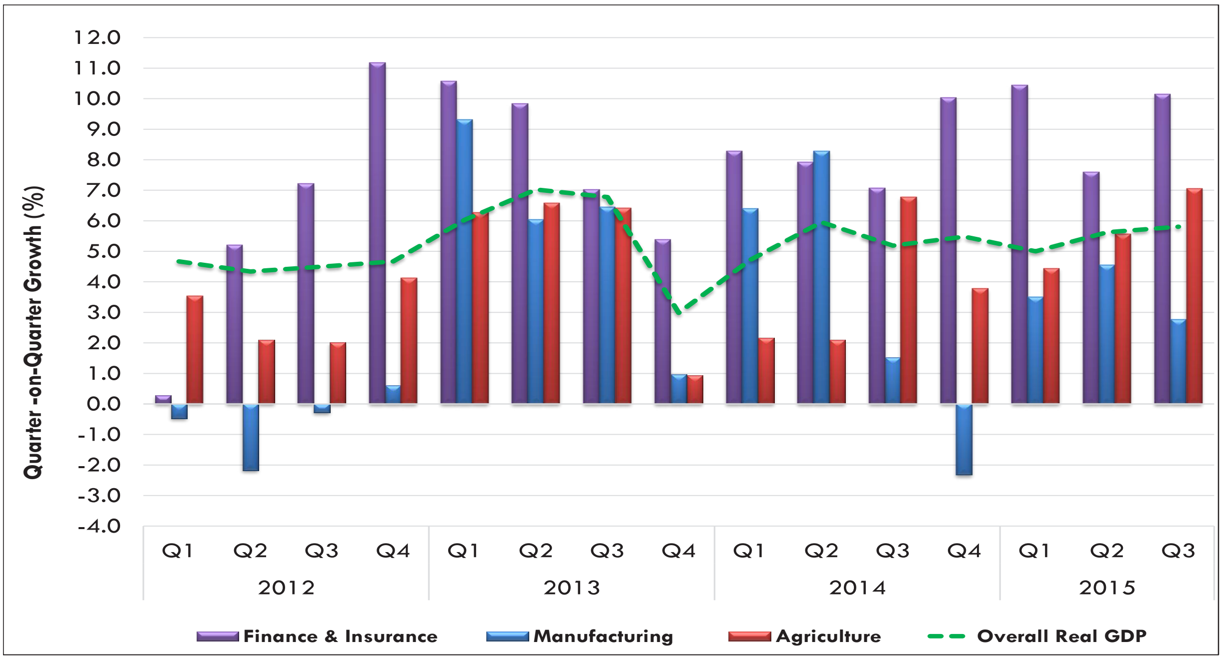
Note: *The CBK usable foreign exchange reserves refer to reserves available for use without any restrictions held by the Central Bank. They exclude reserves held by CBK on behalf of the Government or commercial banks.*

Source: Central Bank of Kenya

c. Economic Growth

The economy remains robust; real GDP growth accelerated to 5.8 percent in the third quarter of 2015 compared with 5.6 percent in the second quarter and 5.0 percent in the first quarter (Chart 5). This performance was supported by higher public investment spending, improved weather conditions that boosted agricultural and hydro-power electricity production, lower oil prices, and a higher country profile. In addition, strong performance of construction, agriculture, wholesale and retail trade, transport and storage; mining and quarrying, and electricity and water supply during the period was an indication of the sustained growth in the economy supported by macroeconomic stability. The finance and insurance sector which grew by 10.1 percent continued to provide strong support to the growth performance.

Chart 5: Quarter-on-Quarter Sectoral and Overall Real GDP growth rates (%)



Source: Kenya National Bureau of Statistics

d. Fiscal Developments and Debt

The Government's borrowing plan in the first half of the Fiscal Year 2015/16 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. The issuance of a Syndicated Loan in November 2015 eased pressure on domestic borrowing and domestic interest rates.

e. Other Activities of the MPC, and Policy Coordination

The MPC held forums with Chief Executive Officers of commercial banks after every meeting during the second half of 2015. The Committee also continued to improve on the 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. As a result, the media and public understanding of monetary policy decisions and their expected impact on the economy continued to be enhanced.

In July 2015, the Governor who is also the Chairman of the MPC, held meetings with the National Assembly Departmental Committee on Finance, Planning and Trade as well as the Senate Standing Committee on Finance, Commerce and Budget to discuss developments in exchange rates, inflation, economic growth, and interest rates and spreads. The Chairman also held a press conference in September 2015 to brief the media on measures undertaken by the CBK to support macroeconomic and financial stability.

