
Letter of Transmittal

Dear Honourable Minister,

I have the pleasure of forwarding to you the 21st Monetary Policy Statement (MPS) of the Central Bank of Kenya (CBK), pursuant to Section 4B of the Act. The Statement reviews the implementation of monetary policy since June 2007, the last month covered in the previous Statement. It also covers the current economic developments, and outlines the monetary policy stance for the year to December 2008.



Prof. Njuguna Ndung'u
Governor

MONETARY POLICY STATEMENT DECEMBER 2007

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The Principal objectives of the Central Bank of Kenya (CBK) 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), the Bank shall support the economic policy of the Government, including its objectives for growth and employment.

Without prejudice to the generality of the above, the Bank also seeks to:

- Formulate and implement foreign exchange policy;
- Hold and manage its foreign exchange reserves;
- License and supervise authorized dealers in the money market;
- Promote the smooth operation of payments, clearing and settlement systems;
- Act as banker and adviser to, and as fiscal agent of the Government; and
- Issue currency notes and coins.

Objectives of Monetary Policy

The CBK formulates and conducts monetary policy with the aim of keeping inflation low and stable, thereby contributing to a favourable macroeconomic environment for sustainable economic growth and employment creation. Low and stable inflation facilitates higher levels of domestic savings and private investment and therefore leads to better economic outcomes including improved economic growth, higher real incomes and increased employment opportunities.

The Bank's monetary policy is thus designed to support the economic growth and employment objectives of the Government through achieving low and stable inflation.

Instruments of Monetary Policy

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

- **Open Market Operations** (OMO) whereby the CBK either buys or sells Treasury bills and any other eligible securities to achieve a desired level of money in the economy. The CBK injects money to the economy when it buys Treasury bills from commercial banks through repurchase order agreement (Repos) , and withdraws money when it sells them.
- **Standing Facilities** which the CBK, as lender of last resort, provides secured loans to commercial banks on an overnight basis at a rate known as the Central Bank Rate (CBR). The value of the CBR is based on the average of the interbank and the Repo rates plus a margin to be determined and announced by the CBK every eight weeks. Commercial banks facing temporary liquidity needs may also rediscount their Treasury bills holdings at the CBR.
- **Reserve Requirements**, which is the proportion of commercial banks' deposits to be held as cash (CRR) at the CBK in accordance with the law. An increase in CRR reduces the capacity of commercial banks to extend credit. A reduction in the CRR enhances the capacity of commercial banks to expand credit. The CRR has been maintained at 6 percent of commercial banks' deposits since July 2003.
- **Foreign Exchange Market Operations** whereby the CBK either injects or withdraws liquidity by engaging in foreign exchange transactions. The participation by CBK in the foreign exchange market is in most cases geared to forestalling excessive speculative activities rather than influencing domestic liquidity, although it has the scope to do so.

Monetary Policy Statement

1. Section 4B of the CBK Act requires the Bank to submit to the Minister for Finance, 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 the 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 by the Bank of monetary policy during the period to which the preceding Monetary Policy Statement relates.

2. The Minister is required by the law to 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.

- 3 a. The Bank is required by the law to 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), the expression “appropriate committee” means the committee of the National Assembly appointed to investigate and inquire into matters relating to monetary policy.

EXECUTIVE SUMMARY

World real GDP grew by over 5 percent in the first half of 2007 according to the October 2007 World Economic Outlook. Russia, China and India accounted for half of the global expansion in the past year with growth in emerging market and developing countries remaining robust. Strong domestic demand in emerging market countries counterbalanced the slowdown in US growth arising from the difficulties in the housing market. The prospects for the world economy remain positive with output growth estimated at 5.2 percent in 2007 and 4.8 percent in 2008. This is, however, a slowdown following disruptive financial market conditions in 2007, particularly in the US where the housing sector crisis dampened consumption spending and residential investment.

Following a 5.7 percent growth in 2006, the expansion in Sub-Saharan Africa is projected to increase to 6.1 percent in 2007 and 6.8 percent in 2008 according to the October 2007 World Economic Outlook (WEO). The coming on stream of new production facilities in Angola and Nigeria is the main driver of the recent pace of expansion. Growth in oil importing countries in the region remains robust reflecting sound policy implementation which has also led to substantial progress in the area of trade liberalization and diversification. Slower global expansion leading to weaker demand for African commodity exports and adverse political developments could, however, weaken the prospects for higher growth. Sustaining the economic expansion therefore requires building strong institutions, developing infrastructure and strengthening the business environment.

Leading economic indicators show improved performance with the Kenya's economy estimated to have grown by 7 percent in 2007, marking the fifth year of sustained expansion. Real GDP which grew by 6.6 percent and 7.1 percent in the first and second quarters of 2007 respectively was underpinned by a vibrant tourism sector, increased activity in building and construction, manufacturing and financial services. Output in 2008 is projected to grow by at least 4.5 percent. In line with the Vision 2030, the economic expansion is also expected to be sustained over the medium term towards 10 percent stimulated by favourable macroeconomic conditions and sustained progress in implementing key economic and structural reforms. A major risk to the economic outlook in the short term is volatile international oil prices, re-emergence of drought conditions, as well as disruptive effects of the recent post election violence.

In the June 2007 monetary policy statement, the CBK had projected reserve money to grow by 12 percent by the end of September 2007 and 12.7 percent by the end of June 2008. At the same time, more effort was to be directed towards enhancing the effectiveness of the Bank's indirect instruments, to facilitate achievement of reserve money targets.

However, growing concerns over continued money supply growth in excess of targets and emergent double digit inflation from June 2007 onwards led to a tightening of the monetary

policy stance indicated by the upward adjustment in the Central Bank Rate (CBR) from 8.5 percent to 8.75 percent in August 2007. Several modifications were also made to the OMO framework in the second half of 2007 in line with the quest for improving the effectiveness of the Bank's indirect instruments. Some of the reforms began to bear fruit with the CBK moving towards the reserve money target by end-September 2007.

During the third and final Review by the International Monetary Fund (IMF) of the Poverty Reduction and Growth Facility (PRGF) for Kenya in mid-September 2007 a revised reserve money path was set. Consequently, reserve money growth for the years to end December 2007, March and June 2008 were revised to 14 percent. By the end of December 2007, reserve money had grown beyond the target following higher than anticipated foreign exchange inflows that led to increased net foreign assets (NFA) of the CBK. Overall inflation, however, eased from 13.6 percent in July 2007 to 10.6 percent in October 2007 following improved food supplies occasioned by the onset of the short rains. In November 2007, overall, inflation picked up to 11.8 percent and further to 12 percent in December 2007, mainly reflecting increased prices of food and drink category of goods and services which carry a large weight in the consumer price index (CPI) index. When publishing the previous statement, volatile oil prices in comparison with other commodities and the possibility of re-emergence of unfavourable weather conditions had been considered to be the main supply side risks to price stability.

Going forward, the monetary policy stance of limiting reserve money growth to 14 percent by the end of June 2008 has been revised to 18 percent at the end of June 2008, and 16 percent at the end of December 2008 to allow for a more gradual adjustment in view of the accelerated inflation towards the end of 2007 and early 2008. This is expected to forestall any short term adverse effects on the broader economy from the disruptions caused by the recent political uncertainty while promoting stable prices over the medium to long term. While the revised stance adopts a gradual approach to easing inflation, it is considered appropriate to mitigate risks to inflation expectations posed by; (i) higher food prices arising from supply disruptions caused by recent political uncertainty and; (ii) volatile oil prices as the shocks are not expected to deepen in 2008. In the medium term, monetary policy will be in line with the Governments economic policy and price stability targets specified by the Minister as required by the Finance Act 2007.

Another concern for monetary policy is the influx of Foreign Direct Investment (FDI) related inflows. Although foreign exchange inflows are expected to boost economic growth in the long term and in part to reflect strengthened macroeconomic fundamentals, they present short-term macroeconomic policy challenges. In this regard, the Bank will continue to monitor developments in the foreign exchange market in the face of FDI and portfolio inflows expected in 2008 with a view to effectively managing them. The Bank will seek to consolidate the gains made so far and to sustain reforms in the framework of monetary operations. This process will be supported by the new institutional monetary policy framework outlined in the 2007 Finance Act effective January 2008.

INTRODUCTION

The 21st Monetary Policy Statement (MPS) for December 2007 is made pursuant to Section 4B of the CBK Act, and sets out monetary policy for the remainder 2008. The MPS is part of a wider set of publications that the CBK uses to report and explain its views on monetary and inflationary conditions, and the implication for monetary policy.

