Central Bank of Kenya

Monetary Policy Statement

June 2021

LETTER OF TRANSMITTAL

In accordance with Section 4B of the Central Bank of Kenya Act, it is my pleasure to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the 48th Monetary Policy Statement of the Central Bank of Kenya. It reviews and assesses the implementation of monetary policy during the first half of 2021, and outlines the direction of monetary policy for the next twelve months.

Dr. Patrick Njoroge

Governor

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THE PRINCIPAL OBJECTIVES OF THE CENTRAL BANK OF KENYA

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

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

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

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

INSTRUMENTS AND TRANSMISSION OF MONETARY POLICY

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

- **Open Market Operations (OMO):** This refers to actions by the CBK involving purchases and sales of eligible securities to regulate the money supply and the credit conditions in the economy. OMO can also be used to stabilise short-term interest rates. When the Central Bank buys securities in the open market, it increases the reserves of commercial banks, making it possible for them to expand their loans and hence increase the money supply. To achieve the desired level of money supply, OMO is conducted using:

    i. **Repurchase Agreements (Repos):** A repo is a collateralized loan involving a contractual arrangement between two parties, in which one party sells a security at a specified price with a commitment to buy the security back at a later date. Both parties therefore, meet their investment goals of secured funding and liquidity. CBK Repos are conducted through auctions with tenors of 3 and 7 days and are for mopping up liquidity from the market. The Late Repo, sold in the afternoon, has a 4-day tenor and is issued at 100 basis points below the repo rate of the day. Reverse Repos, on the other hand, are for liquidity injections and involve purchase of securities from commercial banks. The current tenors for Reverse Repos are 7, 14, 21, 28 and 91 days.

    ii. **Term Auction Deposit (TAD):** The TAD is used when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer dated tenors. TAD is essentially not backed by collateral and it is conducted through an auction, similar to Repos. Currently, the tenors for such deposits at CBK are 14, 21, 28 or 91 days and upon maturity of TAD, the CBK credits the respective commercial bank with the deposit and interest.

    iii. **Horizontal Repos:** Horizontal Repos are modes of improving liquidity distribution between commercial banks, and are conducted under CBK supervision. They are transacted between commercial banks on the basis of signed agreements using government securities as collateral, and have negotiated tenors and yields. Commercial banks, short of deposits at the CBK, borrow from banks with excess deposits on the security of an appropriate asset, normally a government security. Horizontal Repos also help banks overcome the problem of limits to lines of credit, thus promoting more efficient management of interbank liquidity.

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

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

- **Standing Facilities:** The CBK does not have automatic standing facilities with respect to overnight lending. The CBK, as lender of last resort, provides secured loans to commercial banks on an overnight basis at a penal rate that is over the CBR. This facility is referred to as the Discount Window. Access to the Window is governed by rules and guidelines which are reviewed from time to time by the CBK. Banks making use of this facility more than twice in a week are scrutinised closely, and supervisory action taken.

- **The Cash Reserves Ratio (CRR):** In accordance with the law, the CRR is the proportion of a commercial bank's total deposit liabilities which must be held as deposits at CBK. These deposits are held in the CRR Account at no interest. The ratio is currently 4.25 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.

- **Licensing and Supervision of Financial Institutions:** The CBK uses the licensing and supervision tools to ensure stability and efficiency of the banking system; this includes vetting potential managers for suitability.

- **The National Payments System:** The modernisation of the National Payments System has continued to lower transaction costs and enhanced the efficiency of the payments systems. This has ensured the effectiveness of monetary policy instruments.

- **Communication:** The increasing use of communication media ensures a wider dissemination of monetary policy decisions and background data thereby increasing the efficiency of information transmission and managing expectations. The regular interaction between the MPC and the Chief Executive Officers of banks has ensured that monetary policy decisions are transmitted to the banking sector. The regular Governor's Press Conferences have also enhanced the media understanding of monetary policy decisions. The CBK website is an important source of up-to-date data on all aspects of the financial market including interest rates, exchange rates, results of auctions of government securities, and the MPC releases.

EXECUTIVE SUMMARY

This Monetary Policy Statement provides the direction of monetary policy for the financial year (FY) 2021/22. It also reviews the outcome of the monetary policy stance adopted in the first half of 2021.

Monetary policy in the first half of 2021 was conducted in the context of the global COVID-19 (coronavirus) pandemic, measures taken by authorities around the world to contain its spread and impact, and the rollout of COVID-19 vaccination programmes. The CBK conducted monetary policy in the period with the objective of keeping overall inflation within the target range of 5±2.5 percent. Monetary policy was also aimed at supporting economic activity through provision of liquidity to banks for onward lending to the private sector amidst the continuing COVID-19 pandemic.

The Monetary Policy Committee (MPC) maintained an accommodative monetary policy stance during the period, and retained the Central Bank Rate (CBR) at 7.00 percent. The monetary policy stance together with CBK liquidity management ensured both price and market stability. Overall inflation remained anchored within the target range during the first half of 2021, supported by lower food prices, muted demand pressures and prudent monetary policy. The inflation rate stood at 6.3 percent in June 2021 compared to 5.6 percent in December 2020, largely reflecting higher fuel prices due to the rise in international oil prices. Non-food Non-fuel (NFNF) inflation remained low and stable below 5 percent, reflective of muted demand pressures.

The foreign exchange market remained stable during the period, supported by balanced flows. The current account deficit was estimated at 5.5 percent of GDP in the 12 months to May 2021, reflecting resilient exports particularly of horticulture, strong diaspora remittances and a pickup in intermediate goods imports. The CBK foreign exchange reserves, which stood at USD 9,494.5 million (5.81 months of import cover) as at end June, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient during the period, with strong liquidity and capital adequacy ratios. The average commercial banks' liquidity and capital adequacy ratios stood at 56.6 percent and 18.9 percent, respectively, in May 2021. The ratio of gross non-performing loans (NPLs) to gross loans stood at 14.2 percent. The CBK continued to monitor the outcomes of the policy and measures deployed at the onset of the COVID-19 pandemic in March 2020, to mitigate the anticipated adverse economic effects and financial disruptions from the pandemic. These measures were intended to provide liquidity to the banking sector, mitigate the adverse impact on bank borrowers and facilitate the use of mobile money. These measures protected the economy from substantial decline, and supported the most vulnerable citizens. In particular, the measures ensured continued provision of financial services and provided a buffer against a more adverse impact on the economy. Private sector credit growth remained resilient in the first half of 2021, supported by an accommodative monetary policy stance and increased demand in the first quarter resulting from improved economic activity. Growth in private sector credit stood at 7.1 percent in the 12-months to May 2021, with strong credit growth observed in trade, building and construction and consumer durables.

Leading indicators pointed to a recovery of the Kenyan economy in the fourth quarter of 2020 and first quarter of 2021. This recovery was supported largely by strong performance of agriculture, construction, real estate, finance and insurance, and the wholesale and retail trade. Additionally, private sector optimism on economic prospects in 2021 remained strong due to the rollout of COVID-19 vaccines, the stable macroeconomic environment and increased Government spending on infrastructure. The approval of the Extended Credit Facility (ECF) and Extended Fund Facility (EFF) Arrangements with the International Monetary Fund (IMF) in April 2021, underscored confidence in the country's macroeconomic policies.

The monetary policy stance in the FY2021/22 will aim at maintaining overall inflation rate within the target range of 5±2.5 percent. The foreign exchange market is expected to remain stable supported by a stable current account deficit of 5.2 percent of GDP in 2021 and 2022, respectively. The continued coordination of monetary and fiscal policies is expected to sustain macroeconomic stability and support economic activity in the post COVID-19 period. Consistent with the Government's inflation and economic growth objectives in FY2021/22, the 12-month growth in broad money (M3) is expected at about 10.4 percent by December 2021 and 11.0 percent by June 2022. Growth in private sector credit is expected at 10.2 percent by December 2021 and 11.6 percent by June 2022. Private sector credit growth is expected to be supported by enhanced economic activities from the COVID-19 economic recovery plan, and the ongoing implementation of the Credit Guarantee Scheme for the vulnerable Micro Small and Medium-sized Enterprises (MSMEs).

