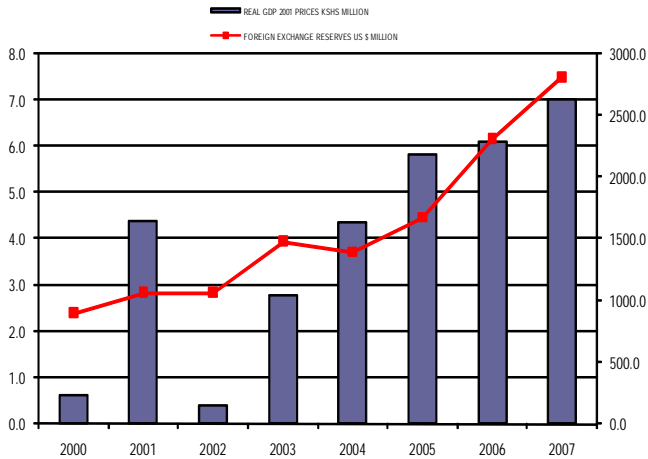




CENTRAL BANK OF KENYA

Monetary Policy Statement

Issued under the Central Bank of Kenya Act, Cap 491



JUNE 2008

Letter of Transmittal

Dear Honourable Minister,

I have the pleasure of forwarding to you the 22nd 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 December 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 June 2009.



Prof. Njuguna Ndung'u
Governor

MONETARY POLICY STATEMENT

JUNE 2008

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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 implements monetary policy by controlling money supply. To achieve the desired level of money supply, OMO is conducted using various instruments
 - o Repurchase agreements (Repos) – The CBK uses repos to withdraw liquidity by selling Treasury bills and other eligible securities to commercial banks, and uses reverse repos to inject liquidity by buying Treasury bills and other eligible securities from commercial banks.
 - o Term Auction Deposits – The CBK uses the Term Auction Deposit to withdraw liquidity from the banking system.
- **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.

INTRODUCTION

The 22nd Monetary Policy Statement (MPS) for June 2008 is made pursuant to Section 4B of the Central Bank of Kenya (CBK) Act. It reviews implementation of monetary policy for the period December 2007 to June 2008, evaluates key macroeconomic indicators during this period against projections, while setting out possible risks in the short term, and lays out monetary policy for the fiscal year 2008/09 in order to deliver on the Bank's principal objective of low and stable inflation as well as supporting the Government's economic growth and employment objectives.

The MPS is part of a wider set of publications that the CBK uses to report and explain its views on monetary conditions and inflation, and their implications for monetary policy. The MPS is presented in three parts. Section one reviews the performance of monetary policy in the first half of 2008. Section two covers economic developments in the first half of 2008, and outlines the outlook in 2008/09 and in the medium term. The last section contains the monetary policy stance for the fiscal year 2008/09. The section also summarizes both prospects and risks that could influence the outlook for inflation by the end of June 2009. This is expected to be part of the information that markets consider when forming expectations on monetary conditions and inflation.

EXECUTIVE SUMMARY

World real GDP growth is estimated to have increased by 5 percent in 2007 according to the July 2008 update of the IMF World Economic Outlook. Growth in emerging markets and developing countries remained robust with real GDP in China and India increasing by 11.9 percent and 9.3 percent respectively on account of productivity gains arising from increased integration into the global economy, improved terms of trade and strengthened policy frameworks. World output growth momentum is, however, expected to ease from 5 percent in 2007 to 3.9 percent in 2008 and 3 percent in 2009. The slowdown reflects weakened industrial production in advanced economies and weakening business activity in emerging economies.

Sub-Saharan Africa (SSA) real GDP grew by 6.9 percent in 2007 compared with 6.6 percent in 2006. Increased oil and diamond production in Angola coupled with strong domestic demand and improved macroeconomic stability in other countries in the SSA region were the main drivers of the recent pace of expansion. Economic prospects for SSA remain positive though with growth in 2008-09 projected to slow down modestly. In particular, increased diversification from primary exports into manufacturing has reduced the region's vulnerability to terms of trade shocks.

The Kenyan economy maintained the recent broad based expansion of economic activity to grow by 7 percent in 2007 on the basis of stable macroeconomic conditions. However, economic growth declined by 1 percent in the first quarter of 2008 compared with a growth of 7.7 percent in the first quarter of 2007. The economy rebounded in the second quarter of 2008 with real economic growth of 3.2 percent. The contraction in first quarter economic activity followed political disruptions that affected key sectors of the economy. Accordingly, growth is projected to moderate to 4.5 percent in 2008. Economic growth is expected to recover to 7.9 percent in 2009 as the Government implements key flagship projects under the Vision 2030 framework.

In the previous monetary policy statement, the Bank had assessed the growth in money supply, M3, which is the intermediate target, and reserve money which is the operating target and sought to limit the growth of reserve money in June and December 2008 to 18 percent and 16 percent respectively. This was considered appropriate to anchor inflation pressures and forestall short term adverse effects on the economy from disruptions in the first quarter of 2008.

Money supply, M3, growth was, however, higher at 19.3 percent in the year to June 2008, well above the 17.5 percent target, reflecting strong credit growth and increased foreign exchange inflows to finance Safaricom initial public offer (IPO). Reserve money also broadly exceeded the targets in the first quarter of 2008 before slowing down in the second quarter of 2008. The increase in reserve money was as a result of the Bank's attempt to deal with liquidity problems

in the banking system resulting from the Safaricom IPO. To deal with the skewed liquidity in the banking system, the Central Bank of Kenya provided short term liquidity through reverse repurchase agreements (Reverse Repos) from May to mid-August 2008. To neutralise reverse Repos impact on its monetary targets, the Central Bank used repurchase agreements (Repos) and the newly introduced instrument, the Term Auction Deposit Facility to mop up available liquidity from the section of the market with excess liquidity.

Inflation became a major concern for the Central Bank in the first half of 2008 as overall inflation increased from 12 percent in December 2007 to 29.3 percent in June 2008. The driving force for high inflation was the disruption of supply chains earlier in the year leading to high food and fuel prices. International oil prices rose substantially mainly driven by supply concerns in the context of limited spare capacity and inelastic demand. Higher food prices were also as a result of unfavourable weather conditions and slow restoration of supply capacity. Under the current measure of inflation, food is given a weight of about 51 percent.

While inflation was driven more by supply related factors than by monetary developments, the Monetary Policy Committee (MPC) which held its inaugural meeting on 5th June 2008 adjusted the Central Bank Rate from 8.75 percent to 9 percent to forestall inflationary expectations from being translated into more generalised inflation pressures. To keep inflation under control during the 2008/09 period, the Central Bank of Kenya has set targets of 17.1 percent and 16.2 percent for money supply and reserve money respectively, for end-June 2009.