The 21st MPS reviews implementation of monetary policy for the period June 2007 to December 2007, evaluates key macroeconomic indicators during this period against projections while setting out possible risks in the short term, and lays out monetary policy for 2008.

The MPS is presented in three parts. Section one reviews the performance of monetary policy in the second half of 2007. Section two covers economic developments in the second half of 2007, and presents the outlook in 2008 and in the medium term. The last section contains the monetary policy stance for the remainder 2008 and is expected to inform economic agents when forming expectations on monetary conditions and inflation. The section also summarizes both prospects and risks that could influence the outlook for inflation.

1. MONETARY POLICY SINCE THE LAST STATEMENT OF JUNE 2007

1.1 Review of Recent Monetary Policy Stance

Monetary policy sought to limit the annual growth in both reserve money and broad money to 14 percent by end-June 2007 and 12 percent by end-September 2007 to address the risk posed by faster growth in monetary aggregates than projected expansion in line with the inflation objective. Following the third and final review under the PRGF programme in September 2007, the path for reserve money was revised midstream limiting to accommodate reserve money and broad money growth of 14 percent and 15 percent respectively for the remainder of the fiscal year 2007/8.

Economic growth was projected to pick up from 6.1 percent in the fiscal year 2006/07 to 6.4 percent in the fiscal year 2007/08. In the medium term, annual GDP growth was expected to accelerate to 10 percent as the Government implements flagship projects identified under the vision 2030 framework. The main elements of the monetary expansion path are summarized in Table 1 below.

Table 1: Growth Targets for Key Aggregates for 2007/08

	S e p '07	D e c '07	J u n '08	J u n '09
Reserve money (Ksh million)	125.3	139.1	137.2	142.6
NFA of CBK (Ksh million)	182.9	189.5	198.1	206.2
M e m o :				
Annual change in reserve money	12.0	10.0	12.7	12.8
Annual change in broad money (M3)	12.0	11.0	12.7	12.8
Real GDP growth			6.4	6.5
Overall inflation			5.0	5.0

Source: Central Bank of Kenya

Implementation of monetary policy in the second half of 2007 was anchored on quarterly targets for reserve money as in the past. Monthly targets for reserve money (currency in circulation and commercial bank deposits at the Central Bank) were set in line with agreed quarterly targets. The monetary program was monitored on the basis of performance on reserve money and Central Banks' net foreign assets (NFA).

1.2 Performance of Monetary Policy Implementation to December 2007

Monetary policy was implemented through OMO using repurchase order agreement securities (REPOs). OMO were guided by comparing the forecast reserve money with the target reserve money on a daily basis. In most cases, the deviation of the forecast reserve money from target formed the basis for determining the amount of repos required to align reserve money to the desired path on a daily basis. Daily repos are conducted to absorb commercial bank balances at the CBK projected to be excess, while the effect on the other component of reserve money - currency in circulation - is expected to take place through the public's opportunity cost considerations after commercial banks adjust interest rates following OMO.

Liquidity mopped up under OMO was on average below the amount required to bring reserve money on target between June 2007 and December 2007. While the stock of securities under repos was above 17 billion between July and November 2007, it declined thereafter to Ksh 11.8 billion by the end of November 2007 and to Ksh 10.2 billion by the end of December 2007. As at the end of December 2007, the stock of repos required to bring reserve money on track was Ksh 21.8 billion.

In the period June 2007 through early September 2007, the framework for OMO was modified to address structural constraints that hampered effective monetary policy operations. To increase both flexibility and participation in OMO, the repo threshold was reviewed downwards from Ksh 50 million to Ksh 20 million in August 2007. A late repo facility window to run from 2.00 p.m. to 2.30 p.m. was also introduced in September 2007 to mop funds that banks receive after closure of the first window. This was intended to capture cash reserves received by banks late in the day thus helping to reduce reserve money close to target. In December 2007, the late REPO threshold was lowered further to Ksh 10 million, and the margin on the late REPO yield narrowed to increase participation.

While reserve money growth remained volatile, measures taken by the Bank to enhance the effectiveness of OMOs were instrumental in slowing down reserve money expansion. In particular, while annual reserve money growth in the third quarter of 2007 increased by 17.9 percent in July 2007 to 19 percent in August 2007, it eased to 17 percent in the year to September 2007. In the fourth quarter of 2007, however, reserve money growth increased by 17.6 percent, 19.8 percent and 26 percent in October, November and December 2007, respectively.

Reserve Money

Reserve money remained above target resulting in the failure to observe the June 2007 performance criteria in addition to missing the September 2007 benchmark on reserve money under the PRGF program. Reserve money was also above the monthly operational targets between June 2007 and December 2007. Reserve money increased from Ksh 126.3 billion in June 2007 to Ksh 145.5 billion by December 2007, well above the December 2007 target of Ksh 141.6 billion as shown in Table 2. The excess reserve money in December 2007 was distributed as follows: currency outside banks (Ksh 3.4 billion) and bank reserves (Ksh 0.5 billion). In December 2007, reserve money turned out to be much higher than expected matched by unprecedented demand for currency during the long holidays, and the immediate post election period.

The excess reserve money from the target in December 2007 was to a large extent from increased NFA of the CBK and partly from lower holdings of repo securities of Ksh 10.2 billion compared with Ksh 21.8 billion targeted to bring reserve money back on track, reflecting a lower mop-up in OMO. In particular, CBK NFA increased faster than anticipated from Ksh 174.1 billion by the end of June 2007 to Ksh 214.4 billion by the end of December 2007, reflecting the third disbursement of USD 59.3 million under the PRGF program, USD 173.2 million from sale of equity by Equity bank, and USD 388.2 million from the privatisation of Telkom Kenya Limited.

A strong build up of Government deposits at the Bank from the privatisation of Telkom partially offset the increase in reserve money.

Unencumbered CBK NFA was also monitored against a floor for December 2007. At Ksh 169.4 billion, the adjusted unencumbered CBK NFA was well above the floor of Ksh 169.2 billion.

Table 2: Reserve Money Performance and Targets for 2007/08 (Ksh Billion)

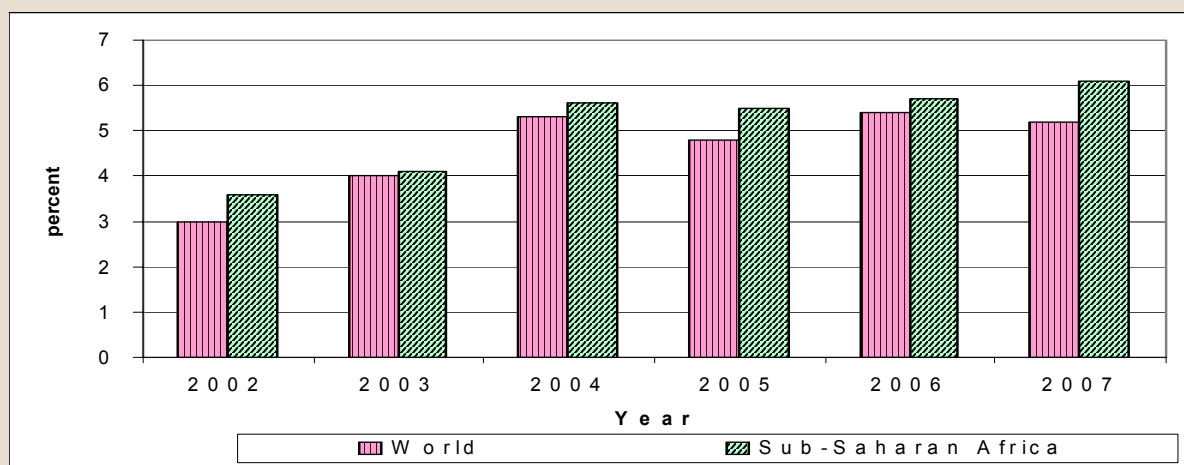
	Reserve Money			Currency outside Banks			Banks Reserves		
	Actual	Target	Dev	Actual	Target	Dev	Actual	Target	Dev
Jun-06	106.1	100.4	5.7	66.2	62.2	4.0	40.0	38.3	1.7
Sep-06	113.2	106.9	6.3	70.5	66.0	4.5	42.7	40.9	1.8
Dec-06	124.2	116.9	5.7	77.8	72.8	5.0	44.9	44.1	0.7
Mar-07	122.2	122.8	- 0.6	76.5	77.4	- 0.9	45.7	45.4	0.3
Jun-07	126.3	123.1	3.2	79.3	76.6	4.8	47.0	46.5	- 1.6
Jul-07	128.5	123.8	4.6	80.8	76.6	4.3	47.7	47.2	0.3
Aug-07	131.7	124.2	7.5	82.7	76.4	6.3	49.1	47.8	1.2
Sep-07	132.8	131.3	1.5	83.6	82.0	1.5	49.2	49.3	- 0.1
Oct-07	135.4	132.6	2.8	85.2	83.1	2.1	50.2	49.6	0.7
Nov-07	139.3	136.0	3.2	88.3	85.7	2.6	51.0	50.3	0.7
Dec-07	145.5	141.6	3.9	93.6	90.2	3.4	51.9	51.4	0.5