The Bank will continue to monitor the risks posed by developments in the domestic and global economies on the overall price stability objective. The Bank will also continue to closely monitor the economic impact of COVID-19 and the outcomes of policy measures in place as well as other developments in the domestic and global economies to safeguard price stability.

1. INTRODUCTION

This Monetary Policy Statement (MPS) provides the direction of monetary policy for the financial year 2021/22. It also presents the outcome of the monetary policy stance adopted in the first half of 2021.

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

Global economic prospects have improved largely on account of the deployment of vaccines and strong policy measures, but the outlook remains highly uncertain due to concerns on the pace of rollout of vaccination programmes, the emergence of new variants, and reintroduction of containment measures in some economies. After a contraction of 3.3 percent in 2020, the global economy is expected to grow by 6.0 percent in 2021.

The CBK continued to monitor the impact of the policy measures deployed to mitigate the adverse economic effects and financial disruptions from the COVID-19 pandemic. During its January, March and May meetings, the MPC noted that the package of policy measures deployed since March 2020, had the intended effect on the economy. The monetary policy measures were augmented by implementation of the fiscal measures in the FY2020/21 Budget. In particular, the package of policy measures implemented in 2020 had protected the economy from substantial decline, and supported the most vulnerable citizens. Private sector credit growth remained resilient, supported by accommodative monetary policy.

The rest of this Policy Statement is organized as follows. Section 2 reviews the outcome of the monetary policy stance implemented in the first half of 2021 while Section 3 describes the external economic environment and outlook for the financial year (FY) 2021/22. Section 4 concludes by outlining the specific monetary policy path for FY 2021/22.

2. ACTIONS AND OUTCOMES OF THE POLICY STANCE IN THE FIRST HALF OF 2021

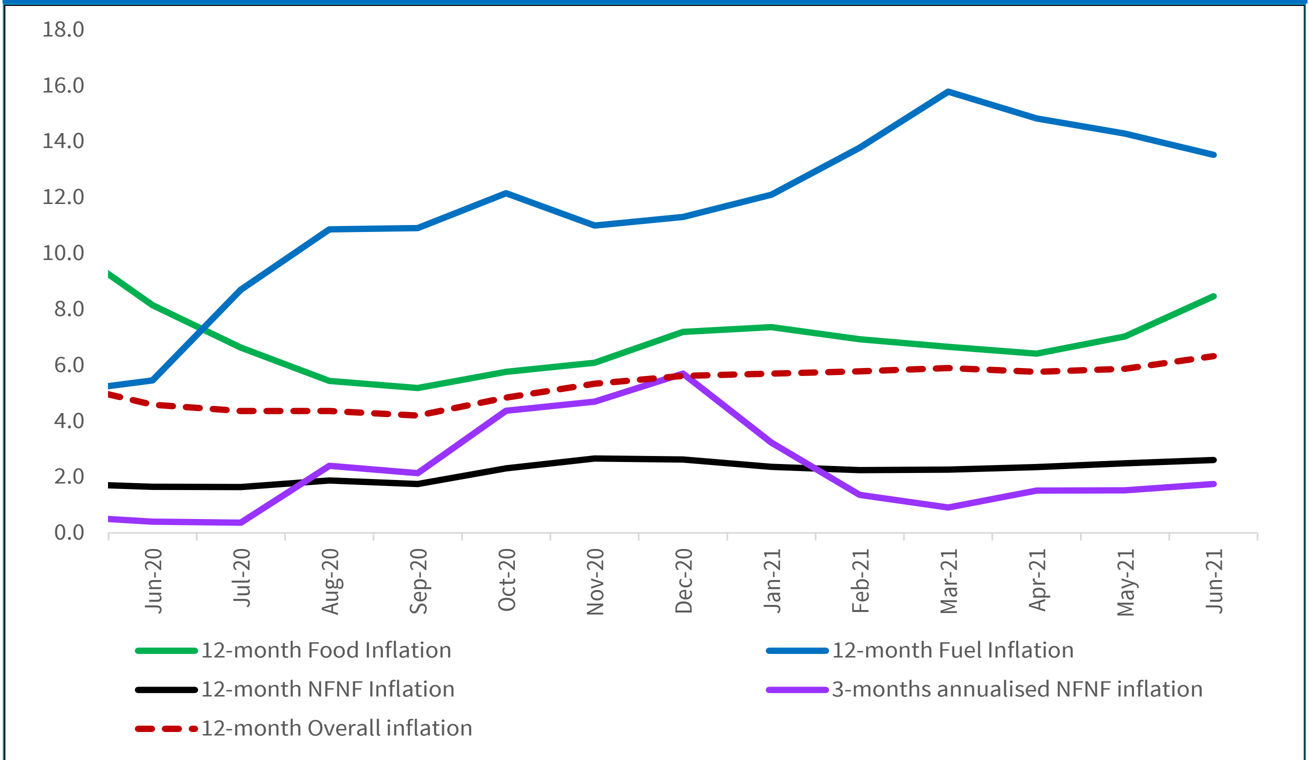
During the first half of 2021, monetary policy formulation and implementation was aimed at maintaining overall inflation at the target of 5.0 percent with a flexible margin of 2.5 percent on either side. The stance of monetary policy continued to mitigate the adverse economic effects and financial disruption of the COVID-19 pandemic, supporting stable interest rates and encouraging growth. The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 7.00 percent during its meetings of January, March and May 2021. The MPC observed that the package of policy measures adopted since March 2020 had yielded the intended effect on the economy. These measures were augmented by implementation of the announced fiscal measures in the FY2020/21 Budget. The following are the specific outcomes of the policy stance.

i. Inflation

Overall inflation remained anchored within the medium term target range during the first half of 2021, supported by lower food prices, muted demand pressures and prudent monetary policy **(Chart 1a)**. The inflation rate stood at 6.3 percent in June 2020 compared to 5.6 percent in December 2020,mainly reflecting increases in fuel prices during the period. The VAT adjustment in January 2021 had a mild impact on inflation. Fuel inflation remained elevated, consistent with trends in energy prices and continued interventions in the transport sector to contain the spread of COVID-19 virus. Food inflation increased slightly despite improved food supply arising from favourable weather conditions. Non-food Non-fuel (NFNF) inflation remained low and stable below 5 percent during the period, reflective of muted demand pressures. It stood at 2.6 percent in June 2021, the same level as that in December 2020.