Following a methodological review, it was concluded that the current method used in calculating inflation produced inflation numbers with an upward bias. As a result, the Kenya National Bureau of Statistics (KNBS) is expected to use the internationally recommended methodology to correct for upward bias. Likewise it is expected that the KNBS will reweight the consumer price index (CPI) based on 2005/06 Kenya Integrated Household Budget Survey data instead of the 1993/94 survey to correct for undue weights of various commodities in the basket to calculate inflation. Both of these actions will have a significant impact on inflation numbers.

Going forward, it is expected that overall inflation will slow down as implementation of the appropriate monetary policy stance dampens inflation expectations and as the double digit food inflation eases following resumption of near normal rainfall patterns. However, the upside risks to inflation remain, based on international developments due to the subprime crisis, and how the international community deals with the resulting crisis. Containing overall inflation close to the target and mitigating second-round effects from food and fuel price increases and other internationally induced challenges will be the foremost focus for the Bank.

1. MONETARY POLICY SINCE THE LAST STATEMENT OF DECEMBER 2007

1.1 Review of Recent Monetary Policy Stance

Monetary policy sought to limit reserve money growth to 18 percent for end of June 2008 and 16 percent for the end of December 2008. This was considered appropriate to ease inflation pressures that were building as a result of the election related expenditures in December 2007.

Economic growth projection for 2008 was revised from 6.5 percent to 4.5 percent following the post-election crisis that adversely affected agriculture, industry and services. Economic growth is expected to exceed 7 percent in 2009 after the economy recovers from the 2008 post election crisis and from renewed investor confidence.

Monetary policy implementation in the first half of 2008 was anchored on quarterly targets for reserve money (currency in circulation and commercial bank deposits at the Central Bank) as has been the case in the past. The main elements of the monetary expansion path are summarized in Table 1 below. To guide daily monetary policy operations, monthly targets for reserve money were set consistent with the established quarterly targets.

Table 1: Growth Targets for Key Aggregates for 2007/08- End of Period

	Sep '07	Dec '07	Jun '08	Jun '08
	Actual			Proj
Reserve money (Ksh million)	131.3	155.6	150.8	149.2
NFA of CBK (Ksh million)	179.7	211.3	213.9	220.6
Memo:				
Annual change in reserve money	17.0	25.3	19.3	18.0
Annual change in broad money (M3)	17.7	20.9	19.3	17.5
Real GDP growth			3.2	5.8
Inflation			29.3	5.0

Source: Central Bank of Kenya

1.2 Performance of Monetary Policy Implementation to June 2008

Monetary policy was implemented through open market operations (OMOs). Daily open market operations were guided by the need to align the daily reserve money to the respective monthly target for reserve money. The Bank also introduced a new instrument – the Term Auction Deposit Facility – to increase the scope for liquidity management that was not possible with the existing repo securities. The mode of operation of the Term Auction Deposit Facility is similar to the repo agreements. Banks place bids competitively in the OMO auction. The Term Auction Deposit provided additional flexibility for liquidity management during the

Safaricom IPO. The Term Auction Deposit Facility augments existing repo securities. It enables the Bank to take a more aggressive approach on liquidity management.

Liquidity mopped up under OMO was on average below the amount required to bring reserve money on target between December 2007 and June 2008 due to developments related to the post election crisis and later due to the Safaricom IPO. Due to end-year commitments and election related expenditures, commercial banks repo holdings started to decline reaching Ksh 5.6 billion by January 2, 2008. However, commercial banks' Repo holdings began to build up in January 2008 in line with the programmed levels, increasing to Ksh 35 billion by February 22, 2008. The build up in commercial banks' repo holdings also reflected political developments in early 2008 that disrupted banking services leaving commercial banks with high balances. Given a ceiling of Ksh 35 billion worth of repo holding stock for monetary policy operations the Central Bank of Kenya introduced the Term Auction Deposit Facility to expand its scope for open market operations because the repo stock was almost used up.

To perform its function of ensuring financial stability of the banking system after the over-subscribed Safaricom IPO and to correct skewed liquidity conditions within the banking system, the Central Bank of Kenya performed reverse Repos to counter slow recycling of IPO-related payments from receiving banks to banks in need of liquidity.

The Bank also took measures to enhance the effectiveness of open market operations to curb reserve money growth and to ensure stability of the banking system. In addition, the MPC in its inaugural meeting on 5th June 2008 adjusted the Central Bank Rate from 8.75 percent to 9 percent to stem any incipient pressures on inflation from excess liquidity. As a result, annual reserve money growth slowed down from first quarter of 2008 of 23.3 percent to 19.3 percent at the end of June 2008.

Reserve Money

Reserve money was above the monthly operational targets between December 2007 and June 2008 as it increased from Ksh 145.5 billion in December 2007 to Ksh 149.1 billion in June 2008. As shown in Table 2, average actual reserve money was above June 2008 operational target by Ksh 4.9 billion. Excess reserve money was in form of excess bank reserves amounting to Ksh 3.9 billion and currency outside banks equivalent to Ksh 0.9 billion. The outturn for June 2008 was attributable to liquidity movements associated with Safaricom IPO.

Increase in reserve money to June 2008 originated from increased net foreign assets (NFA) in the CBK balance sheet. The CBK NFA increased from an average of Ksh 185.4 billion in December 2007 to Ksh 213.9 billion in June 2008 reflecting capital inflows for investment in the Safaricom IPO. Meanwhile, net domestic assets of CBK declined from Ksh -39.9 billion to Ksh -64.8 billion mainly due to build up of Government deposits at the Central Bank as well as increased Repo holdings by commercial banks. Increase in Government deposits reflected receipt of Safaricom IPO proceeds by Government. The commercial banks repo holdings averaged Ksh 23.9 billion from Ksh 9.3 billion in December 2007.

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

	Reserve Money			Currency Outside Banks			Banks Reserves			OMO		
	Act	Target	Dev	Act	Target	Dev	Act	Target	Dev	Desired Mop Up	Actual Mop Up	Dev
Jun-07	126.3	123.1	3.2	79.3	76.6	4.8	47.0	46.5	-1.6	3.6	2.1	-1.5
Jul-07	128.5	123.8	4.6	80.8	76.6	4.3	47.7	47.2	0.3	3.8	2.3	-1.5
Aug-07	131.7	124.2	7.5	82.7	76.4	6.3	49.1	47.8	1.2	4.8	3.2	-1.5
Sep-07	132.8	131.3	1.5	83.6	82.0	1.5	49.2	49.3	-0.1	4.1	3.8	-0.4
Oct-07	135.4	132.6	2.8	85.2	83.1	2.1	50.2	49.6	0.7	2.6	3.4	0.8
Nov-07	139.3	136.0	3.2	88.3	85.7	2.6	51.0	50.3	0.7	2.7	2.5	-0.2
Dec-07	145.5	141.6	3.9	93.6	90.2	3.4	51.9	51.4	0.5	2.9	2.3	-0.6
Jan-08	150.9	138.2	12.7	96.7	86.4	10.4	54.2	51.8	2.4	3.9	4.5	0.6
Feb-08	148.9	137.2	11.6	93.2	83.7	9.4	55.7	53.5	2.2	6.3	7.4	1.1
Mar-08	150.4	139.2	11.2	92.4	84.8	7.6	58.0	54.4	3.6	8.4	6.6	-1.8
Apr-08	147.6	143.7	3.9	89.3	88.0	1.2	58.3	55.6	2.7	8.0	6.2	-1.6
May-08	146.7	144.0	2.8	86.4	86.1	0.3	60.3	57.8	2.5	4.4	8.1	3.7
Jun-08	149.1	144.2	4.9	87.3	86.4	0.9	61.8	57.8	3.9	2.3	3.5	1.2