Source: Central Bank of Kenya

2. ECONOMIC SITUATION AND OUTLOOK FOR 2008 AND MEDIUM TERM

2.1 The World Economy

World output grew by more than 5 percent in the first half of 2007 according to the IMF's World Economic Outlook (WEO) for October 2007 (Chart 1). The expansion was mainly China, India, Russia as well as emerging market and developing countries. The IMF's assessment is that sound policy frameworks, and strong domestic demand in emerging market countries should continue to sustain global expansion. However, restoration of normal financial conditions and safeguarding continued expansion of activity would be key for growth prospects.

Chart 1: Global Economic Output (2002 - 2007)

Source: IMF World Economic Outlook

Sub-Saharan Africa is expected to grow by 6.1 percent in 2007 compared with 5.7 percent in 2006. The increase reflects higher oil revenues from new production facilities in Angola and Nigeria. Non-oil importing countries in the region have also achieved rapid growth rates, reflecting sound policy implementation, a favourable external environment and increased openness. The growth acceleration could be partially offset by weaker global expansion and demand for commodity exports, as well as political developments in individual countries.

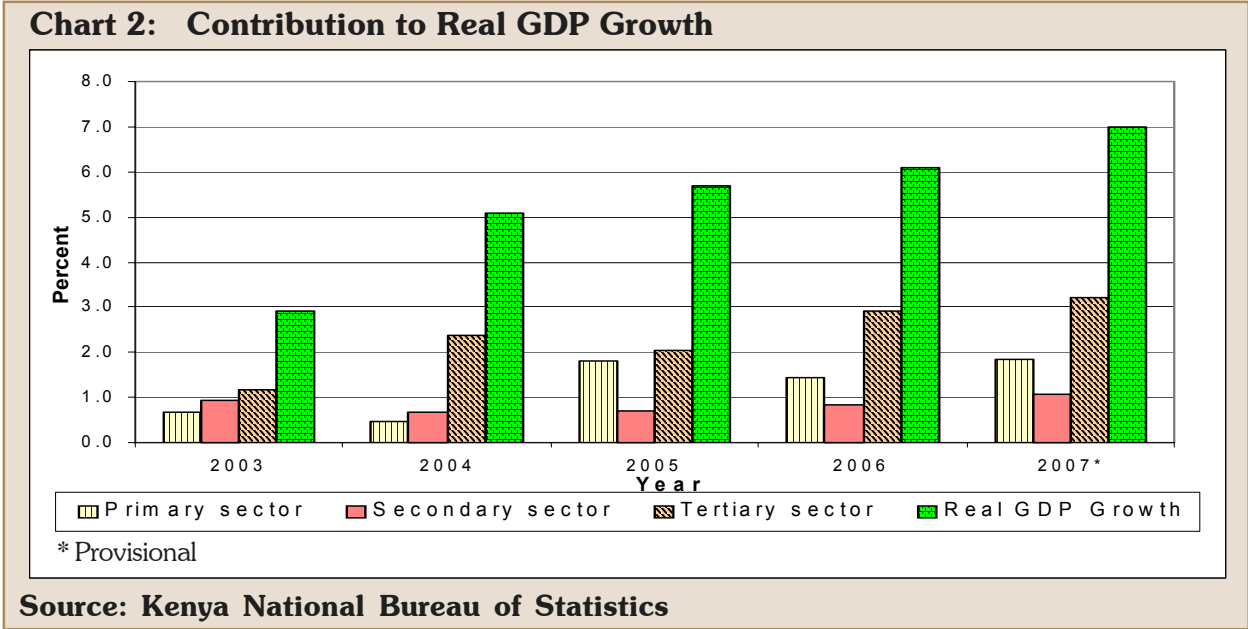
Outlook for 2008 and the Medium Term

World real GDP growth is expected to slow to 5.2 percent in 2007 and 4.8 percent in 2008, from 5.4 percent in 2006. The slowdown in growth taking place in the US economy is expected in Canada, Mexico and parts of emerging Asia reflecting financial and trade spillovers. Growth in emerging and developing countries is expected to remain strong.

The economic outlook for Sub-Saharan Africa continues to be positive with output estimated to increase by 6.1 percent in 2007 and to 6.8 percent in 2008. Growth prospects in the region depend on the pace of global economic expansion through its impact on commodity prices. Sustaining the growth momentum in this region will depend more on the economic policy framework, infrastructure and institution building.

2.2. Domestic Economy

Kenya’s economy is estimated to have grown by 7 percent in 2007, from 6.1 percent in 2006. The growth acceleration largely reflects improved performance in agriculture, tourism, transport and communication, building and construction, and manufacturing sectors. Stable interest rates coupled with a stable exchange rate, as well as increased liquidity from improved access to credit and increased remittances from Kenyans in the Diaspora provided a conducive environment for investment.



In the second quarter of 2007, the agricultural sector grew by 5.6 percent, reflecting improved production on account of favourable weather that prevailed for most part of the year. The manufacturing sector grew by 8.6 percent supported by increased production of major manufactures. Increased exports of manufactured goods and raw materials to meet strong demand from the sub region also led to growth of the manufacturing sector. Tourism earnings were higher on account of increased tourist arrivals, mainly by air and sea, reflecting a combination of improved marketing abroad, increased market recovery programs in the traditional markets and increased conference tourism. Strong growth in the tourism sector of 11.1 percent also had a positive spill-over effect on air transport and, hotels and restaurants. The continued positive performance in the building and construction sector was as a result of increased budgetary allocation to physical infrastructure in 2007/8 and Constituency Development Fund (CDF) projects, particularly schools and hospitals.

Projections for 2008 and the Medium Term

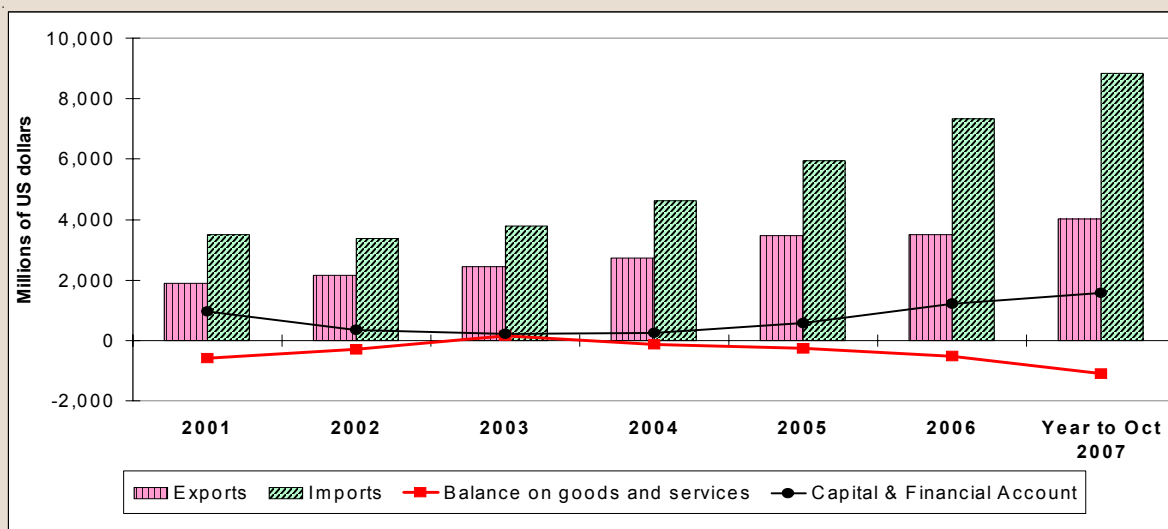
The stable macroeconomic environment is expected to continue in 2008 and in the medium term as envisaged in the vision 2030. This is largely premised on strong performance in all sectors of the economy and continued strong growth in our trading partners' economies. However, improved growth in 2008 is conditional on the speed of reconstruction and revival from post-election disturbances that rocked the country in December 2007. The outlook, nevertheless, builds on increased public and private investment, a strengthened financial sector, increased investment in infrastructural development, and increased credit to the private sector.