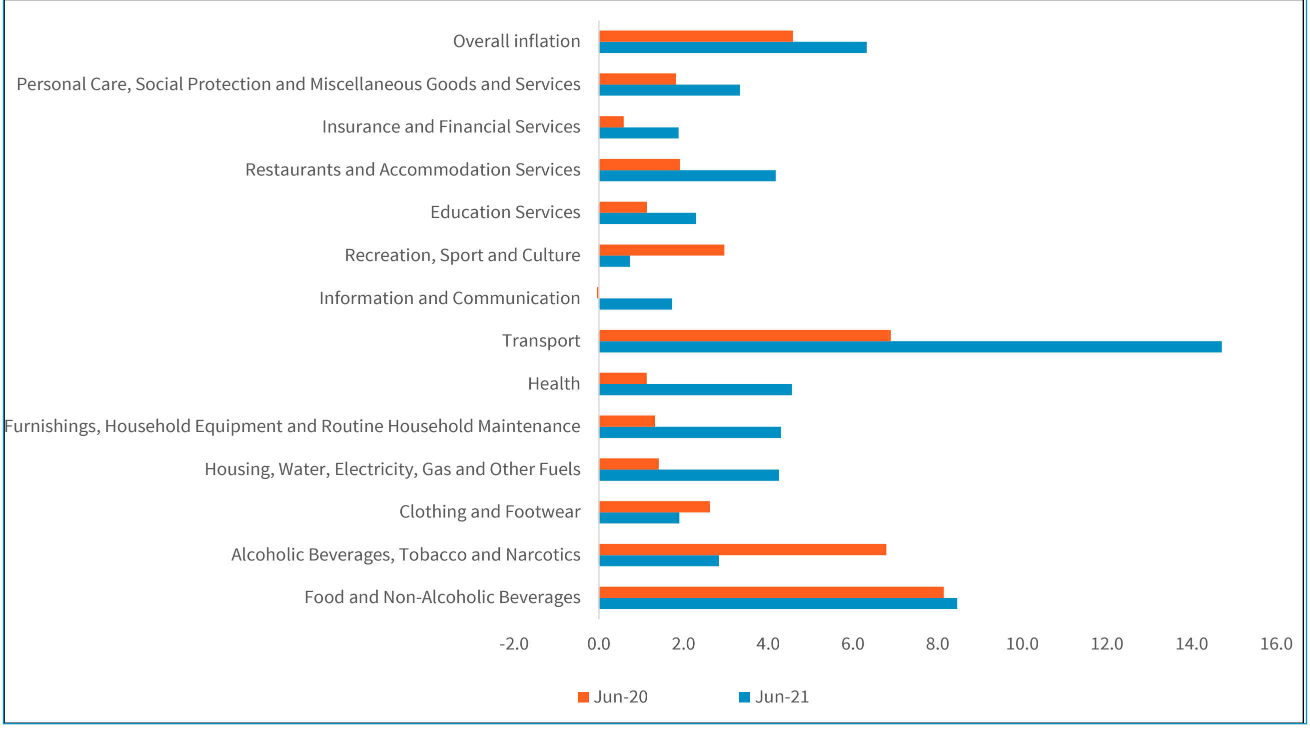
Inflation rates of all consumer good categories except food and non- alcoholic beverages and transport were within the target range in June 2021 **(Chart 1b).**

Chart 1a: Inflation in Broad Measures (Percent)



Source: Kenya National Bureau of Statistics and CBK

Chart 1b: 12-Month Inflation by Broad CPI Categories (Percent)



Source: Kenya National Bureau of Statistics

ii. Bank Credit to the Private Sector

Private sector credit growth remained resilient in the first half of 2021, supported by an accommodative monetary policy stance and increased demand in the first quarter resulting from improved economic activity. Growth in private sector credit stood at 7.1 percent in the 12-months to May 2021. Strong credit growth observed in transport and communication, finance and insurance, real estate and consumer durables **(Table 1)**. Growth in credit moderated from 8.4 percent in December 2020 and 9.7 percent in February 2021, largely reflecting increased loan repayments and write-offs, and reduced demand with re-introduction in April of partial lockdown in 5 counties that are major business centres and outlets. Additionally, stronger credit demand from manufacturers of fast-moving consumer goods and COVID-19 related products was witnessed in a similar period in 2020 after the announcement of the first case of COVID-19 in the country.

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

Main sectors	Mar-20	Jun-20	Sep-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21
Agriculture	1.4	2.2	1.7	15.3	15.6	13.4	12.3	10.0	4.3
Manufacturing	15.3	11.1	12.6	12.0	12.6	15.8	10.7	4.0	1.5
Trade	9.4	9.4	6.6	3.8	5.5	3.9	2.1	0.9	3.8
Building and construction	9.5	4.6	4.1	3.4	2.5	5.2	2.9	3.4	4.5
Transport and communication	7.1	14.9	20.6	13.6	14.4	19.0	17.4	13.3	16.3
Finance and insurance	6.6	3.2	-3.3	7.1	14.0	9.0	7.5	7.6	6.7
Real estate	2.2	4.9	6.6	8.7	8.8	8.8	7.7	5.8	5.7
Mining and quarrying	3.9	10.0	8.2	-12.9	-6.1	21.6	-3.6	-8.8	-18.1
Private households	3.4	3.6	3.5	4.3	5.2	4.6	3.4	4.9	3.1
Consumer durables	24.1	15.2	15.6	18.1	18.7	20.3	17.6	19.3	22.0
Business services	3.3	5.3	4.1	4.0	6.5	5.0	5.7	7.2	6.9
Other activities	36.8	-3.7	-5.8	14.0	5.8	3.8	5.2	24.3	39.8
Total private sector credit	**8.9**	**7.7**	**7.6**	**8.4**	**9.3**	**9.7**	**7.7**	**6.8**	**7.1**

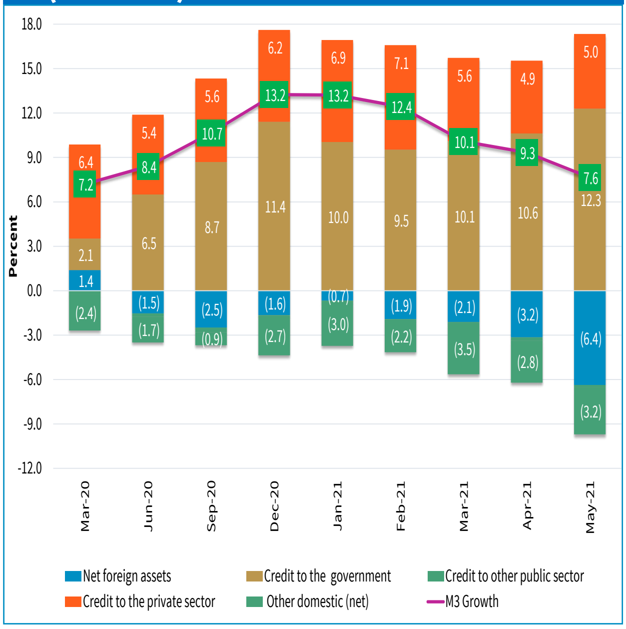
Source: Central Bank of Kenya

iii. Developments in the other Monetary Aggregates

The 12-month growth of broad money, M3, moderated to 7.6 percent in May 2021 from 13.2 percent in December 2020, mainly reflecting slowdown in the growth of net domestic assets (NDA) of the banking system. Growth in the NDA of the banking system slowed down on account of private sector credit growth but was however supported by improvement in net lending to government. On the liabilities side, the slower growth of money supply was reflected in deposits, mainly the household sector deposits, partly reflecting subdued business activities following implementation of partial COVID-19 restrictions in April, increased non-bank investments in government securities and loan repayments. Meanwhile, currency outside banks positively contributed to growth in M3 **(Chart 2)**. Although growth in M3 in the period under review remained relatively higher compared to a similar period in 2020, overall, monetary aggregates grew at a relatively slower pace compared to projections **(Table 2)**.

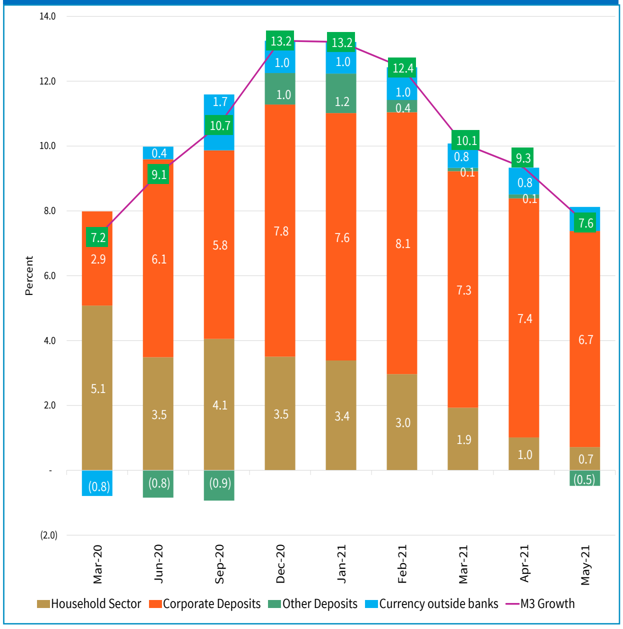
Chart 2: The 12-Month Growth in Broad Money Supply (M3) (Percent)