The Governor also participated in a Meeting of the Governors of the East African Community partner states' held in December 2015, in Tanzania, to review exchange rate developments in the region and agree on coordinated measures to address the challenges. Given the risks posed by the persistent turbulence in the global financial markets, continued commitment to the price stability objective, market discipline, and strong international reserves buffers were identified as key to ensuring stability in the regional exchange rates.

3. The Current Economic Environment and Outlook for 2016

a. International Economic Environment

Global growth is projected to rise to 3.4 percent in 2016 from 3.1 percent in 2015, but the recovery is expected to be uneven across the advanced and emerging market economies (Table 5). The risks to the global growth outlook relate to the slower growth prospects in China and other emerging markets, lower commodity prices, as well as the possibility of tight financing conditions following commencement of tightening of U.S. monetary policy. However, the impact on Kenya will be limited due to weak trade and financial linkages to these economies. About 40 percent of Kenya's exports are to Sub-Saharan Africa (SSA), while the country does not depend on only one major export like most commodity dependent economies. The projected strong growth in SSA countries is expected to support Kenya's exports and ensure exchange rate stability.

Despite weak prospects for commodity prices, a modest pick-up in global inflation is expected in 2016. Inflation in advanced economies is expected to rise, albeit unevenly, from 0.3 percent in 2015 to 1.1 percent in 2016 while that in emerging market economies is projected to pick-up slightly from 5.5 to 5.6 percent. Inflation prospects in emerging market economies reflect the conflicting implications of weak domestic demand and lower commodity prices versus possible currency depreciations.

Table 5: Performance and Outlook for the Global Economy

	Real GDP Growth (%)		
	2014 Act.	2015 Est.	2016 Proj.
World	**3.4**	**3.1**	**3.4**
Advanced Economies	**1.8**	**1.9**	**2.1**
United States	2.4	2.5	2.6
Japan	0.0	0.6	1.0
Euro Area	0.9	1.5	1.7
United Kingdom	2.9	2.2	2.2
Other Advanced economies	2.8	2.1	2.4
Emerging and developing economies	**4.6**	**4.0**	**4.3**
Sub-Sahara Africa	5.0	3.5	4.0
Developing Asia	6.8	6.6	6.3
China	7.3	6.9	6.3
India	7.3	7.3	7.5
Middle East and North Africa	2.8	2.5	3.6

Source: IMF World Economic Outlook

b. Domestic Economic Environment

i. Economic Growth

The Bank aims at price stability so as to support sound and sustained economic growth. The Government projects real GDP growth to rise from an estimated 5.6 percent in 2015 to 6.0 percent in 2016. The growth outlook will be supported by increased economic activities with the completion of the Standard Gauge Railway and continued investments in other infrastructural projects such as roads, energy and port; increased agricultural production, and a recovery in tourism. The growth is also expected to benefit from increased investments and domestic demand following enhanced investor confidence and the ongoing initiatives to deepen regional integration and the development of the counties.

The MPC Market Perceptions Survey conducted in January 2016 showed optimism by private sector firms for a stronger growth in 2016 relative to 2015 on account of: macroeconomic stability; infrastructural development benefits; robust activity in the construction sector; rebound in the tourism sector due to improved security; lower international oil prices which will benefit manufacturing through lower costs of production; improved agricultural sector performance; implementation of measures to enhance governance in Government: all these will have boosted foreign investor confidence. However, there are downside risks to growth including: the high recurrent expenditure by the Government; political noise which could affect confidence; insecurity which, though improved, still remains a challenge; high interest rates; and rising external debt.

ii. External Sector and Foreign Exchange Market

The Kenya Shilling is expected to be stable in 2016 on account of a narrowing current account deficit attributed to a lower oil import bill reflecting lower international oil prices and improved performance of tea and horticulture exports; strong diaspora remittances; recovery in tourism, improved market discipline; and increased foreign direct investment in infrastructure. Despite expected imports of machinery and transport equipment related to the ongoing Standard Gauge Railway project, the current account deficit is expected to ease from an estimated 8.2 percent of GDP in 2015 to 8.0 percent of GDP in 2016. In addition, the projected growth recovery in SSA economies and that of Kenya's main trading partners is expected to boost regional trade. The Kenya Shilling exchange rate will also be supported by the adequate buffer of foreign exchange reserves and the Precautionary Arrangements with the IMF.