Some constraints that could hinder the growth outlook include high and volatile international oil prices, which lead to deteriorating terms of trade. Infrastructural constraints, in particular, poor roads and high costs of energy could also dampen growth of the economy.

2.3 Balance of payments

The surplus in the balance of payments declined from US\$ 725 million in the year to October 2006 to US\$ 455 million in the year to October 2007 due to deterioration in the current account which exceeded the improvement in the capital and financial account (Chart 3).

Chart 3: Balance of Payments



Source: Central Bank of Kenya

The trade balance closed with a wider deficit of US\$ 4,840 million in the year to October 2007 following 26.6 percent growth in merchandise imports to US\$ 8,852 million that more than offset to value of merchandise exports that grew by 17.4 percent to US\$ 4,012 million. The increase in the value of merchandise imported during the year to October 2007 was mainly in machinery and transport equipment, manufactured goods, chemicals and oil categories, while the increase in the value of merchandise exports was mainly in coffee, tea, horticulture, oil, manufactured goods and raw materials export categories.

The services account, however, improved from a surplus of US\$ 3,148 million in the year to October 2006 to a surplus of US\$ 3,724 million in the year to October 2007, largely reflecting increased receipts from non-factor services and private current transfers. Net receipts from non-factor services increased by US\$ 396 million during the year to October 2007 following increased receipts from transportation services and foreign travel, which surpassed the increase in payments for foreign travel, insurance services, royalties and licence fees. The balance on the income account also improved during the review period on account of increased interest earned on official foreign exchange reserves and increased income earned on foreign investments by the private sector. Net current transfers received rose to US\$ 1,860 million in the year to October 2007, mainly through the private sector.

The capital and financial account improved by US\$ 419 million in the year to October 2007 to a surplus of US\$ 1,572 million, reflecting increased short term private financial inflows as well official financial and capital flows. Net private short term financial inflows increased to US\$ 1,362 million in the year to October 2007 as private medium and long-term financial flows improved to a net inflow of US\$ 16 million compared with a net outflow of US\$ 7 million recorded over a comparable period in the previous year. The improvement in private medium and long-term flows reflected net increase in receipts of foreign loans, which offset the net increase

in direct investment outflows and commercial banks foreign assets. Net official capital and financial flows also improved reflecting reduced net repayment of official foreign loans and increased project related grants to the Government.

The favourable position in the balance of payments was reflected in a build up in official and private foreign reserve assets. Official foreign exchange reserves held by the Central Bank rose from US\$ 2,441 million (4.4 months of imports cover) at the end of November 2006 to US\$ 2,971 million (4.4 months of import cover) at the end of November 2007 while foreign exchange assets of commercial banks rose from US\$ 810 million at the end of November 2006 to US\$ 1,098 million at the end of November 2007.

Projections for 2008 and the Medium Term

The recent post-election violence is expected to temporarily slow down imports and exports. The overall effect of the post-election violence on the trade balance depends on relative effects on imports and exports. Over the medium to long-term, however, the paths for imports and exports are expected to resume their previous trends. Therefore, the current account deficit is expected to continue into 2008 financed by anticipated capital and financial inflows, some of which will be related to privatisation of public enterprises.

Consistent with the expected outcome in the balance of payments, gross official foreign exchange reserves are projected to increase from US\$ 3.4 billion in December 2007 to US\$ 3.6 billion, equivalent to 5.0 months of imports cover, in December 2008 and to US\$ 4.1 billion in December 2009, equivalent to 4.1 months of imports cover.

2.4 Fiscal Developments

Government budgetary operations in the first half of 2007/08 resulted in an overall budget deficit including grants of Ksh 24.3 billion or 1.3 percent of GDP on commitment basis compared with Ksh 7.8 billion or 0.5 percent of GDP in a similar period of 2006/07. Cumulative central Government expenditure and net lending increased from Ksh 177.9 billion or 10.6 percent of GDP in the first half of 2007/08 to Ksh 234.5 billion or 12.1 percent of GDP in a similar period of 2006/07 (Table 3). Similarly, Government revenue including grants increased from Ksh 170.2 billion or 10.1 percent of GDP to Ksh 210.2 billion or 10.8 percent of GDP during the period.

Due to a significant growth in ordinary Government revenue and lower than budgeted expenditure, the budget deficit was much lower than the target for the first half of 2007/08 of Ksh 45.6 billion or 2.3 percent of GDP on commitment basis. Consistent with the Government expenditure management policy of restructuring the outlays in favour of priority areas including infrastructure and flagship projects for Vision 2030, development expenditure increased from

1.7 percent to 2.6 percent of GDP. Similarly, the proportion of recurrent expenditure in GDP increased from 8.9 percent to 9.5 percent during the period, partly due to once off expense relating to the general elections.

Table 3: Central Government Fiscal Outturn (Ksh Billion)

	2005/06	Jul 2006-Dec 2006	Jul 2007-Dec 2007		2007/08	2008/09	2009/10
	Act	Act	Prov.	Target	Proj.	Proj.	Proj.
1. Total Revenue and Grants	331.3	170.2	210.2	221.3	469.2	528.9	601.6
Total Revenue	311.3	164.1	202.3	202.9	428.9	487.3	554.1
% of GDP	20.2	9.7	10.4	10.4	20.8	21.1	21.4
Grants	20.1	6.0	7.9	18.4	40.3	41.6	47.5
% of GDP	1.3	0.4	0.4	0.9	2.0	1.8	1.8
2. Total Expenditure	374.2	177.9	234.5	266.9	580.4	599.6	676.7
Recurrent	306.5	149.6	184.6	196.4	411.2	428.9	473.4
% of GDP	19.9	8.9	9.5	10.1	20.0	18.6	18.3
Development	67.7	28.3	50.0	70.5	169.2	170.7	203.3
% of GDP	4.4	1.7	2.6	3.6	8.2	7.4	7.9
3. Balance (commitment basis including grants)	-42.9	-7.8	-24.3	-45.6	-111.2	-70.7	-75.1
% of GDP	-2.8	-0.5	-1.3	-2.3	-5.4	-3.1	-2.9
4. Adjustment to cash	6.4	-18.7	9.8	1.5	-1.5	0.0	0.0
5. Balance (cash basis including grants)	-36.5	-26.4	-14.6	-44.0	-109.7	-70.7	-75.1
% of GDP	-2.4	-1.6	-0.7	-2.3	-5.3	-3.1	-2.9
6. Total Financing	36.5	26.4	14.6	44.0	109.7	70.7	75.1
a. Net External	1.2	-0.8	1.5	12.0	39.8	27.7	33.6
b. Net Domestic	28.3	27.2	-8.9	33.3	33.9	37.9	39.9
c. Others*	7.0	0.0	22.0	-1.2	36.0	5.1	1.6

* Includes privatisation proceeds and securitisation of domestic arrears

Source: Treasury

Budgetary operations of the Government in the first half of 2007/08 resulted in a financing requirement of Ksh 49.8 billion which was required to finance a budget deficit on a cash basis of Ksh 14.6 billion, and to build up Government deposits at the CBK by Ksh 35.2 billion. The Ksh 49.8 billion financing requirement was sourced through net external borrowing of Ksh 1.5 billion, net domestic borrowing of Ksh 4.3 billion from CBK, Ksh 5.5 billion from commercial banks, Ksh 16.5 billion from non-banks, and Ksh 22.0 billion net privatisation proceeds from sale of Government shares in the Kenya Re-Insurance Company and TELKOM Kenya.

Government domestic borrowing in the first half of 2007/08 resulted in domestic debt increasing from Ksh 404.7 billion or 22.1 percent of GDP in June 2007 to Ksh 438.1 billion or 22.5 percent of GDP in December 2007. Treasury bonds increased from Ksh 272.2 billion to Ksh 304.7 billion during the period while Treasury bills decreased from Ksh 94.4 billion to Ksh 90.8 billion. The significant rise in Treasury bonds was partly attributed to issuance of Ksh 8.97 billion restructuring bonds by the Government in December 2007 to offset the TELKOM Kenya liabilities in its preparation for privatisation. Consequently, the average maturity profile of domestic debt increased from 3.07 years in June 2007 to 3.41 years in December 2007.