2a: Components of Money Growth (Percent)



Source: Central Bank of Kenya

2b: Sources of Money Growth (Percent)



Source: Central Bank of Kenya

Table 2: Actual and Targeted Growth in Key Monetary Aggregates

	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21
Actual Broad Money,M3 (Ksh Billion)	3,990.9	3,992.9	4,043.0	4,030.0	4,040.8	4,039.6
Target (Ksh Billion)	3,897.3	4,001.1	4,041.2	4,081.3	4,121.8	4,162.4
Actual Reserve Money (Ksh Billion)	469.9	442.3	444.8	451.0	455.4	469.3
Target (Ksh Billion)	479.4	456.9	460.7	464.4	473.9	474.5
Actual Net Foreign Assets of CBK (Ksh Billion)	738.5	724.8	703.2	690.7	660.4	654.8
Target (Ksh Billion)	756.1	703.9	679.9	672.4	657.6	630.9
Actual Net Domestic Assets of CBK (Ksh Billion)	-268.6	-282.6	-258.5	-239.8	-205.0	-185.5
Target (Ksh Billion)	-276.7	-247.0	-219.2	-207.9	-183.7	-156.5
Actual Credit to private sector (Ksh Billion)	2,813.1	2,841.6	2,866.8	2,867.1	2,866.0	2,865.0
Target (Ksh Billion)	2,849.4	2,826.5	2,849.3	2,886.3	2,920.0	2,944.0
Memorandum Items						
12-month growth in actual Reserve Money (Percent)	1.9	0.2	-1.1	1.2	4.5	8.6
12-month growth in actual Broad Money, M3 (Percent)	13.2	13.2	12.4	10.1	9.3	7.6

Source: Central Bank of Kenya

iv. Interest Rates Developments

a. Central Bank Rate (CBR)

The MPC retained the CBR at 7.00 percent during the first half of 2021, noting that the policy package deployed since March 2020 had yielded the intended effect on the economy. The monetary policy measures were augmented by implementation of the announced fiscal measures in the FY2020/21 Budget. Additionally, the CBK ensured that the interbank market and liquidity management across the sector continued to function smoothly, as the MPC closely monitored the evolution of COVID-19 and other domestic and global developments.

b. Short Term Rates

Short-term interest rates remained relatively stable in the first half of 2021, supported by accommodative monetary policy stance and improved market liquidity **(Table 3)**. The average interbank interest rate remained below the CBR, mainly reflecting ample liquidity conditions in the market. Average interbank rate declined to 4.63 percent in June 2021 compared to 5.29 percent in December 2020. Interest rates on government securities increased slightly; with the average 91-day Treasury bill rate increasing to 7.03 percent in June 2021 from 6.90 percent in December 2020, while the average 182-day Treasury bill rate increased to 7.60 percent from 7.38 percent. Liquidity management operations by the CBK continued to ensure stability in the market.

c. Commercial Bank Rates

Commercial banks' average interest rates remained relatively stable in line with the monetary policy stance. The average commercial bank lending rate was 12.06 percent in May 2021 compared to 12.02 percent in December 2020, while the average deposit rate was 6.30 percent, respectively. Consequently, the interest rate spread remained relatively stable, at 5.76 percent in May 2021 compared to 5.73 percent in December 2020.

Table 3: Interest Rates (Percent)

	2020				2021					
	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun
Central Bank Rate	7.25	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
Interbank	4.40	3.27	2.95	5.29	5.12	4.49	5.23	5.12	4.62	4.63
Repo	6.13	3.50	3.18	6.88	5.82	6.04	6.12	6.61	6.05	5.37
91-Tbill	7.29	7.14	6.29	6.90	6.92	6.90	7.03	7.10	7.15	7.03
182-Tbill	8.14	7.93	6.70	7.38	7.48	7.64	7.82	7.92	7.98	7.60
Average Lending Rate (1)	**12.09**	**11.89**	**11.75**	**12.02**	**12.00**	**12.02**	**12.05**	**12.08**	**12.06**	
Overdraft/loan	11.79	11.24	11.15	11.51	11.43	11.52	11.61	11.66	11.57	
1-5years	12.20	12.07	11.62	12.13	12.10	12.10	12.15	12.19	12.20	
Over 5years	12.11	11.98	12.12	12.12	12.11	12.12	12.11	12.15	12.10	
Average Deposit Rate (2)	**7.07**	**6.86**	**6.41**	**6.30**	**6.31**	**6.47**	**6.46**	**6.30**	**6.30**	
Demand	1.52	1.47	1.39	1.25	1.25	1.35	1.27	1.22	1.25	
0-3months	7.42	7.11	6.47	6.66	6.64	6.67	6.68	6.74	6.63	
Over 3months	7.56	7.40	7.07	6.97	7.01	6.97	6.89	6.88	7.03	
Savings	4.15	4.15	3.78	2.70	2.73	3.37	3.48	2.66	2.55	
Spread (1-2)	**5.02**	**5.02**	**5.34**	**5.73**	**5.69**	**5.55**	**5.58**	**5.78**	**5.76**	

Source: Central Bank of Kenya

v. Banking Sector Developments

The banking sector remained stable and resilient in the first half of 2021, with strong liquidity and capital adequacy ratios. The average commercial banks' liquidity and capital adequacy ratios stood at 56.6 percent and 18.9 percent, respectively, in May. The ratio of gross non-performing loans (NPLs) to gross loans stood at 14.2 percent in May. Most economic sectors registered decreased NPLs largely due to repayments, including: transport and communication; real estate; tourism, restaurant and hotels; and agriculture.

Interest rates remained low supported by accommodative monetary policy and improved liquidity conditions. Private sector credit growth remained resilient, benefiting key sectors of the economy. The operationalisation of the Credit Guarantee Scheme (CGS), in October 2020, is expected to de-risk commercial banks' lending and support additional credit uptake by the vulnerable Micro Small and Medium-sized Enterprises (MSMEs). As at end April 2021, all the seven approved banks had started lending under the Scheme.

vi. Impact of COVID-19 Mitigation Measures

The CBK continued to monitor the outcomes of the measures deployed at the onset of the COVID-19 pandemic in March 2020 to mitigate the anticipated adverse economic effects and financial disruptions from the pandemic. These measures were intended to provide liquidity to the banking sector, mitigate the adverse impact on bank borrowers and facilitate the use of mobile money. An assessment by the Committee showed that the measures ensured continued provision of financial services and provided a buffer against a more adverse impact on the economy.

The lowering of the Cash Reserve Ratio (CRR) in March 2020 had by April 2021 injected KSh 32.8 billion to support lending to tourism (31.8 percent), trade (14.8 percent), transport and communication (13.9 percent), real estate (12.6 percent), manufacturing (12.1 percent), and agriculture (10.0 percent). In line with the March 2020 measures, loans amounting to KSh1.7 trillion (54.8 percent of total gross loans) were restructured over the last one year. The outstanding restructured loans as at end February 2021 amounted to KSh 521.1 billion (16.9 percent of the total gross loans).

The measures, which expired on March 2, 2021, provided the intended relief to borrowers, supported continued operation of business including essential sectors – manufacturing, trade, and transport and communication, and mitigated more severe loss of jobs and livelihoods. Additionally, the measures provided space for the banking sector to build capital and liquidity buffers, thereby strengthening resilience of the sector.

On the fiscal front, the Government continued to implement programmes to cushion citizens and businesses from the effects of the COVID-19 under the Economic Stimulus Programme. Revenues began to gradually improve in the first half of 2021 following reopening of the economy and implementation of tax reversals and tax measures in the Finance Act, 2020.

vii. Exchange Rates and Foreign Exchange Reserves

The Kenya Shilling exchange rate remained stable against the US Dollar in the first half of 2021, despite the impact of COVID-19 on global financial conditions **(Chart 3a and 3b)**. This stability was supported by resilient receipts from tea and horticulture exports, and strong diaspora remittances. The Kenya Shilling and other major EAC currencies strengthened against the US Dollar in the second quarter of 2021. A similar trend was recorded for major international currencies against the US Dollar during the period.