Source: Central Bank of Kenya

The unencumbered NFA of Central Bank of Kenya was Ksh 209.3 billion by the end of June 2008 compared to the target of Ksh 195.7 billion for the period. Consequently, NFA was above target by Ksh 13.6 billion.

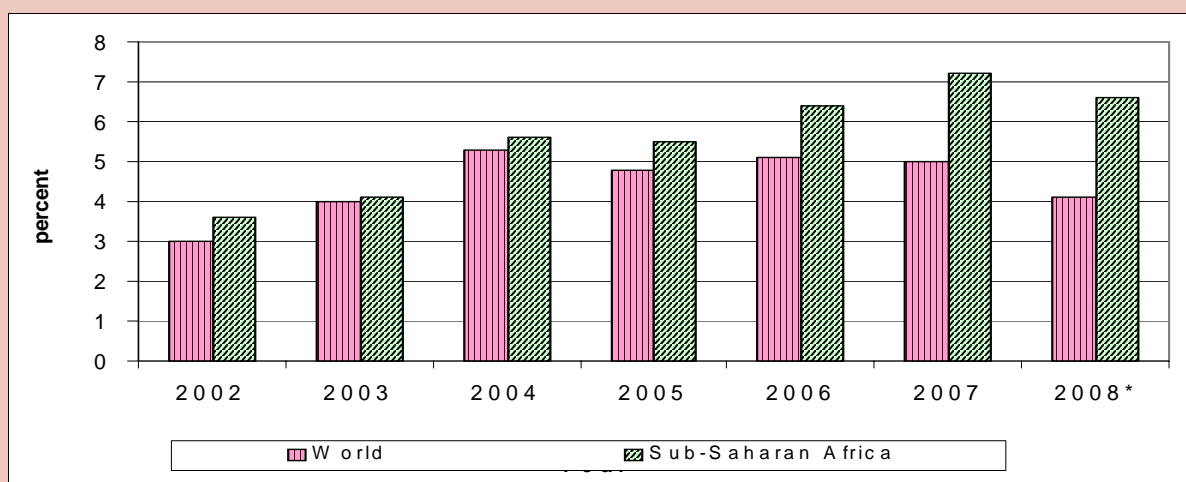
2. ECONOMIC SITUATION AND OUTLOOK FOR 2008 AND MEDIUM TERM

2.1 The World Economy

According to the International Monetary Fund's July update of the World Economic Outlook, the global economy grew by 5 percent in 2007 compared with 5.1 percent in 2006. Most of the slowdown was in advanced economies, particularly in the United States, where the housing market correction aggravated financial stress. Emerging and developing economies, led by China and India maintained robust growth on account of strong productivity gains following progressive integration into the global economy, improvement in terms of trade and strengthened policy frameworks.

Sub-Saharan Africa Real GDP grew by 6.9 percent in 2007 reflecting increased production in oil exporting countries and, rising domestic investment and productivity in the region. Good progress in economic stabilization and structural reform implementation are behind the good economic performance. Stable global demand for commodities, huge capital flows, and debt relief have also helped increase resources and boost growth in the Sub-Saharan Africa region.

Chart 1: Global Economic Output (2002 - 2008)



Source: IMF World Economic Outlook

Outlook for 2008/09 and the Medium Term

Global growth is projected to fall to 3.9 percent in 2008 and 3 percent in 2009. Growth in emerging and developing economies, which had risen from 7.9 percent in 2006 to 8 percent in 2007, is expected to decline to 6.9 percent in 2008 and 6.1 percent in 2009. These projections do not include the fallout from the subprime markets which is expected to adversely affect growth outlook for 2009.

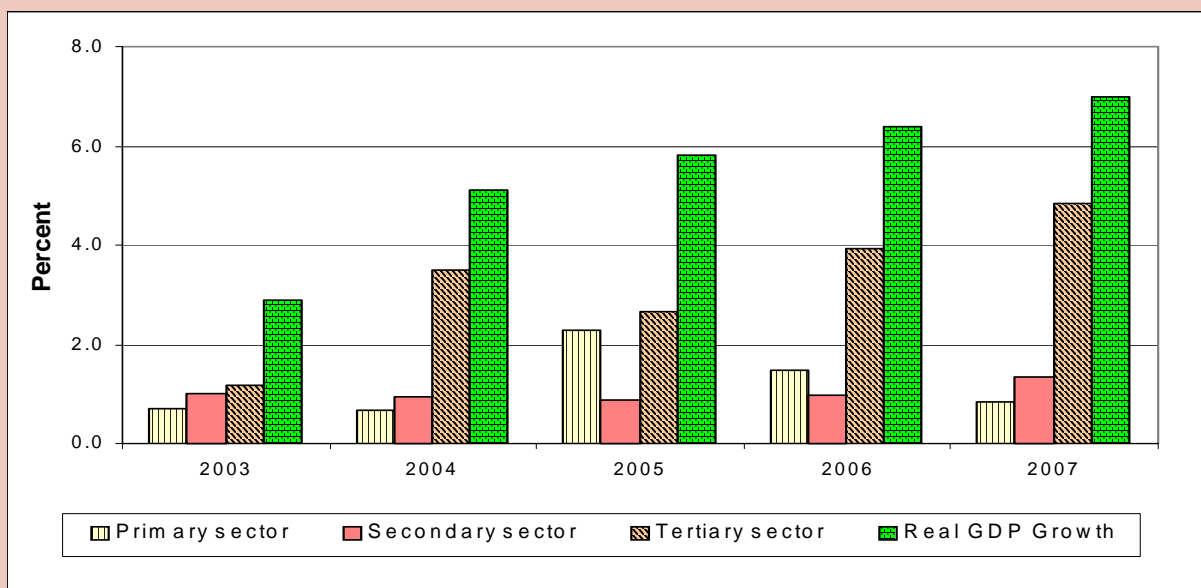
The slowdown in global growth is expected to affect African economies through lower demand for exports and most likely, lower commodity prices. Consequently, declines could be experienced in foreign direct investment, portfolio flows and remittances inflows. Therefore, growth in Sub-Saharan Africa which had risen from 6.6 percent in 2006 to 6.9 percent in 2007 is expected to decline to 6.1 percent in 2008. Thereafter, growth is expected to pick up to 6.3 percent in 2009.