Outlook for the fiscal year 2007/08 and the Medium Term

When formulating the fiscal year 2007/08 budget, Government revenue was projected to grow to Ksh 428.9 billion or 20.8 percent of GDP. The growth in revenue during the year was to be boosted by good performance of the economy and increased efficiencies generated by continued implementation of tax management reforms by Kenya Revenue Authority. Similarly, external grants were projected to amount to Ksh 40.3 billion or 2.0 percent of GDP during the fiscal year. Total Government expenditure was projected at Ksh 580.4 billion or 28.2 percent of GDP during the fiscal year and was to comprise Ksh 411.2 billion or 20.0 percent of GDP in recurrent expenditure and Ksh 169.2 billion or 8.2 percent of GDP in development expenditure.

As a result, overall budget deficit including grants was projected at Ksh 109.8 billion or 5.3 percent of GDP in the fiscal year. The higher projected deficit compared with that in the previous fiscal year largely reflected the planned substantial rise in development expenditure. The deficit was to be financed through net external borrowing of Ksh 39.8 billion, net domestic borrowing totalling Ksh 33.9 billion and net privatization receipts amounting to Ksh 36.0 billion. The net domestic borrowing requirement of 1.6 percent of GDP in the fiscal year 2007/08 would be lower than the 1.9 percent of GDP in the fiscal year 2006/07 and would be consistent with the medium-term target of 1.5 percent of GDP.

Government revenue was projected to increase further from 21.1 percent of GDP in the fiscal year 2008/09 to 21.4 percent of GDP in the fiscal year 2009/10 while external grants were projected to ease to 1.8 percent of GDP during the period. Similarly, Government expenditure is expected to increase slightly from 26.0 percent of GDP to 26.2 percent of GDP during the period under review. However, Government budget deficit on commitment basis was projected to fall from 3.1 percent to 2.9 percent during the period.

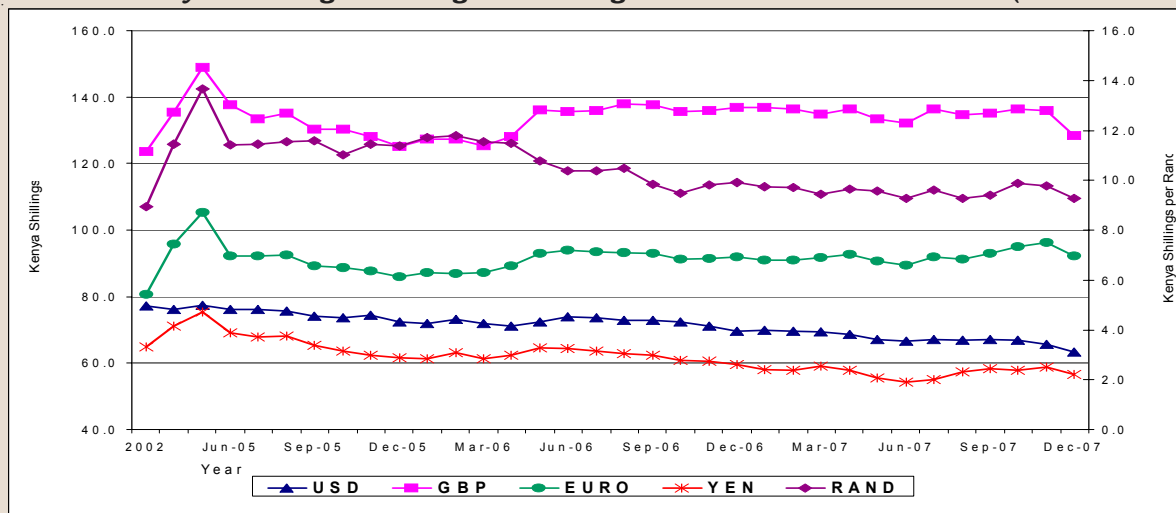
2.5 Exchange Rate

The Kenya shilling strengthened against major world currencies in the last quarter of 2007 after depreciating in the September 2007 quarter. The Kenya shilling depreciated by 45 cents against the US dollar between June 2007 and September 2007 but appreciated by 3 shillings and 72 cents between September 2007 and December 2007. Much of the strengthening of the shilling against the US dollar in the December 2007 quarter was recorded in December 2007 following FDI inflows associated with the CFC-Stanbic merger and the sale of shares to foreign investors by Equity Bank and Telkom Kenya. Net inflows associated with other balance of payments transactions also supported the shilling. The shilling thus traded at an average of Ksh 63.3 per US dollar in December 2007 compared with Ksh 67.0 in September 2007. The appreciation of the shilling against the US dollar also reflected the weakening of the US dollar internationally. The US dollar depreciated by 0.6 percent against the Sterling Pound and 4.9 percent against the Euro between September 2007 and December 2007.

Chart 4 shows that the Kenya shilling also strengthened against the Sterling Pound, the Euro and the Japanese Yen between September 2007 and December 2007. The shilling gained 6 shillings and 74 cents against the Sterling Pound, 82 cents against the Euro, and 1 shilling and 73 cents against the Japanese Yen during the period in review.

The Kenya shilling recorded mixed performance against regional currencies between September 2007 and December 2007, appreciating by 3.3 percent against the Uganda Shilling but depreciating by 2.3 percent against the Tanzania shilling.

Chart 4: Kenya Shilling Exchange Rates Against Selected Currencies (2002-2007)



Source: CBK

The CBK will continue to pursue prudent macroeconomic policies and maintain market determined exchange rate. The Kenya shilling is expected to weather the effects of the recent post-election violence and is therefore expected to remain stable in 2008.

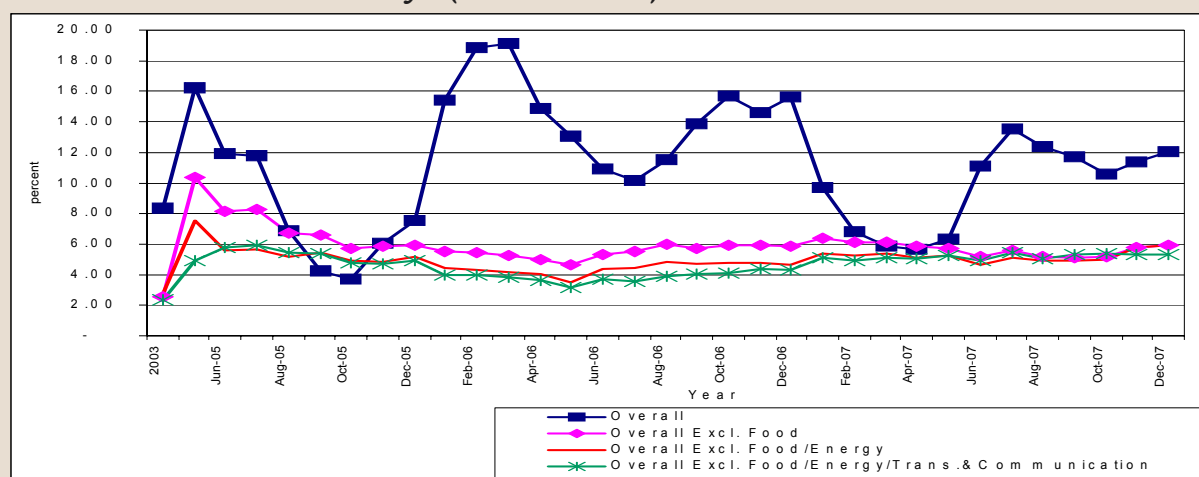
2.6 Inflation

Overall inflation remained in double digit level in the second half of 2007 compared with the single digit level for the most part of the first half of 2007. Between July and December 2007, month on month overall inflation fell from 13.6 percent to 12 percent (Chart 5).

Overall inflation eased to 10.6 percent in the year to October 2007 reflecting a significant drop in food inflation due to improved food supply following the onset of the short rains. The pick up in headline inflation in November and December 2007 was occasioned by an increase in domestic prices of perishables and transport costs, as would be expected during this time of the year. Inflation in the transport and communication category of goods and services accounts for 5 percent of the consumer price index (CPI) basket while about 50 percent is accounted for by the food and soft drinks category of goods and services. Increased spending during the election period is expected to have put additional inflationary pressure on prices of goods and services in the last quarter of 2007.

In the second half of 2007, food inflation remained in double digit, ranging from between 14 percent in October 2007 to 19 percent in July 2007. Inflation in the fuel and power category ranged from 6 percent to 9 percent in the second half of 2007, compared with 12 percent and 14 percent for most of 2006 despite increases in oil prices. With the exception of the 11.6 percent inflation in the alcohol and tobacco category in December 2007, other prices in the CPI basket remained virtually unchanged.