The main risks to the foreign exchange market in 2016 relate to possible volatility in the global financial markets due to the projected slowdown in China's growth and other emerging markets, and the possibility of tight financing conditions following commencement of tightening of U.S. monetary policy.

iii. Inflation

Overall inflation is expected to ease and stabilise within the Government's target range in 2016 supported by the monetary policy measures, lower international oil prices, a stable Kenya Shilling exchange rate and the declining international food prices which have dampened any upside risks to domestic food prices in the case of imports, and moderate electricity prices with increased output of geothermal power generation. However, the main risks to the inflation outlook remains the vulnerability to adverse weather conditions given the dominance of food in the consumer basket, and volatility in international oil prices.

iv. Interest Rates

Interest rates are expected to ease in 2016 with lower inflation and a stable exchange rate, coupled with improved liquidity conditions in the money market. In addition, the CBK will work with stakeholders to improve the KBRR framework in order to enhance its capacity as a monetary policy transmission mechanism, and to ensure transparency in credit pricing. The main risk to the outlook on interest rates is the international economic developments or supply side factors which could prompt additional measures by CBK to alleviate any adverse expectations with respect to inflation and /or exchange rate movements.

v. Fiscal Policy

Government borrowing in 2016 is anchored in the Medium-Term Debt Management Strategy which aims at maintaining public debt at sustainable levels. The planned reduction in domestic borrowing in the Fiscal Year 2015/16, through expenditure rationalisation, to Ksh. 168.2 billion from Ksh. 221.5 billion is expected to dampen pressure on both domestic borrowing and domestic interest rates. The CBK will continue to work with the National Treasury to strengthen the coordination between monetary and fiscal policies.

vi. Confidence in the Economy

Confidence in the economy is expected to continue to improve in the 2016 due to macroeconomic stability, improved security, and higher country profile. Specifically, Kenya was among the top 10 reformers in 2015 in the World Bank's Ease of Doing Business Index, with improvements especially in the provision of electricity, access to credit, and ease of registering property. The most recent Sovereign Rating by Moody's shows expectations of continued macroeconomic stability, and sustained growth. The MPC Market Perception Survey conducted in January 2016 showed increased optimism by private sector firms for the business environment to improve in 2016 on account of improving macroeconomic environment, public investment in infrastructure, increased global focus on Kenya, improving tourism due to improved security and falling international oil prices.

4. Direction of Monetary Policy in 2016

Monetary policy in 2016 will focus on: setting monetary targets which are consistent with the objective of achieving and maintaining a low and stable inflation, encouraging growth, and supporting the long-term sustainability of public debt; and, enhancing financial inclusion.

a) Monetary Programme and Foreign Exchange Reserves

The monetary targets for March to December 2016 are consistent with the Medium-Term Government Budget Policy Statement for 2016 summarised in Annex 1. The monetary targets for the period are presented in Table 6. Monetary policy will aim at ensuring that annual growth in broad money (M3) is 17.2 percent by March 2016, 14.6 percent by June, 19.5 percent by September and 17.4 percent by December. Net Domestic Asset (NDA) of the CBK is projected at Ksh. -272 billion in March 2016, Ksh. -251 billion in June, Ksh. -240 billion in September and Ksh. -270 billion in December. The annual growth in credit to the private sector is projected at 17.5 percent in March 2016, 15.3 percent in June, 15.4 percent in September and 16.4 percent in December. The Net International Reserves (NIR) targets of the CBK are USD 5,784 million in March 2016, USD 5,900 million in June, USD 5,852 million in September and USD 6,283 million in December. 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 also continue to review and enhance the effectiveness and efficiency of its monetary policy instruments in order to maintain price stability while ensuring financial sector stability.

These monetary targets are expected to enable the Bank maintain overall inflation within the current allowable margin of 2.5 percent on either side of the Government's medium-term target of 5 percent in order to anchor inflation expectations. The CBK foreign exchange reserves and the Precautionary Arrangements with the IMF will provide a buffer against short-term shocks in the foreign exchange market. The monetary policy stance will aim at ensuring that short-term interest rates remain stable which will support growth and ensure the long-term sustainability of public debt. The coordination of monetary and fiscal policies will also support macroeconomic stability and sustainable public debt. The Bank will also continue to enhance the effectiveness and efficiency of its monetary policy instruments. The CBK will also continue to work closely with the National Treasury and regional Central Banks in order to enhance the effectiveness of monetary policy through policy coordination.

Table 6: Monetary Targets for March to December 2016

	Mar-16	Jun-16	Sep-16	Dec-16
Broad Money, M3 (Ksh Billion)	2,812	2,925	3,055	3,112
Reserve Money, RM (Ksh Billion)	391	421	428	446
Credit to Private Sector (Ksh Billion)	2,266	2,388	2,519	2,586
NFA of CBK (Ksh Billion)	663	671	667	716
NDA of CBK (Ksh Billion)	-272	-251	-240	-270
12-month growth in RM (Percent)	12.9	13.1	13.5	13.6
12-month growth in M3 (Percent)	17.2	14.6	19.5	17.4
12-month growth in Credit to Private Sector (Percent)	17.5	15.3	15.4	16.4
12-month growth in Real GDP (Percent)		5.8		6.0
Medium-Term 12-month overall Inflation (Percent) Target	5.0	5.0	5.0	5.0

Source: Central Bank of Kenya and the National Treasury

The Bank will continue to monitor developments in the Monetary Targets and make any necessary reviews. The information will be reviewed and incorporated in the data so as to inform the MPC decision process accordingly. Monetary policy implementation will be based on the targets for NDA, NIR, RM and broad money (M3) to be achieved through Open Market Operations (OMO). The Repurchase agreements (Repos) and Term Auction Deposits instruments will be used to withdraw any excess liquidity in the banking system on a timely basis and where necessary Reverse Repos will be used to inject liquidity.