2.2 Domestic Economy

Kenya's economy grew by 7 percent in 2007 compared with 6.4 percent in 2006. The increase in growth reflected improved performance in key sectors of the economy particularly tourism, transport and communication, and mining and quarrying. The broad based economic growth reflected improved business confidence and a stable macroeconomic environment.

Production in the agricultural sector is estimated to have grown by 2.3 percent in 2007, compared with 4.4 percent in 2006. This was attributed to delayed long rains and inadequate short rains, which mainly affected the production of maize and beans. Production in the manufacturing sector grew by 6.2 percent in 2007 mainly on account of increased manufacture of beverages, cement, and cigarettes among other products, coupled with increased exports to the EAC and COMESA. Tourism sector marked improved performance in 2007, growing by 16.3 percent compared with 14.9 percent in 2006, following continued aggressive marketing in traditional markets and the Far East. The building and construction sector sustained an impressive growth of 6.9 percent in 2007, attributed to a boom in the housing sector. The growth momentum in this sector was also supported by the on-going rehabilitation and construction of new roads. The transport and communication sector grew by 14.9 percent, compared with 11.4 percent in 2006, boosted mainly by the impressive performance of the post and telecommunications sector.

Chart 2: Contribution to Real GDP Growth



Source: Kenya National Bureau of Statistics

GDP growth in the first quarter of 2008 declined by 1 percent compared with a 7.7 percent growth in the first quarter of 2007. This was mainly attributed to adverse economic effects of the post election crisis on key sectors of the economy like agriculture, tourism, transport and communication, which recorded negative growth. Construction, mining and quarrying, financial services, and electricity and water sectors, however, sustained an upward momentum. The economy is estimated to have grown by 3.2 percent in the second quarter of 2008.

Projections for 2008/09 and the Medium Term

Economic growth in 2008 is set to slow down due to the disruptions that affected economic activity in the first quarter. Unfavourable weather coupled with disruption of agricultural activities by the post-election crisis is expected to adversely affect agricultural output. Despite these developments, economic growth is expected to be boosted by manufacturing, transport and communication, financial services, building and construction, and wholesale and retail trade sectors. The growth will also be supported by continued strong tourism marketing, easy accessibility of credit for investment and if the high cost of production in key sectors like agriculture, manufacturing, and rehabilitation and construction of infrastructure is addressed. Real GDP is projected to grow by 4.5 percent in 2008, 7.9 percent in 2009, and 10 percent by 2012 in line with the Vision 2030 path.

There are, however, some downside risks to the growth outlook which include high international oil prices, and the impact of the subprime crisis. The deteriorating terms of trade arising from the high and volatile oil prices in the international market and high prices of other critical imported inputs may therefore undermine economic performance.

2.3 Balance of Payments

In the year to June 2008, the trade deficit widened from US\$ 2,174 million last year to US\$ 5,224 million. This is partly attributed to an increase in the value of merchandise imports by US\$ 1,667 million compared to a US\$ 737 million increase in the value of merchandise exports. The increase in merchandise imports was mainly in oil, manufactured goods, machinery and transport equipment and chemicals.

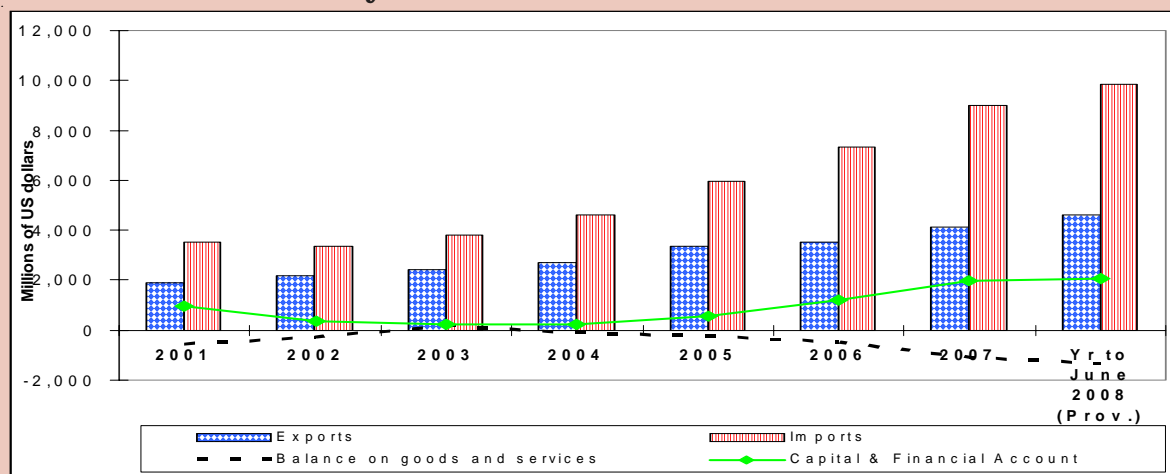
The surplus in the services account improved by US\$ 288 million to reach US\$ 3,883 million in the year to June 2008. The increase reflected additional net current transfers which rose from US\$ 1,957 million to US\$ 2,182 million. The increase was largely in remittances which amounted to about US\$ 664 million. The improvement in the services account was also attributed to increased interest earnings on official foreign exchange reserves and income earned by the private sector. Income earned by the private sector increased from US\$91 million in the year to June 2007 to US\$ 124 million this year.

The surplus in the capital and financial account improved by US\$ 978 million in the year to June 2008 from US\$ 1,071 million last year. The improvement resulted from increased foreign direct investment (FDI). FDI inflows in the year to June 2008 were US\$ 584 million compared with an outflow of US\$ 16 million in a similar period last year. Similarly, net short term financial inflows were US\$ 1,602 million in the year to June 2008 compared with US\$ 1,276 million last year. Official capital and financial flows also improved during the period because of increased receipts of grants and loans to the Government.

The balance of payments therefore improved from US\$ 372 million surplus in the year to June 2007 to US\$ 708 million in a similar period this year as a result of increased flows into the

capital and financial account which exceeded the amount required to finance the current account deficit (Chart 3).

Chart 3: Balance of Payments



Source: Central Bank of Kenya

The favourable balance of payments resulted in a build up in foreign asset holdings of the banking system. For instance, official foreign exchange reserves held by the Central Bank rose from US\$ 2,723 million (4.3 months of imports cover) at the end of June 2007 to US\$ 3,445 million (4.5 months of import cover) at the end of June 2008. In comparison, foreign exchange assets of commercial banks rose from US\$ 1,044 million at the end of June 2007 to US\$ 2,341 million at the end of June 2008.