Chart 5: Inflation in Kenya (2003 - 2007)



Source: Central Bank Kenya

Non-food inflation was 5.9 percent in December 2007, an increase from 5.6 percent in July 2007. Between August and October 2007, non food inflation ranged between 5.1 percent and 5.2 percent before rising to 5.8 percent in November 2007. Excluding the effects of food, as well as fuel and energy, and, transport and communication, inflation was 5.3 percent in December 2007. It gradually declined from 5.5 percent in July 2007 to 5.1 percent in August 2007, before increasing to 5.4 percent in October 2007 as shown in Table 4.

Table 4: Consumer Price Index (June 2006 - Dec 2007)

	2007											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
CPI	9.7	6.8	5.9	5.7	6.3	11.1	13.6	12.4	11.7	10.6	11.8	12.0
Food & Drink	11.8	7.2	5.7	5.5	6.7	15.0	18.9	17.2	16.1	14.0	15.7	15.9
Alcohol & Tobacco	6.0	5.6	5.6	5.1	6.6	8.0	9.8	8.1	8.1	7.8	9.3	11.6
Clothing & Footwear	3.4	3.6	3.7	3.8	4.0	3.3	3.0	2.7	2.8	2.8	3.1	3.1
Housing	7.3	6.9	7.3	7.2	7.1	5.8	7.2	6.5	7.5	7.5	6.9	6.0
Fuel & Power	12.8	11.5	10.9	10.5	8.6	8.5	8.7	7.0	6.3	5.9	5.7	5.7
Household Goods & Services	5.1	5.3	5.4	5.2	5.7	5.9	6.0	6.3	6.2	6.2	5.7	5.5
Medical Goods & Services	4.9	4.0	4.0	4.1	3.5	4.7	4.8	4.9	4.1	4.4	3.8	3.9
Transport & Communication	6.5	7.2	6.7	5.8	5.5	3.1	3.2	3.8	2.8	3.1	8.6	9.5
Recreation & Education	3.6	3.0	3.2	3.3	3.2	3.1	2.9	2.7	2.8	3.2	3.2	3.3
Personal Goods & Services	2.6	2.7	2.7	2.6	3.0	3.6	3.8	4.1	3.9	3.7	3.8	4.2
Underlying Inflation (various measures)												
CPI excluding food	6.4	6.1	6.1	5.9	5.7	5.2	5.6	5.2	5.1	5.2	5.8	5.9
CPI excluding food and energy	5.4	5.3	5.4	5.1	5.3	4.6	5.1	4.9	4.9	5.0	5.8	5.9
CPI excluding food, energy and transport & communication	5.1	4.9	5.1	5.0	5.2	4.9	5.5	5.1	5.3	5.4	5.3	5.3

Source: Central Bank Kenya

Outlook in 2008 and the Medium Term

For the remainder of 2008, the reserve money program is geared towards achieving inflation of 5 percent. Implementation of the reserve money program is therefore expected to contain inflation pressures. Increased public sector investment in the form of infrastructure development mainly in roads, transport and energy under the Vision 2030 framework is also expected to ease supply bottlenecks which have an impact on inflation.

To cushion against external shocks, the Government has built up foreign exchange reserves which are expected to increase further in the medium term in line with the East African Community (EAC) Convergence Criteria. Nonetheless, a major risk to the outlook for inflation continues to be uncertain weather conditions and volatile oil prices.

2.7 Monetary and Financial Markets Developments

Money and Credit

The growth in Money supply, M3, in the year to December 2007 was higher at 20.9 percent than the 17.8 percent a year earlier and the projected growth of 14 percent for the fourth quarter of 2007. Similarly money supply, M2, which excludes foreign currency deposits, grew by 20.4 percent in the year to December 2007 compared with 16.7 percent in December 2006.

The M3 growth in the year to December 2007 followed increased NFA and NDA of the banking system. NFA of the banking system grew less rapidly by 25.7 percent in the year to December 2007, compared with 29.2 percent increase in the year to December 2006. The NDA of the banking system grew by 18.6 percent compared with 12.9 percent in a similar period in 2006 reflecting increased domestic credit. The contribution of NFA to money supply, M3, expansion declined from 8.8 percent in December 2006 to 8.5 percent in December 2007. Meanwhile, the NDA contribution to M3 expansion was 12.4 percent in December 2007 compared with 9 percent a year earlier.

The banking system credit to the domestic economy grew by 17.6 percent in the year to December 2007 compared with 15.4 percent in December 2006. Credit to Government grew much slower at 1.9 percent in December 2007, compared with 12.8 percent in December on account of increased Government deposits at the CBK. Growth in private sector credit was however faster at 24.6 percent in the year to December 2007 compared with 15 percent a year ago. The credit to private sector in the year to December 2007 was mainly to other activities

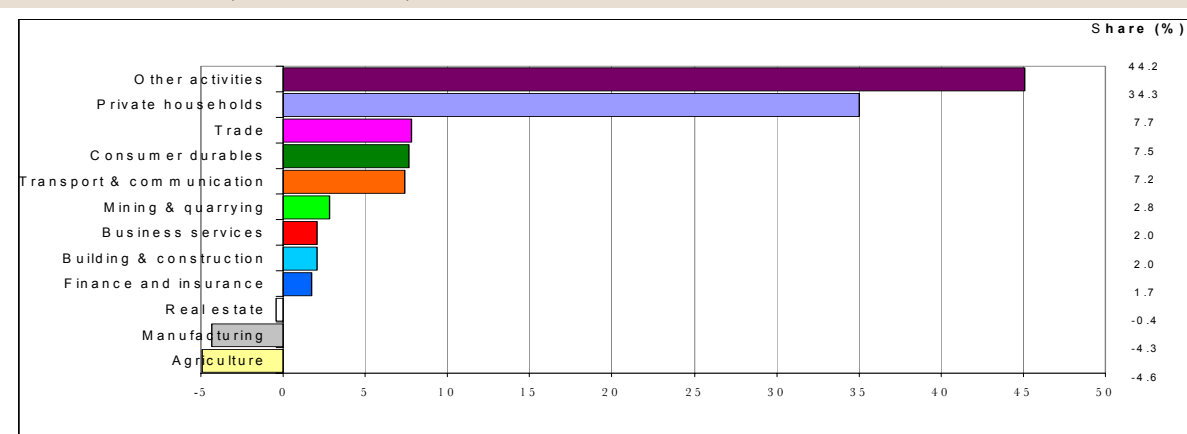
(44.2 percent) private households (34.3 percent), Trade (7.7 percent), consumer durables (7.5 percent) and transport and communication (7.2 percent), as shown in Chart 6.

Table 5: Contribution to Growth in Broad Money, M3 (percent)

	2006				2007			
	Sep	Oct	Nov	Dec	Sep	Oct	Nov	Dec
Annual growth in M3	17.4	17.0	17.9	17.8	17.7	16.7	16.7	20.9
Net Foreign Assets	8.1	9.0	8.6	8.8	5.6	4.1	4.7	8.5
Net Domestic Assets	9.4	8.0	9.3	9.0	12.1	12.6	12.0	12.4
Domestic Credit	11.7	12.5	13.4	13.6	15.4	13.9	14.5	13.5
Government (net)	2.2	3.2	3.7	2.8	4.8	3.8	2.9	0.4
Rest of the Economy	9.5	9.4	9.7	10.8	10.6	10.1	11.6	13.9
Other public sector	0.8	1.0	1.3	1.2	-0.4	-0.7	-1.3	-0.6
Private sector	8.7	8.4	8.4	9.7	11.0	10.8	12.9	15.5
Other Items (net)	-2.4	-4.6	-4.2	-4.6	-3.2	-1.3	-2.5	-2.8

Source: Central Bank of Kenya

Chart 6: Share of Credit to the Private Sector in twelve months to December 2007 (Ksh billion)