Chart 3a: The Kenya Shilling and Regional Currencies against the US Dollar (Jan 4, 2021=1)

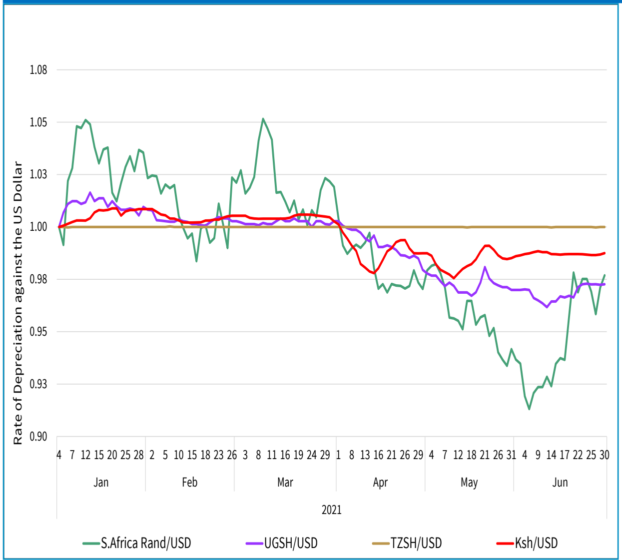
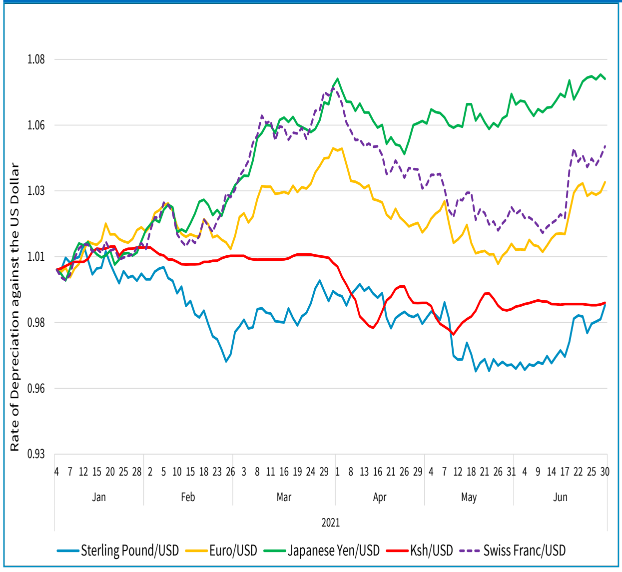
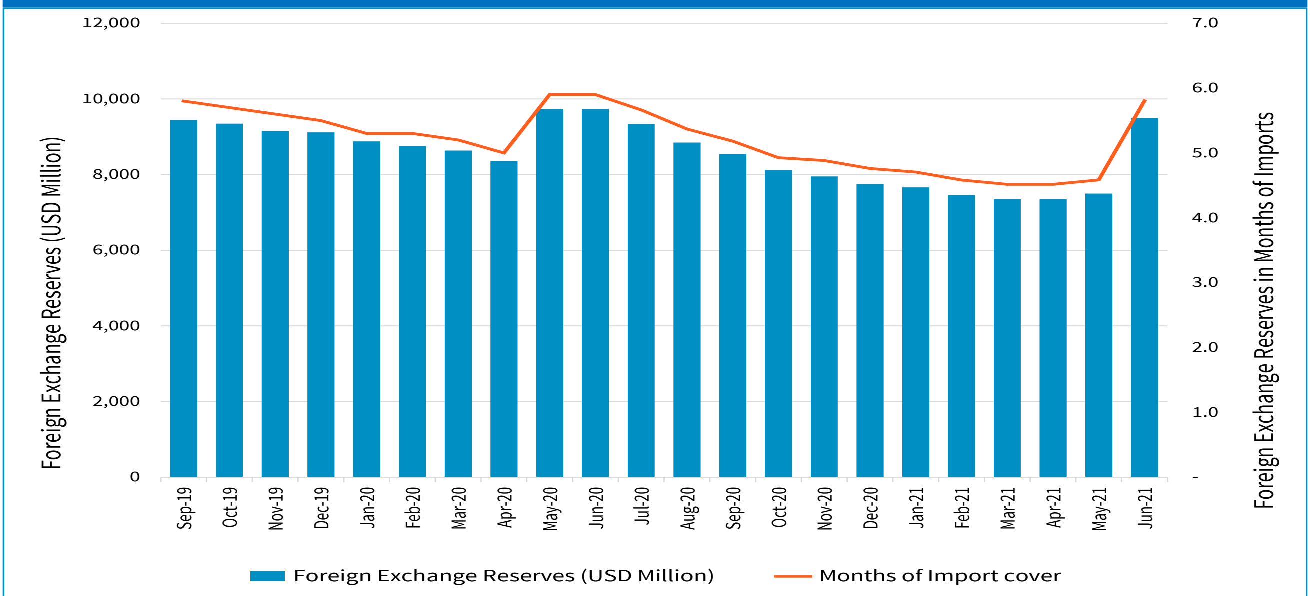


Chart 3b: The Kenyan Shilling and Major International Currencies against the US Dollar (Jan 4, 2021 = 1)



The official foreign exchange reserves remained above the statutory requirement to endeavour to maintain at least 4.0 months of import cover and the EAC convergence criteria of 4.5 months of import cover. Official foreign exchange reserves stood at USD 9494.5 million (5.81 months of import cover at the end of June 2021), and continue to provide an adequate buffer against short term shocks in the foreign exchange market **(Chart 3c)**. The approval on April 2, 2021 of a new program with the IMF under ECF and EFF arrangements indicates confidence in the country's macroeconomic policies and will provide an additional buffer against short term shocks.

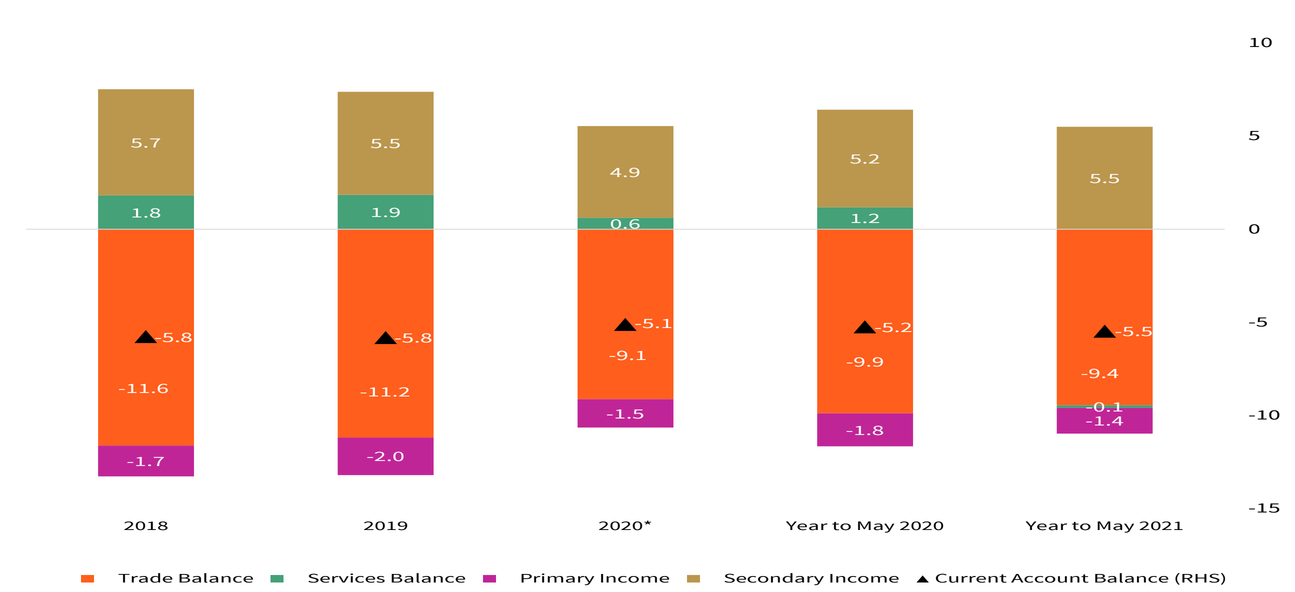
Chart 3c: CBK Foreign Exchange Reserves



viii. Balance of Payments Developments

In the 12-months to May 2021, the current account balance was a deficit of USD 5,361.8 million (5.5 percent of GDP), compared to a deficit of USD 5,137.5 million (5.2 percent of GDP) in May 2020. This was largely due to lower receipts from services exports which offset the impact of lower imports of oil, machinery and transport equipment as well as increased receipts from tea and horticultural exports and strong remittances **(Chart 4 and Table 4)**.