Outlook for 2008 /09

Available trade data for the first half of 2008 shows that merchandise exports grew by 10.5 percent compared with 6.4 percent growth in merchandise imports. The performance of trade in services between January 2008 and June 2008 was also favourable despite the 11.1 percent decline in receipts from foreign travel. This trend in imports and exports is expected to continue through December 2008. The current account deficit will be financed by capital and financial inflows.

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\$ 3.5 billion in December 2008 (equivalent to 4.3 months imports cover). This is however contingent on how the economy will be impacted by effects of global events.

2.4 Fiscal Developments

Government budgetary operations in the fiscal year 2007/08 resulted in an overall budget deficit including grants of Ksh 87.5 billion or 4.3 percent of GDP on commitment basis compared with Ksh 18.3 billion or 1.1 percent of GDP in the fiscal year 2006/07. Government expenditure and net lending to public entities increased from Ksh 406.8 billion or 23.7 percent of GDP in

the fiscal year 2006/07 to Ksh 543.5 billion or 26.7 percent of GDP in a similar period of 2007/08 (Table 3). Similarly, Government revenue including grants increased from Ksh 388.5 billion or 22.6 percent of GDP to Ksh 455.9 billion or 22.4 percent of GDP during the period.

Table 3: Central Government Fiscal Outturn (Ksh Billion)

	2006/07	2007/08		2008/09	2009/10	2010/11
	Proj.	Prov.	Revised Budget	Proj.	Proj.	Proj.
1. Total Revenue and Grants	388.5	455.9	471.4	547.9	627.0	709.1
Total Revenue	373.0	431.2	434.5	512.7	583.7	651.9
% of GDP	21.7	21.2	21.3	21.4	21.7	21.8
Grants	15.5	24.7	36.9	35.2	43.3	57.2
% of GDP	0.9	1.2	1.8	1.5	1.6	1.9
2. Total Expenditure	406.8	543.5	597.3	678.5	731.9	816.8
Recurrent	325.7	412.6	429.6	475.1	507.3	555.8
% of GDP	19.0	20.3	21.1	19.9	18.9	18.6
Development	81.1	130.9	167.7	203.4	224.6	261.0
% of GDP	4.7	6.4	8.2	8.5	8.4	8.7
3. Balance (commitment basis including grants)	-18.3	-87.5	-125.9	-130.6	-104.9	-107.7
% of GDP	-1.1	-4.3	-6.2	-5.5	-3.9	-3.6
4. Adjustment to cash	-20.1	29.5	1.2	0.0	0.0	0.0
5. Balance (cash basis including grants)	-38.4	-58.0	-124.7	-130.6	-104.9	-107.7
% of GDP	-2.2	-2.8	-6.1	-5.5	-3.9	-3.6
6. Total Financing	36.7	58.0	124.7	130.5	104.9	107.7
a. Net External	-2.0	4.4	24.6	28.8	40.3	41.9
b. Net Domestic	34.7	-13.9	34.0	35.9	29.6	26.9
c. Others*	4.0	67.5	66.1	65.8	35.0	38.9

* Includes privatisation proceeds, securitisation of domestic arrears and Infrastructure Bonds

Source: Treasury

The budget deficit on commitment basis in the fiscal year 2007/08 was much lower than the target of 6.2 percent of GDP following significant growth in Government revenue and grants, and lower than budgeted expenditure. Development expenditure increased from 4.7 percent to 6.4 percent of GDP during the period, which is in line with the Government's expenditure management policy of directing more expenditure to priority areas such as infrastructure and flagship projects identified in the Vision 2030 development plan. The percentage of recurrent expenditure in GDP increased from 19.0 percent to 20.3 percent during the period.

Budgetary operations of the Government in the fiscal year 2007/08 resulted in Ksh 90.7 billion financing requirement. The amount was required to finance Ksh 58.0 billion budget deficit, to build up Government deposits at the Central Bank of Kenya by Ksh 26.4 billion and to repay domestic debt totalling Ksh 6.2 billion due to commercial banks. The Ksh 90.7 billion financing requirement was sourced through net external borrowing of Ksh 4.4 billion, net domestic borrowing of Ksh 18.8 billion and privatisation proceeds (net of restructuring costs) of Ksh 67.5 billion from sale of Government shares in Safaricom, Telkom Kenya and Kenya Re-Insurance Company.

Government domestic borrowing operations in the fiscal year 2007/08 resulted in increased domestic debt from Ksh 404.7 billion or 23.6 percent of GDP in June 2007 to Ksh 430.6 billion or 21.1 percent of GDP in June 2008. The decline in debt as a ratio to GDP reflected faster growth in nominal GDP. Treasury bonds increased from Ksh 272.2 billion to Ksh 315.2

billion during the period while Treasury bills decreased from Ksh 94.4 billion to Ksh 76.8 billion. The average maturity profile of domestic debt increased from 3.07 years to 3.60 years during the period.

Outlook for the Fiscal Year 2008/09

The fiscal year 2008/09 budget projects revenue of Ksh 512.7 billion (excluding grants) or 21.4 percent of GDP and external grants of Ksh 35.2 billion or 1.5 percent of GDP. Total Government expenditure is projected at Ksh 678.5 billion or 28.1 percent of GDP which will comprise Ksh 475.1 billion or 19.9 percent of GDP in recurrent expenditure, and Ksh 203.4 billion or 8.5 percent of GDP in development expenditure.