The achievement of the targets set will depend on stability in the international prices of oil, favourable weather conditions, and continued commitment by the Government to operate within the domestic borrowing target in the Fiscal Year 2015/16 and 2016/17. The success of the monetary policy measures will also depend on the effectiveness of the institutions charged with the responsibility of managing the supply side of economy that would have a direct impact on food and fuel prices.

b) Measures to Extend Access to Financial Services and Enhance Market Efficiency

The CBK will continue to support development of new products and innovations towards enhancing financial access in order to encourage economic growth. Appropriate legislation and regulations will be proposed to ensure that such innovations are operationalized accordingly so as to enhance market confidence. The Bank will monitor any new financial derivatives and /or innovations in the market that could have adverse effects on market stability. It will work with stakeholders in the banking and real sectors in order to enhance the monetary policy transmission mechanism. The CBK will work closely with the other stakeholders to facilitate a review of the KBRR framework with a view to improving its capacity as a monetary policy transmission mechanism, and thereby promoting transparency in credit pricing.

The CBK will continue to work with stakeholders to identify and implement measures to enhance redistribution of liquidity in the interbank market. Forums with Chief Executive Officers of banks through the KBA will continue to be held both to obtain feedback and to explain the background to MPC decisions. These initiatives will support improvements in the financial sector that contribute to the lowering of the cost of doing business. The CBK will also continue with its transparency policy through the timely dissemination of all the requisite data through its website.

ANNEX 1: MAIN MACROECONOMIC INDICATORS (2015/16 – 2018/19)

	2015/16		2016/17	2017/18	2018/19
	Budget	*Rev. Proj.*	*Projections*		
Annual percentage change, unless otherwise indicated					
National account and prices					
Real GDP	7.0	5.8	6.1	6.3	6.5
GDP deflator	6.5	6.8	6.2	5.6	5.4
CPI Index (eop)	5.0	5.3	5.0	5.0	5.0
CPI Index (avg)	5.0	5.6	5.0	5.0	5.0
Terms of trade (-deterioration)	0.3	1.5	-1.0	-0.1	-0.9
In percentage of GDP, unless otherwise indicated					
Investment and saving					
Investment	26.9	23.5	22.8	22.6	23.8
Gross National Saving	19.7	15.9	16.3	16.1	17.4
Central government budget					
Total revenue	20.8	20.3	20.6	20.9	21.1
Total expenditure and net lending	30.6	29.5	28.3	27.1	26.0
Overall balance (commitment basis) incl. grants	-8.7	-8.0	-6.8	-5.4	-4.1
Overall balance (commitment basis) incl. grants excl. SGR	-8.7	-6.2	-5.6	-5.2	-3.6
Net domestic borrowing	3.4	2.6	2.7	2.8	1.8
External sector					
Current external balance, including official transfers	-7.2	-7.6	-6.5	-6.5	-6.5

Source: Budget Policy Statement, 2016, National Treasury

ANNEX 2: CHRONOLOGY OF EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (JULY – DECEMBER 2015)

Date	Events
July	a) The CBR was raised from 10.0 percent to 11.5 percent to anchor inflation expectations
	b) Introduction of a 3-day repo to augment the instruments for liquidity management
	c) The CBK revised the KBRR from 8.54 percent to 9.87 percent on 7th July 2015
	d) Uncertainty in the Eurozone and the global financial markets over the collapse of a multi-billion-Euro bail-out for Greece, and its subsequent default on IMF debt
August	a) Dubai Bank Kenya Limited was placed under receivership by the CBK
	b) The European Commission signed a Memorandum of Understanding with Greece following approval by the European Stability Mechanism Board of Governors for further stability support and economic adjustment programme
	c) Global financial markets were volatile following the Chinese stock market crash
September	The CBR was retained at 11.50 percent in order to anchor inflation expectations
October	Imperial Bank Limited was placed under receivership by the CBK
November	The CBR was retained at 11.50 percent in order to anchor inflation expectations
December	Commencement of normalisation of U.S. monetary policy. The Federal Fund Rate was raised by 50 basis points.

GLOSSARY OF KEY TERMS

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.

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