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



Source: Kenya National Bureau of Statistics

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

	2019	2020	Year to May 2020	Year to May 2021
	Act	Act	Prov	Prov
Current account	**-5.8**	**-4.7**	-5.2	**-5.5**
1.1 Goods balance	-11.2	-8.5	-9.9	-9.4
Goods: exports, f.o.b.	6.1	6.2	6.1	6.5
o/w Tea	1.2	1.3	1.2	1.2
Horticulture	1.0	1.0	1.0	1.1
Manufactured Goods	0.4	0.4	0.4	0.4
Other	3.5	3.5	3.5	3.7
Goods: imports, f.o.b.	17.3	14.7	16.0	15.9
o/w Oil products	3.5	2.3	2.9	2.5
Other	10.1	8.4	8.4	9.2
Machinery & Transport equipment	3.7	4.1	4.6	4.2
1.2 Services balance	**1.9**	**0.2**	**1.2**	**-0.1**
Services, Credit	5.9	3.9	5.1	3.7
Transportation	2.3	1.3	2.0	1.1
Travel	1.1	0.5	0.9	0.4
Services, Debit	4.0	3.7	3.9	3.8
1.3 Primary income, balance	**-2.0**	**-1.5**	**-1.8**	**-1.4**
Credit	0.2	0.2	0.2	0.1
Debit	2.2	1.6	2.0	1.5
1.4 Secondary income, balance	**5.5**	**5.1**	**5.2**	**5.5**
Credit	5.6	5.1	5.3	5.6
o/w Remittances	3.0	3.2	2.9	3.5
Debit	0.1	0.1	0.1	0.0
Capital account	**0.2**	**0.1**	**0.2**	**0.3**
Financial Account	**-6.5**	**-2.8**	**-3.6**	**-3.6**
Foreign Direct Investment balance	-1.2	-0.2	-0.8	0.3
Portfolio Investment balance	-1.4	1.4	1.2	1.0
Other Investment balance	-4.0	-4.0	-4.0	-4.8

Source: Central Bank of Kenya

The goods account balance improved to a deficit of 9.4 percent of GDP in the 12 months to May 2021 from 9.9 percent of GDP in May 2020, reflecting lower merchandise imports due to lower oil imports, increased tea exports, and resilient horticulture exports. The value of merchandise exports remained stable at USD 6,326.5 million in the 12-months to May 2021 compared with USD 5,975.9 million in the 12-months to May 2020. Earnings from tea and horticulture increased by 0.6 percent and 12.3 percent, respectively. Horticulture earnings were boosted by the relaxation of restrictions in key export markets and the increased availability of cargo space. Imports fell by 0.5 percent during the same period, mainly driven by reduced imports of petroleum products, which fell by 13.8 percent on account of lower global oil prices.

Exports to Africa accounted for 40 percent, with COMESA and the EAC region accounting for 28 and 25 percent, respectively. China and the European Union were the major importers, accounting for 24.2 percent and 14.9 percent of total exports, respectively. **(Table 5)**.

Table 5: Kenya's Direction of Trade

IMPORTS	(in Millions of US Dollars)		Share of Imports (%)		EXPORTS	(in Millions of US Dollars)		Share of Exports	
	Year to May		Year to May			Year to May		Year to May	
Region/Country	2020	2021	2020	2021	Region/Country	2020	2021	2020	2021
Africa	**1,994.9**	**1,807.5**	**12.7**	**11.6**	**Africa**	**2,221.6**	**2,529.1**	**37.2**	**40.0**
Of which					*Of which*				
South Africa	588.6	388.6	3.8	2.5	Uganda	627.0	769.8	10.5	12.2
Egypt	410.4	441.1	2.6	2.8	Tanzania	315.1	307.3	5.3	4.9
Others	995.9	977.8	6.4	6.3	Egypt	179.6	190.7	3.0	3.0
					Sudan	70.7	71.2	1.2	1.1
EAC	584.3	608.4	3.7	3.9	South Sudan	172.7	181.1	2.9	2.9
COMESA	1,100.2	1,041.6	7.0	6.7	Somalia	106.6	112.8	1.8	1.8
Rest of the World	13,672.8	13,784.8	87	88	DRC	128.6	219.4	2.2	3.5
Of which					Rwanda	229.6	245.0	3.8	3.9
India	1,753.1	1,806.7	11.2	11.6	Others	391.7	431.9	6.6	6.8
United Arab Emirates	1,281.5	1,130.0	8.2	7.2					
China	3,520.7	3,766.9	22.5	24.2	**EAC**	**1,400.4**	**1,563.4**	**23.4**	**24.7**
Japan	925.0	834.5	5.9	5.4	**COMESA**	**1,479.5**	**1,779.6**	**24.8**	**28.1**
USA	549.0	567.1	3.5	3.6	**Rest of the World**	**3,754.3**	**3,797.3**	**62.8**	**60.0**
United Kingdom	304.6	291.6	1.9	1.9	*Of which*				
Singapore	68.8	60.0	0.4	0.4	United Kingdom	435.6	466.9	7.3	7.4
Germany	397.1	383.7	2.5	2.5	Netherlands	450.7	527.5	7.5	8.3
Saudi Arabia	1,026.6	745.6	6.6	4.8	USA	468.1	491.5	7.8	7.8
Indonesia	590.1	479.4	3.8	3.1	Pakistan	475.3	482.5	8.0	7.6
Netherlands	204.9	481.7	1.3	3.1	United Arab Emirates	388.0	286.7	6.5	4.5
France	217.9	222.5	1.4	1.4	Germany	116.0	142.6	1.9	2.3
Iran	49.5	35.1	0.3	0.2	India	43.7	101.0	0.7	1.6
Italy	195.8	229.8	1.2	1.5	Afghanistan	37.7	7.2	0.6	0.1
Others	2,588.2	2,750.4	16.5	17.6	Others	1,339.4	1,291.2	22.4	20.4
Total	**15,667.7**	**15,592.3**	**100.0**	**100.0**	**Total**	**5,975.9**	**6,326.5**	**100.0**	**100.0**
EU	2,032.4	2,325.5	13.0	14.9	EU	1,327.6	1,476.6	22.2	23.3
China	3,520.7	3,766.9	22.5	24.2	China	149.8	168.7	2.5	2.7

Source: Kenya Revenue Authority and Central Bank of Kenya

The balance on the secondary income remained resilient mainly supported by remittances inflows which accounted for 3.5 percent of GDP in the 12 months to May 2021. Remittance inflows in the 12 months to May 2021 totalled USD 3,437.3 million compared to USD 2,838.8 million in a similar period in 2020, a 21.1 percent increase. However, services exports declined by 27.6 percent in the 12-months to May 2021 due to a 43.4 percent and 50.5 percent drop in earnings from transport and travel services, respectively.

ix. Economic Growth

Kenya's economic performance improved in the third quarter of 2020 after a significant contraction in the second quarter of 2020, largely supported by strong performance in agriculture and construction sectors. Real GDP contracted by -1.1 percent in the third quarter of 2020 compared to -5.5 percent in the previous quarter.