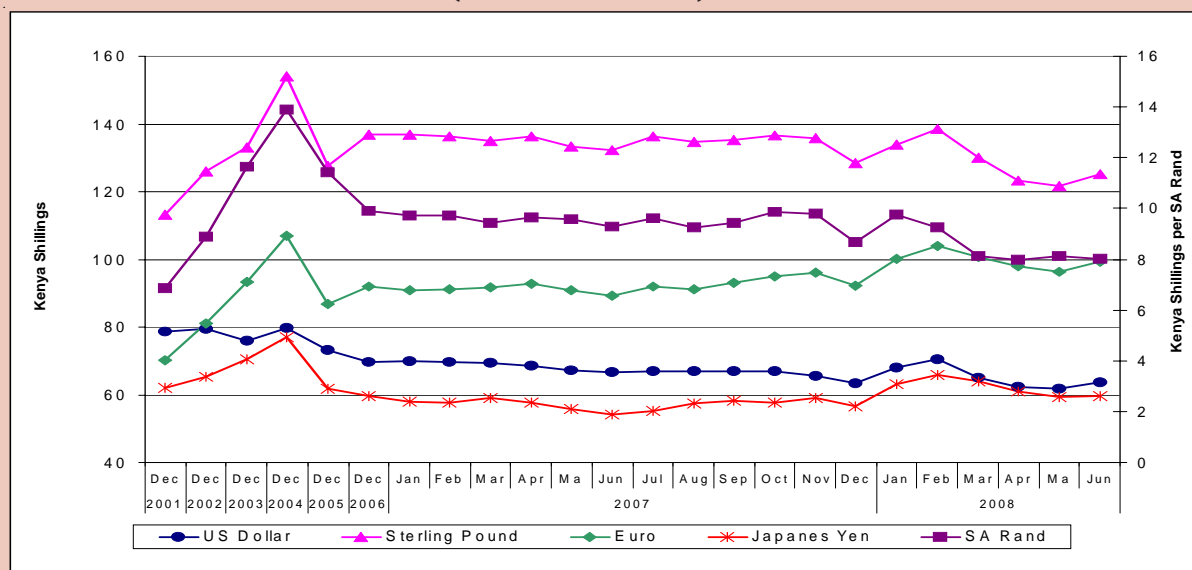
Consequently, Ksh 130.6 billion or 5.5 percent of GDP overall budget deficit including grants is projected in the fiscal year 2008/09. The deficit will be financed through Ksh 28.8 billion net external borrowing, Ksh 35.9 billion net domestic borrowing which includes Ksh 18.8 billion in domestic infrastructure bonds, Ksh 8 billion, privatization receipts, Ksh 33.6 billion from issuance of a sovereign bond to finance infrastructure and Ksh 5.7 billion additional financing for TELKOM Kenya and Kenya Petroleum Refineries.

2.5 Exchange Rate

The Kenya shilling strengthened against major world currencies in the second quarter of 2008 after depreciating in the first quarter of 2008. The Kenya shilling depreciated by 2.6 percent against the US dollar between December 2007 and March 2008 but appreciated by 1.8 percent between March 2008 and June 2008. The shilling strengthened more prominently against the US dollar in May 2008 owing to portfolio investment inflows. Overall, the shilling closed the quarter trading at Ksh 63.8 per US dollar in June 2008 compared with Ksh 64.9 in March 2008.

Chart 4 shows that the Kenya shilling also strengthened against the Sterling Pound, the Euro and the Japanese Yen between March 2008 and June 2008. The shilling gained 3.7 percent against the Sterling Pound, 1.6 percent against the Euro, and 6.9 percent against the Japanese Yen during the period in review.

Chart 4: Kenya Shilling Exchange Rates Against Selected Currencies (2002-June 2008)



Source: Central Bank of Kenya

The Kenya shilling had a mixed performance in exchange against regional currencies between March 2008 and June 2008, depreciating by 2.8 percent against the Uganda shilling and by 2.5 percent against the Tanzania shilling.

Fluctuations in the Kenya shilling exchange rate occasioned by the post-election crisis have dissipated and the shilling exchange rate has resumed its pre-crisis path. Therefore, in the months ahead, the shilling exchange rate movement is contingent on the developments in the international markets and how Kenya is affected.

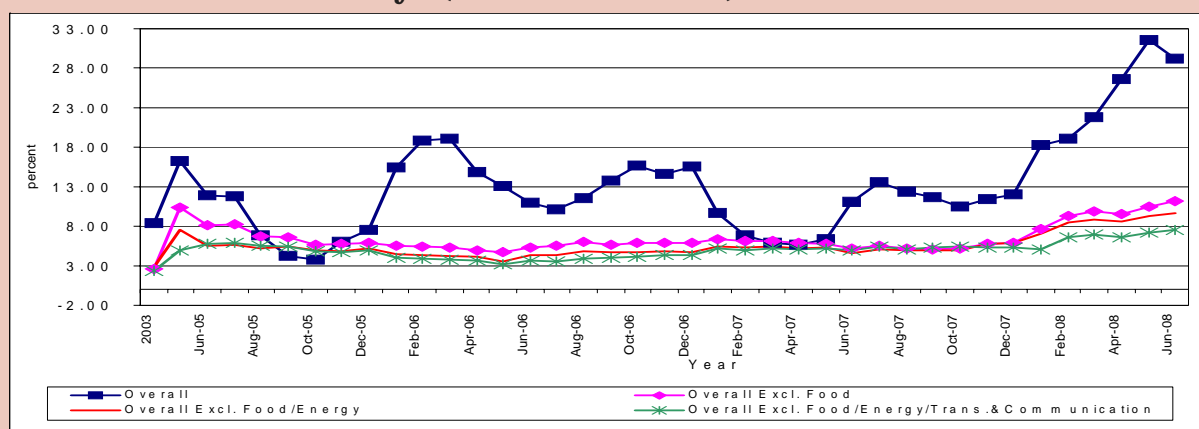
2.6 Inflation

Overall inflation remained significantly high through the first half of 2008. Food and oil price increases were the key drivers pushing overall inflation from 18.2 percent in January 2008 to 31.5 percent in May 2008, before easing slightly to 29.3 percent in June 2008.

Food inflation remained in double digit ranging between 24.6 percent in January 2008 to 44.2 percent in May 2008. Inflation in the fuel and power category ranged between 10.6 percent in January 2008 and 20.1 percent in June 2008. Domestic food price increases in the first half of 2008 reflected a number of factors. Delayed long rains and inadequate short rains led to reduced production of staple food crops and lower harvest yields. Political developments at the beginning of the year also had disruptive effects on key sectors of the economy particularly agriculture through delayed land preparation and displacement of farm workers. Globally, food prices also increased in part due to strong growth in demand for biofuels in advanced economies. Oil prices on the other hand rose substantially reflecting sluggish supply response to demand

in the global economy particularly in the context of limited spare capacity. Rising international oil prices put upward pressure on domestic fuel and energy prices. This also contributed to high food prices through higher transportation and fertilizer costs.

Chart 5: Inflation in Kenya (2003 - June 2008)



Source: Central Bank of Kenya

The underlying rate of inflation also increased from 5.1 percent in January 2008 to 7.60 percent in June 2008, reflecting more generalized inflation pressures.