Source: Central Bank of Kenya

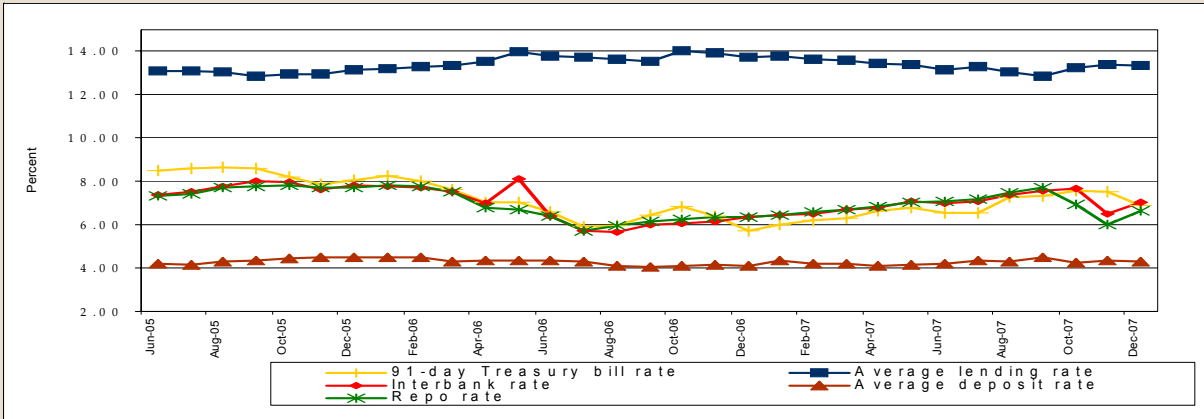
Equity market

Activity improved at the Nairobi Stock Exchange (NSE) in the second half of 2007. The NSE 20 Share Index gained 298.1 points, moving from 5,146.7 in June 2007 to 5,444.8 by December 2007. Market turnover increased over the same period, from Ksh 41.9 billion as at June 2007 to Ksh 46.7 billion in December 2007. Market capitalization increased from Ksh 743.9 billion in June 2007 to Ksh 851.1 billion in December 2007. The improvement in most key indicators could be attributed to increase in the volume of shares traded and improved share prices in most counters. Bond market trading similarly improved as bond turnover increased during the period under review from Ksh 41.5 billion in the period to June 2007 to Ksh 43.8 billion in the six months to December 2007.

Interest Rates

Short-term interest rates edged up in the second half of 2007, the average 91-day Treasury bill rate increased from 6.53 percent in June 2007 to 6.87 in December 2007. The rate had however increased to 7.55 percent in October 2007 before the decline in December. The average interbank rate remained stable at an average of 7.10 percent during the period under review although it peaked in September 2007 at 7.59 percent. The increase in short term interest rates reflected the tightening liquidity in the market and in tandem with the CBR rate.

Chart 7: Short term interest rates (Jun 2005 - June 2007)



Source: Central Bank of Kenya

Commercial banks lending rates edged up in tandem with short term interest rates. Average lending rate moved from 13.14 percent in June 2007 to 13.32 in December 2007 while the average deposit rate went up from 4.18 percent in June 2007 to 4.32 percent in December 2007. Following increased lending rates, the interest rate spread increased marginally from 8.96 in June 2007 to 9.00 by December 2007.

Outlook for 2008 and the Medium Term

While uncertainty caused by the recent post election disturbances dampened activity at the stock exchange, it is expected to stabilize in the mid term. The cross listing in the three bourses of the East African region is expected to boost trade in stocks. Secondary bond market trading is also expected to improve.

Interest rates are expected to remain stable with continued implementation of appropriate monetary policy stance and a sustainable fiscal position.

3. MONETARY POLICY FOR 2007/08

Monetary policy for 2007/08 set out in the June 2007 statement was directed towards securing low and stable inflation over the medium term. As a result, the monetary program targeted reserve money growth of 12 percent at end-September 2007 and 12.7 percent at end-June 2008. This was expected to address the inflationary risk posed by fast growth in monetary aggregates. More effort was also to be expended to enhancing the effectiveness of the Bank's indirect instruments.

Reserve money growth remained above target through June 2007. While annual reserve money growth continued to be volatile, increasing from 17.5 percent in June to 19 percent in August before slowing down to 17 percent in September 2007, corrective actions being taken to achieve reserve money targets were deemed adequate. Overall inflation also fell from 13.6 percent in July 2007 to 11.7 percent by the end of September 2007. Therefore, during the third and final successful review under the PRGF program in September 2007, it was considered appropriate to limit annual reserve money and broad money growth to 14 percent and 15 percent respectively, for the remainder of 2007/08 (Table 6 and Appendix 2).

Although the domestic economy has realised strong growth in the recent quarters, the post election violence has led to a downward revision in the prospects for growth. Economic growth is expected to slowdown to about 4.5 percent in 2008 reflecting a downward adjustment in growth projections in 2008 of between 1 and 2 percentage points. At the same time the economy is facing significant inflationary pressures mainly arising from supply side disruptions and high international oil prices. To gradually ease inflation pressures and to counter some of the macroeconomic risks from the recent disruptions, reserve money growth for the end of June 2008 has been revised from 14 percent to 18 percent. Reserve money is projected to grow by 16 percent at the end of 2008.

Table 6: Growth Target for Monetary Aggregates for 2007/08 - 2008/09

	Sep '07	Dec '07	Mar '08	Jun '08*	Jun '09*
Reserve money (Ksh million)	131.3	141.6	139.2	149.5	175.7
NFA of CBK (Ksh million)	179.3	186.4	193.0	218.2	250.0
Mem o:					
Annual change in reserve money	17.0	14.0	14.0	18.2	17.5
Annual change in broad money	18.4	15.0	15.0	16.9	16.6
Real GDP growth				5.7	6.2
Overall inflation				5.0	5.0
* Revised projection					

Source: Central Bank of Kenya

On the risks to monetary policy, the unpredictable nature of international oil prices poses a threat to domestic energy prices and prices of other goods and services through spill over effects. The monetary policy stance also factors in normal weather patterns so that the recurrence of drought conditions could lead to a spike in food prices. While the post election crisis has had a disruptive impact on liquidity conditions, the effects are not expected to persist deep in 2008.

The Bank will therefore continue to guard against incipient inflationary pressures, in order to provide a stable macroeconomic environment for implementation of projects under the Vision 2030 framework. Further, the Bank will consolidate and sustain reforms in the framework of monetary policy operations in order to ensure that the rate of monetary expansion remains consistent with the objective of low and stable inflation. As has been the case, the Bank's daily monetary operations will be geared towards aligning reserve money to target so as to deliver on the inflation objective.

Appendix 1: Kenya's Selected Economic Indicators (2006/07 - 2011/12)*

	2006/07 <i>Prov.</i>	2007/08 <i>Est.</i>	2008/09	2009/10	2010/11	2011/12
	<i>Medium-term projection</i>					
<i>Annual percentage change, unless otherwise indicated</i>						
National account and prices						
Real GDP	6.5	5.8	6.6	8.6	8.9	9.6
Real GDP per capita	3.7	3.1	3.9	6.0	6.4	7.1
GDP deflator	10.5	8.5	7.4	6.5	5.3	5.3
CPI Index (eop)	11.1	5.8	5.0	5.0	5.0	5.0
CPI Index (avg)	10.4	13.5	11.0	6.3	5.0	5.0
Terms of trade (-deterioration)	-1.9	-3.0	0.3	0.0	0.0	-0.1
<i>In percentage of GDP, unless otherwise indicated</i>						
Investment and saving						
Investment	20.5	19.5	21.3	25.5	26.3	28.0
Central Government	4.3	5.9	6.5	6.5	6.9	7.2
Other	16.2	13.6	14.8	19.0	19.5	20.8
Gross National Saving	16.5	14.3	15.7	20.5	21.4	23.0
Central Government	1.6	0.7	1.6	1.9	2.4	2.7
Other	14.9	13.6	14.1	18.6	19.0	20.2
Central government budget						
Total revenue	20.7	20.3	20.6	20.8	20.9	21.1
Total expenditure and net lending	23.5	26.9	25.6	25.5	25.5	25.7
<i>of which</i> : wages and salaries	7.1	7.0	6.8	6.7	6.6	6.5
Interest payments	2.3	2.4	2.4	2.4	2.2	2.1
Development expenditures	4.4	7.0	6.6	6.6	7.0	7.3
Overall balance (commitment basis) excl. grants	-2.8	-6.5	-5.0	-4.7	-4.6	-4.6
Overall balance (commitment basis) incl. grants	-2.0	-5.0	-3.7	-3.4	-3.2	-3.2
Net external borrowing	-0.1	0.9	2.0	1.3	1.4	1.5
Net domestic borrowing	1.8	1.6	1.7	2.1	1.8	1.7
Total donor support (grant & loans)	1.4	3.1	3.1	3.0	3.1	3.2
Balance of payments						
Exports value, goods and services	25.0	23.6	24.0	24.7	25.1	25.4
Imports value, goods and services	35.3	34.9	35.2	34.9	35.1	35.1
Current external balance, including official transfers	-4.0	-5.2	-5.6	-4.9	-5.0	-5.1
Current external balance, excluding official transfers	-3.9	-5.5	-5.5	-4.9	-5.0	-5.0
Gross international reserve coverage in months of next year	3.1	3.6	3.8	4.0	4.2	4.4
Public debt						
Nominal central government debt (end of period)	40.4	40.5	39.3	38.8	38.0	37.5
Domestic (gross)	22.6	22.1	21.5	21.2	20.8	20.3
Domestic (net)	18.3	18.1	17.5	17.3	16.9	16.4
External	22.1	22.4	21.7	21.5	21.1	21.1
Memorandum items:						
Nominal GDP (in Ksh billions)	1,817.1	2,085.9	2,387.1	2,758.4	3,163.2	3,647.9
Per capita income (Ksh)	49,610.7	55,465.6	61,852.5	69,679.6	77,937.3	87,708.4
Nominal GDP (in US\$ millions)	25,848.5	30,215.8	33,249.6	37,668.2	42,349.0	47,880.2
Per capita income (US\$)	705.7	803.5	861.5	951.5	1,043.4	1,151.2
Avg CPI for trading partners	4.5	4.5	4.5	4.5	4.5	4.5