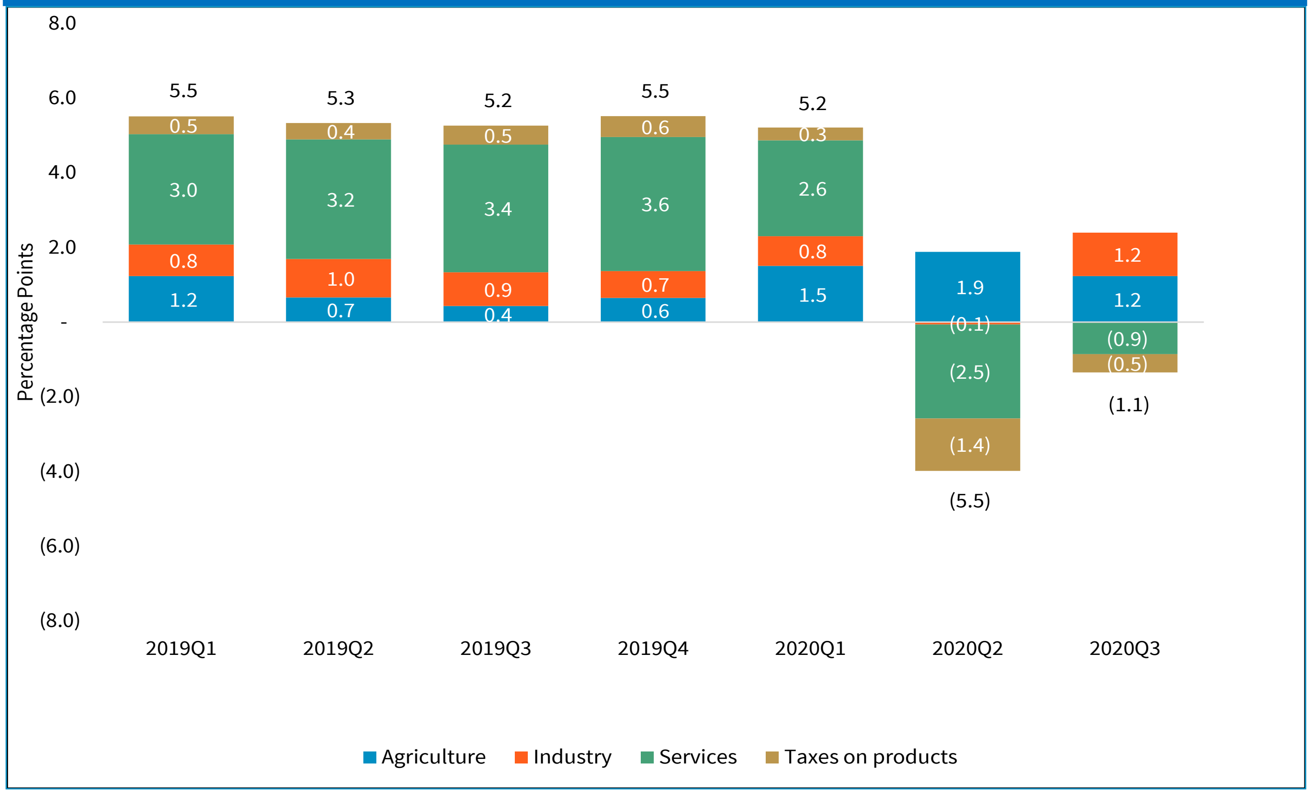
Indicators of the fourth quarter of 2020 and first quarter of 2021 pointed to recovery in economic activity following easing of measures instituted to combat the spread of COVID-19. The fourth quarter of 2020 is projected to record a positive growth.

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

Real GDP Growth Rates	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2019 Q1-Q3	2020 Q1-Q3
1. Agriculture	4.7	2.9	2.4	4.0	5.8	7.3	6.3	3.6	6.4
2. Non-Agriculture (o/w)	5.8	6.0	5.9	5.8	4.9	-9.2	-2.7	5.9	-2.4
2.1 Industry	4.7	5.4	4.7	3.8	4.4	-0.5	4.9	4.9	2.9
2.2 Services	6.5	6.8	6.7	6.8	5.5	-11.6	-5.3	6.6	-3.9
2.3 Taxes on products	4.7	4.0	4.2	4.5	3.4	-14.2	-4.2	4.3	-5.2
Real GDP Growth	5.5	5.3	5.2	5.5	5.2	-5.5	-1.1	5.3	-0.4

Source: Kenya National Bureau of Statistics

Chart 5: Contributions to Real GDP Growth (percent)



Source: Kenya National Bureau of Statistics

x. Domestic Government Borrowing

The coordination between monetary and fiscal policies continued to support macroeconomic stability. The Government's borrowing plan in the first half of 2021 ensured that the build-up in domestic debt was consistent with the thresholds set in the Medium-Term Debt Management Strategy. The Government continued to review its borrowing plan in line with market conditions and prudent budget management that focused on rationalisation of expenditures and strengthening of revenue collection measures.

xi. Stakeholder Forums, MPC Market Perception Surveys, and Communications

The MPC members held virtual stakeholder meetings with the Chief Executives of commercial and microfinance banks in order to apprise them on the background to its decisions and to obtain feedback. The Governor also held virtual media briefings after MPC meetings to apprise the media on the background to the MPC decisions. This was in addition to virtual meetings with various potential investors to brief them on economic developments and the outlook for the economy.

The Committee monitored the implementation of the Committee's policy decisions by the Monetary Policy Management Committee of the Bank, and continued to interact with other government agencies such as the National Treasury and Kenya National Bureau of Statistics(KNBS) on various policy and data issues.

The MPC held a Retreat in March 2021 to discuss strengthening of the monetary policy framework (MPF). During the Retreat, the MPC reviewed: experiences of other countries on the MPF; Report of the Technical Assistance (TA) Mission on Kenya's monetary policy design and implementation; and, issues to be addressed in the White Paper on strengthening of the monetary policy framework and operations.

The MPC also continued to improve on the scope and information gathering processes through the regular Private Sector Market Perceptions Surveys and the Survey of Hotels and Flower Farms. In March 2021, the CBK introduced a Chief Executive Officers' (CEOs) Survey with the objective of capturing information on top firms' perceptions, expectations and decisions and supporting key policy decisions, including monetary policy. The Survey sought CEOs views on selected indicators including business confidence/optimism, previous quarter business activity, and business activity outlook in the near term. The Survey also sought to establish the key internal and external factors that could influence business outlook and strategic priorities over the medium-term. The Survey targeted CEOs of key private sector organizations including members of the Kenya Private Sector Alliance (KEPSA) and the Kenya Association of Manufacturers (KAM).

3. THE ECONOMIC ENVIRONMENT AND OUTLOOK FOR FY 2021/22

i. International Economic Environment

The global economic outlook has improved, despite the high uncertainty about the COVID-19 pandemic's course. The global economy contracted by 3.3 percent in 2020, according to the IMF's April 2021 World Economic Outlook (WEO), but is expected to recover to 6.0 percent growth in 2021. Additional fiscal support in a few major economies, as well as a vaccine-driven recovery, have helped boost global output in the second half of 2021.

Growth in the advanced economies is expected at 5.1 percent in 2021 and 3.6 percent in 2022, owing to continued re-opening of economies, and pent-up demand driven by accumulated savings in 2020 activities. However, there is a substantial divergence in this region's growth recovery direction, with the US and Japan's growth expected to return to pre-pandemic levels in the second half of 2021. Growth in most countries is expected to recover in 2021 as shown in **Table 7**.

Growth in emerging market and developing economies is expected to pick up to 6.7 percent, up from a contraction of 2.2 percent in 2020. China is expected to grow by 8.4 percent in 2021 due to successful containment measures, aggressive public spending, and central bank liquidity support. Latin America's growth is expected to accelerate to 6.4 percent, with Brazil and Mexico growing at 3.7 percent and 5.0 percent, respectively. Growth rates in Emerging Asia have been revised up by 0.6 percentage points due to a stronger recovery following the relaxation of lockdown restrictions in some large countries such as India.