Table 4: Consumer Price Index (June 2007 - June 2008)

	2007							2008					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
CPI	11.1	13.6	12.4	11.7	10.6	11.8	12.0	18.2	19.1	21.8	26.6	31.5	29.3
Food & Drink	15.0	18.9	17.2	16.1	14.0	15.7	15.9	24.6	24.9	28.8	36.8	44.2	40.1
Alcohol & Tobacco	8.0	9.8	8.1	8.1	7.8	9.3	11.6	12.8	14.1	14.2	14.0	13.0	14.2
Clothing & Footwear	3.3	3.0	2.7	2.8	2.8	3.1	3.1	3.6	4.4	4.9	4.3	5.2	5.3
Housing	5.8	7.2	6.5	7.5	7.5	6.9	6.0	5.2	5.9	6.2	5.7	6.5	6.6
Fuel & Power	8.5	8.7	7.0	6.3	5.9	5.7	5.7	10.6	14.1	15.6	15.4	17.9	20.1
Household Goods & Services	5.9	6.0	6.3	6.2	6.2	5.7	5.5	5.4	6.9	7.6	7.5	8.4	8.6
Medical Goods & Services	4.7	4.8	4.9	4.1	4.4	3.8	3.9	3.6	7.7	7.8	7.9	8.3	10.3
Transport & Communication	3.1	3.2	3.8	2.8	3.1	8.6	9.5	17.8	18.5	19.1	19.5	20.3	21.0
Recreation & Education	3.1	2.9	2.7	2.8	3.2	3.2	3.3	2.7	6.7	6.7	5.5	6.8	6.9
Personal Goods & Services	3.6	3.8	4.1	3.9	3.7	3.8	4.2	4.4	5.0	5.7	6.2	6.9	6.8
Underlying Inflation (various measures)													
CPI excluding food	5.2	5.6	5.2	5.1	5.2	5.8	5.9	7.6	9.3	9.8	9.6	10.5	11.2
CPI excluding food and energy	4.6	5.1	4.9	4.9	5.0	5.8	5.9	7.1	8.5	8.9	8.6	9.3	9.7
CPI excluding food, energy and transport & communication	4.9	5.5	5.1	5.3	5.4	5.3	5.3	5.1	6.6	7.0	6.5	7.2	7.6

Source: Central Bank of Kenya

Outlook for 2008/09

Food prices are expected to moderate with normalcy of supply conditions on resumption of adequate rainfall in the food basket regions. In addition, the Government's Emergency Recovery Strategy aims at revitalizing productive sectors within the year. The Government is importing 3

million bags of maize to meet any shortages of food. Given economic slow down in industrial economies, demand for oil is expected to ease thus pushing down oil prices. However, high inflationary pressures in our trading partner's countries and the movements of the shilling against other currencies might influence how imported inflation could affect domestic prices.

The Central Bank will remain vigilant to ensure that appropriate tightness of monetary policy is maintained to keep at bay secondary effects of price increases.

2.7 Monetary and Financial Markets Developments

Money and Credit

Over the year to June 2008, Money supply, M3, grew by 19.3 percent compared with 18.9 percent in a similar period last year. Similarly money supply, M2, which excludes foreign currency deposits, expanded by 18.2 percent in the year to June 2008 compared with 16.0 percent in June last year.

The M3 growth in the year to June 2007 resulted from increased net foreign assets (NFA) and net domestic assets (NDA) of the banking system. NFA of the banking system grew by 31.7 percent in the year to June 2008 compared with 25.1 percent increase in the year to June 2007. The NDA of the banking system grew less rapidly by 13.2 percent in the year to June 2008 compared with 16.0 percent in a similar period in 2007 reflecting increased domestic credit (Table 5).

Table 5: Money Supply and its Sources (Annual Basis), Ksh Bn

	2006	2007	2008	12-Month Change (%)	
	Jun	June	June	Jun-07	Jun-08
1. Money supply, M3 (2+3)	605.5	719.8	859.0	18.9	19.3
1.1 Money supply, M2	522.0	605.5	716.0	16.0	18.2
1.2 Money supply, M1	258.4	338.7	391.7	31.1	15.7
1.3 Currency outside banks	67.2	78.1	83.6	16.2	7.0
2. Net foreign assets	191.6	239.8	315.7	25.1	31.7
Central Bank	159.5	174.1	213.9	9.2	22.8
Banking Institutions	32.1	65.6	101.8	104.4	55.1
3. Net domestic assets (3.1+3.2)	413.9	480.0	543.3	16.0	13.2
3.1 Domestic credit (3.1.1+3.1.2)	521.7	606.2	713.5	16.2	17.7
3.1.1 Government (net)	117.9	157.2	133.4	33.3	-15.1
3.1.2 Private sector and other public sector	403.8	449.0	580.1	11.2	29.2
3.2 Other assets net (5-5.1)	-107.8	-126.2	-170.2	17.0	34.9

Source: Central Bank of Kenya

The contribution of NFA to money supply, M3, expansion increased from 8.0 percent in June 2007 to 10.6 percent in June 2008 as shown in Table 6. Meanwhile, NDA contribution declined from 10.8 percent in June 2007 to 8.9 percent in June 2008.

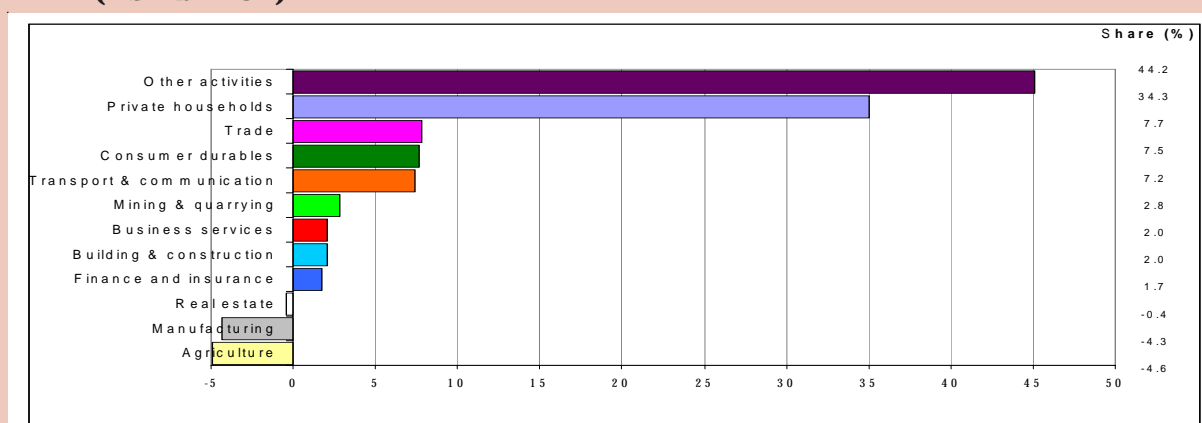
Table 6: Contribution to Growth in Broad Money, M3 (percent)

	2007				2008			
	Mar	Apr	May	Jun	Mar	Apr	May	Jun
Annual growth in M3	17.84	14.99	17.32	18.88	21.39	28.46	23.21	19.34
Net Foreign Assets	8.41	7.61	7.31	7.96	6.56	8.28	11.32	10.55
Net Domestic Assets	9.44	7.24	11.26	10.77	14.82	20.30	11.99	8.92
Domestic Credit	12.80	11.83	15.52	13.95	16.56	23.95	16.02	14.90
Government (net)	2.05	1.46	2.10	6.49	3.32	3.31	-2.37	-3.30
Rest of Economy	10.75	10.37	13.41	7.47	13.25	20.64	18.39	18.20
Other public sector	1.12	1.01	0.58	-0.11	-0.39	0.08	0.03	-0.21
Private Sector	9.63	9.35	12.83	7.58	13.63	20.56	18.36	18.41
Other items (net)	-3.36	-4.59	-4.26	-3.19	-1.74	-3.64	-4.03	-5.98