* Provisional

Sources: The Treasury

Appendix 2: Depository Corporations Survey 2007- 2009

	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Central Bank of Kenya								
Net foreign assets 1/ (in billions of U.S. dollars)	179.7 2.4	211.3 2.9	219.5 3.0	218.2 3.0	226.0 3.1	234.0 3.2	241.8 3.3	250.0 3.4
Net domestic assets	-48.4	-55.7	-75.4	-68.6	-71.6	-54.4	-72.8	-74.3
Net domestic credit	-19.1	-43.3	-50.8	-42.8	-45.1	-36.6	-45.6	-46.7
Government (net)	-3.0	-34.4	-4.4	-4.6	-4.7	-4.8	-5.0	-5.1
Advances to commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repos (liability to commercial banks (-))	-18.4	-10.2	-48.9	-40.7	-42.9	-33.1	-43.3	-44.3
Private sector credit (CBK staff loans)	2.4	1.2	2.5	2.5	2.5	1.3	2.6	2.6
Other items (net; asset (+))	-29.3	-12.4	-24.6	-25.9	-26.5	-17.8	-27.2	-27.6
Reserve money	131.3	155.6	144.1	149.5	154.4	179.6	169.0	175.7
Currency outside banks	80.1	96.0	90.3	94.1	94.1	109.7	106.0	110.1
Bank reserves	51.3	59.6	53.8	55.5	60.3	69.8	63.0	65.6
Monetary Survey								
Net foreign assets 1/	240.1	270.4	279.2	278.5	286.9	295.5	303.3	312.1
Net domestic assets	503.9	527.1	525.9	563.2	579.2	629.6	635.0	669.3
Domestic credit	638.1	670.8	718.0	735.0	766.5	829.4	840.8	881.4
Government (net)	160.4	140.4	169.5	174.8	179.7	184.5	189.4	194.2
Rest of the economy	477.6	530.3	548.5	560.1	586.8	644.8	651.4	687.2
Other public sector	12.6	14.3	19.3	13.3	13.5	15.3	20.6	14.1
Private	465.0	516.0	529.2	546.9	573.3	629.5	630.8	673.1
Other items (net; asset (+))	-134.2	-143.7	-192.1	-171.8	-187.2	-199.8	-205.7	-212.1
M3	744.0	797.5	805.1	841.7	866.1	925.1	938.3	981.4
Deposits in foreign currency	631.1	666.9	132.0	134.6	137.3	140.0	142.8	145.7
M2	112.8	130.7	673.1	707.1	728.8	785.0	795.5	835.7
Currency outside banks	80.1	96.0	90.3	94.1	94.1	109.7	106.0	110.1
Deposits in shillings	32.8	34.7	582.9	613.0	634.7	675.3	689.5	725.7
<u>Memorandum items:</u>								
M3 growth (12-month percent change)	17.7	20.9	17.5	16.9	16.4	16.0	16.5	16.6
Currency outside banks	16.6	25.6	18.0	20.4	17.5	14.3	17.4	17.0
Domestic credit (12-month percent change)	18.0	17.4	21.4	21.1	20.1	23.6	17.1	19.9
Government (net)	23.3	1.9	23.0	11.2	12.0	31.4	11.8	11.1
Rest of the economy	16.3	22.3	21.0	24.5	22.8	21.6	18.8	22.7
of which: private sector	17.6	24.7	21.7	25.1	23.4	22.0	19.3	23.2
Reserve Money (12-month percent change)	17.0	25.3	18.0	18.2	17.6	15.4	17.2	17.5
Money multiplier (M3/reserves)	5.7	5.1	5.6	5.6	5.6	5.2	5.6	5.6
Exchange rate (KSh/US\$ -- e.o.p)	66.90	62.61	70.00	70.50	71.21	71.92	72.64	73.36
Program exchange rate (KSh/US\$)	73.88	73.88	73.88	73.88	73.88	73.88	73.88	73.88

^{1/} at program exchange rate (KSh/US\$ — prevailing on June 30, 2006)

Source: Central Bank of Kenya

APPENDIX 3: CHRONOLOGY OF EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY AND INFLATION (2007)

August 2007

- First release of quarterly GDP data.
- The CBK releases the twentieth Monetary Policy Statement (December 2007) laying out the monetary program for the remainder of the fiscal year 2007/08.
- CBR is adjusted upwards from 8.5 percent to 8.75 percent. Framework for open market operations was modified.
- The REPO threshold was reviewed downwards, from Ksh 50 million to Ksh 20 million.

September 2007

- A late REPO facility window to run from 2.00 p.m. to 2.30 p.m. is introduced.
- An IMF mission visits the country for the third and final review under the PRGF program.

October 2007

- MPAC meeting retains the CBR at 8.75 percent.

December 2007

- CBR retained at 8.75 percent.
- The late REPO facility restructured.
- The maturity profile lengthened from overnight to 3 days.
- The REPO threshold lowered from Ksh 20 million to 10 million.
- Margin between the yield on morning and late REPO lowered.
- Creation of Monetary Policy Committee to replace the Monetary Policy Advisory Committee with effect from January 2008

GLOSSARY OF KEY TERMS

Overall Inflation

This is inflation measured by the movement of indices of all consumer price items of goods and services sampled by the Kenya National Bureau of Statistics (KNBS).

Underlying Inflation

This is inflation measured by movement of indices of all consumer price items of goods and services sampled by KNBS other than food, energy, transport and communications. These items are excluded because they are susceptible to transient effects that are in most cases beyond the control of the CBK. Thus, the underlying measure is used by the CBK to gauge the influence of monetary policy on inflation.

Reserve Money

These are CBK's monetary liabilities comprising currency in circulation (currency outside banks and cash held by commercial banks in their tills) and deposits of both commercial banks and nonbank financial institutions held with the CBK.

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 defined as follows:

M1	Currency outside banking system + demand deposits
M2	M1 + time and savings deposits + certificates of deposits + deposits Liabilities of Non-Bank Financial Institutions (NBFIs)
M3	M2 + residents' foreign currency deposits

Central Bank Rate (CBR)

The rate of interest at which the CBK lends to commercial banks. It is determined and announced by the CBK every eight weeks, based on the average of the interbank and Repo rates plus a margin.

Open Market Operations (OMO)

The act of buying or selling treasury bills in the secondary market by the Central Bank in order to achieve a desired level of currency in circulation and bank reserves. OMO is done in the context of an auction where commercial banks bid through the Reuters screen.

Repurchase Agreement (REPO)

REPOs are agreements between the CBK and commercial banks to purchase/sell government securities from/to commercial banks at agreed interest rate (REPO rate) for a specified period with an understanding that the commercial bank will repurchase/resell the security to the CBK at the end of the period.

Reserve Money Program

This is the desired expansion in the reserve money operating target to achieve the money supply growth target (intermediate target) that is consistent with the inflation target (ultimate target).

Cash Reserve Requirement

This is the legally required position of commercial banks and nonbank financial institutions deposits held with the CBK. The CBK is empowered by the Act to demand that a certain proportion of commercial banks' deposits to be held as reserves at the CBK. The ratio currently stands at 6 percent.