Economic growth in Sub-Saharan Africa (SSA) is expected at 3.4 percent in 2021, significantly lower than the pre-pandemic trend, with tourism-dependent economies bearing the brunt of the blow. Growth rates in Nigeria and South Africa are expected at 2.5 and 3.1 percent, respectively.

The risks of pandemic resurgence, vaccine-resistant strains, and operational threats such as vaccine development and delivery delays remain significant. Tighter financial conditions, which include a re-evaluation of market dynamics, a rise in core sovereign yields, and a re-evaluation of inflation risks, could all result in a rapid repricing of financial assets.

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

Region/Country	2020 Est.	2021 Proj.	2022 Proj.
World Output	**-3.3**	**6.0**	**4.4**
Advanced Economies	**-4.7**	**5.1**	**3.6**
United States	-3.5	6.4	3.5
Euro area	-6.6	4.4	3.8
Japan	-4.8	3.3	2.5
United Kingdom	-9.9	5.3	5.1
Emerging Market and Developing Economies	**-2.2**	**6.7**	**5.0**
China	2.3	8.5	5.6
India	-8.0	12.5	6.9
Brazil	-4.1	3.7	2.6
Russia	-3.1	3.8	3.8
Sub-Saharan Africa	**-1.9**	**3.4**	**4.0**
South Africa	-7.0	3.1	2.0
Nigeria	-1.8	2.5	2.3

Source: IMF, World Economic Outlook

ii. Domestic Economic Environment

The Real GDP growth outlook point to a strong recovery in 2021. The economy is expected to rebound strongly, despite elevated oil prices and continued disruptions of economic activities from measures instituted to contain the spread of COVID-19. The strong recovery is premised on global economic recovery to support trade, gradual easing of COVID-19 containment measures, strong policy support and favourable weather conditions.

Additionally, Surveys conducted ahead of the MPC meeting in May 2021 (CEOs Survey, Private Sector Market Perceptions Survey and Survey of Hotels) revealed general optimism on economic growth prospects in 2021, largely attributed to the rollout of vaccines, gradual resumption to normalcy with easing of containment measures, favourable weather conditions, prospects for improved exports to the EAC region and expected increase in demand for credit by the private sector. Respondents were however, concerned about continued uncertainties over the pandemic, and the increased cost of inputs.

The macroeconomic environment is expected to remain stable, with overall inflation remaining within the target range (5 percent with a margin of 2.5 percent on either side). The exchange rate is expected to be stable, reflecting expected stability in the current account balance and adequate foreign exchange reserves. The 12-month current account deficit is projected at 5.2 percent of GDP in 2021 and 2022 on the back of a rebound in export earnings from horticulture and tea, strong remittances, and a lower import bill particularly oil. Services receipts are expected to remain subdued due to weaknesses in international travel and transport.

The execution of the budget for FY 2020/21 has progressed well albeit challenges of lower revenues and elevated expenditures due to the adverse impact of COVID-19 Pandemic. For FY2021/22, fiscal deficit as percent of GDP is projected to decline to 7.7 percent of GDP from 8.7 percent in FY2020/21. Fiscal consolidation will be supported by the on-going reforms in tax policy and revenue administration measures as well as tax measures proposed in the Finance Bill, 2021.

4. DIRECTION OF MONETARY POLICY IN THE FY 2021/22

Price stability remains the overriding objective of monetary policy during FY2021/22. Monetary policy also will support economic recovery in the post COVID-19 period. Growth in the monetary aggregates in FY2021/22 is therefore consistent with Government policy objectives articulated in the Medium-Term Government Budget Policy Statement for 2021 published by the National Treasury.

Considering the government inflation and economic growth objectives in FY2021/22, the growth in the monetary aggregates in FY2021/22 is presented in **Table 8**. The 12-month growth in broad money (M3) is expected at 10.4 percent by December 2021 and 11.0 percent by June 2022. Growth in private sector credit is expected at 10.2 percent by December 2021 and 11.6 percent by June 2022. Private sector credit growth is expected to be supported by enhanced economic activities from the COVID-19 economic recovery plan, and the ongoing implementation of the Credit Guarantee Scheme for the vulnerable Micro Small and Medium-sized Enterprises (MSMEs), which de-risk lending by commercial banks to this sector.

The CBK foreign exchange reserves are projected to remain adequate in FY 2021/22, consistent with positive outlook of the balance of Payments. The reserves will continue to provide a buffer against external shocks in the foreign exchange market. The coordination of monetary and fiscal policies will also support macroeconomic stability.

Table 8: Outlook for Key Monetary Aggregates in FY 2021/22

	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Broad Money, M3 (Ksh Billion)	4,269.9	4,281.8	4,405.6	4,531.3	4,737.9
Reserve Money, RM (Ksh Billion)	472.7	490.3	503.0	480.6	510.6
Credit to Private Sector (Ksh Billion)	2,922.8	3,011.1	3,098.7	3,179.3	3,260.7
NFA of CBK (Ksh Billion)	859.7	752.3	770.6	681.1	737.9
NDA of CBK (Ksh Billion)	-386.9	-262.0	-267.6	-200.5	-227.3
12-month growth in RM (Percent)	9.1	8.0	6.4	4.9	8.2
12-month growth in M3 (Percent)	9.8	11.4	10.4	12.4	11.0
12-month growth in Credit to Private Sector (Percent)	8.5	8.8	10.2	10.9	11.6
Medium-Term 12-month overall Inflation (Percent)	5.0	5.0	5.0	5.0	5.0

Source: Central Bank of Kenya

The price stability objective and growth in monetary projections are subject to risks emanating from both the domestic and global fronts. The predictability of money demand continues to be affected by sustained preference for electronic payments over cash. On the external front, the key downside risks include: uncertainty about the global outlook, largely due to new COVID-19 strains and waves and possibility of reintroduction of containment measures, and volatility in international oil prices and global financial markets. However, global business sentiment has improved with implementation of COVID-19 vaccination programs. Monetary developments will therefore be closely monitored in light of these risks, in order to provide necessary reviews to inform the decision-making process in the MPC. Additionally, the CBK will continue to monitor the economic impact of COVID-19 and the outcomes of policy measures in place as well as other developments in the domestic and global economies to safeguard price stability.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (JANUARY - JUNE, 2021)

January	Withdrawal (effective January 1) of temporary tax relief measures introduced in April 2020 to cushion businesses and individuals against impact of COVID-19.
	The MPC retained the Central Bank Rate (CBR) at 7.00 percent. The Committee noted that the package of policy measures implemented since March 2020 were having the intended effect on the economy, augmented by implementation of the announced fiscal measures in the FY2020/21 Budget.
March	The CBR retained at 7.00 percent. The Committee noted that the package of policy measures im-plemented over the last year had protected the economy from substantial decline, and supported the most vulnerable citizens.
	Re-introduction or extension of lockdown measures in Europe in response to third wave of the COVID-19 infections particularly in key export markets for horticulture and flowers.
	Announcement of lockdown measures in five counties of Kajiado, Kiambu, Machakos, Nairobi and Nakuru), in response to resurgence of COVID-19 infections
April	Kenya entered into a 38-month program with the IMF under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) arrangements. The program will support Government's next phase of COVID-19 response; stabilise debt to GDP ratio and lay the ground for durable and inclu-sive growth.
	Release of April 2021 IMF WEO report showing stronger projections for 2021 and 2022 relative to October 2020 WEO. This reflects additional fiscal support in a few large economies, the anticipated vaccine-powered recovery in the second half of 2021, and continued adaptation of economic activity to subdued mobility.
May	The Committee retained the Central Bank Rate (CBR) at 7.00 percent, noting that inflation expectations remained well anchored within the target range, and the economy continued to operate below its potential level.

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.

Central Bank of Kenya

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