Source: Central Bank of Kenya

The banking system increased its extension of credit to the domestic economy by 17.7 percent in the year to June 2008 compared with 16.2 percent in June 2007. However, its credit to Government decreased by 15.1 percent in the year to June 2008, in contrast to 33.3 percent growth in the year to June 2007. Growth in credit to private sector was, however faster at 30.3 percent in the year to June 2008 compared with 11.7 percent a year ago. The credit to private sector in the year to June 2008 was mainly to private households (34.7 percent), other activities (27.9 percent), business services (12.0 percent), consumer durables (7.2 percent) and manufacturing (7.2 percent) as shown in Chart 6.

Chart 6: Share of Credit to the Private Sector in 12-months to June 2008 (Ksh billion)



Source: Central Bank of Kenya

Equity Market

Activity slowed down at the Nairobi Stock Exchange (NSE) in the first half of 2008. The NSE 20 share index dropped 259.1 points, moving from 5,444.8 in December 2007 to 5,185.7 by

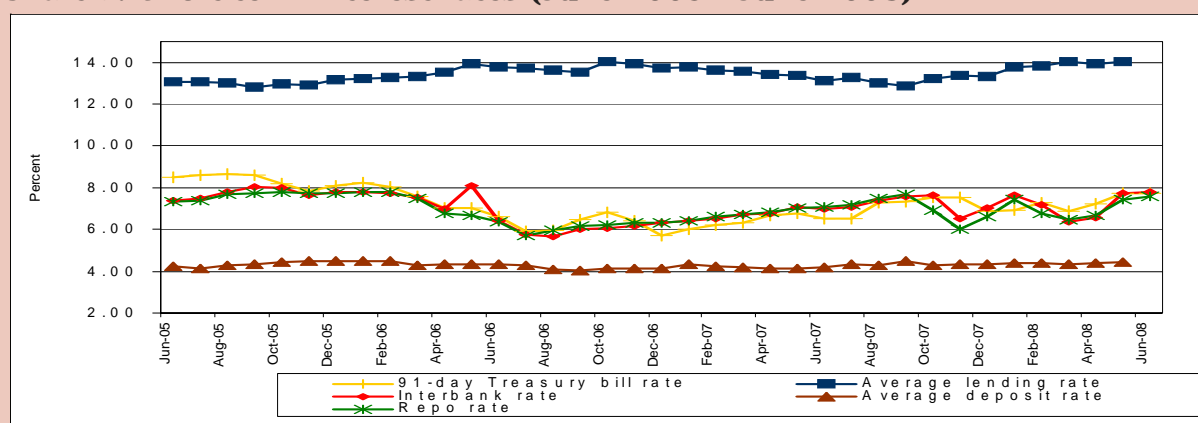
June 2008. Market turnover declined over the same period from Ksh 46.7 billion as at December 2007 to Ksh 38.9 billion in June 2008. Market capitalization increased from Ksh 851.1 billion in December 2007 to Ksh 1230.67 billion in June 2008. The decline in most key capital market indicators is mainly attributed to a fall in the volume of shares traded in the earlier parts of the year propagated by low investor confidence occasioned by the post election disturbances. Bond market trading declined as bond turnover declined during the period under review from Ksh 43.8 billion in the period to December 2007 to Ksh 33.7 billion in the six months to June 2008.

Interest Rates

Short-term interest rates edged up in the first half of 2008. The average 91-day Treasury bill rate increased from 6.87 percent in December 2007 to 7.72 in June 2008. The average interbank rate remained stable at 7.21 percent during the period under review although it peaked in June 2008 at 7.79 percent. The increase in short term interest rates reflected the import of skewed liquidity distribution primarily caused by the Safaricom IPO. The Central Bank Rate (CBR) was also raised by 25 basis points to 9 percent in June 2008.

Commercial banks lending rates edged up in tandem with short term interest rates. Average lending rate moved from 13.32 percent in December 2007 to 14.06 in June 2008, while the average deposit rate went up from 4.32 percent in December 2007 to 4.48 percent in June 2008. Following increased lending rates, the interest rate spread increased from 9 percent in December 2007 to 9.58 percent by June 2008.

Chart 7: Short term interest rates (June 2005 - June 2008)



Source: Central Bank of Kenya

Outlook for 2008/09 and the Medium Term

The stock exchange is expected to recover its losses as the economy rebounds and as a result of various reforms being undertaken to ensure efficiency and transparency in the Capital markets.

Secondary Bond market trade is also expected to improve as the government lengthens the maturity of its debt. Interest rates are expected to reflect appropriate monetary policy stance of the Bank to curb inflationary pressures.

3. MONETARY POLICY FOR 2008/09

The monetary program set out in the December 2007 monetary policy statement was developed against a background of increasing inflationary pressures resulting from election related expenditure. Deep concern for rising inflationary pressures was therefore key in designing the monetary program for 2007/08, which targeted reserve money growth of 18 percent by the end of June 2008 and 16 percent by the end of December 2008. The monetary policy stance was seen as appropriate for easing inflation pressures gradually and insuring against macroeconomic risks resulting from the disruptions in early 2008, which led to a downward revision in growth prospects for 2008 from 6.5 percent to 4.5 percent.

Reserve money growth remained broadly above target through June 2008 increasing by 23.3 percent in the first quarter of 2008. Enhanced open market operations and liquidity developments during the Safaricom IPO in the second quarter of 2008 led to a slowdown in reserve money growth to 19.3 percent. Overall inflation, however, maintained an upward trajectory increasing from 18.2 percent in January to 29.2 percent in June 2008.

Although economic activity in the first quarter of 2008 declined by 1 percent, initial steps have been taken by the Government to increase outlays for programs having high social impact in eradicating poverty and unemployment. The second quarter growth outturn of 3.2 percent cemented the view that the economy was not in a recession as earlier feared. The Government's measures are expected to facilitate a quick recovery of the economy. Accordingly, real GDP growth is expected to increase to 7.9 percent by the years 2009-2010 consistent with the Vision 2030 growth path.

The tightening of monetary policy in mid-June 2008 through an increase in the Central Bank Rate alongside limiting growth in reserve money in 2008/09 to 16.2 percent is expected to anchor inflation expectations and guard against second round effects from earlier increases in food and fuel prices. The monetary policy being implemented by the Central Bank seeks to contain end-period inflation to the Government's objective of 5 percent. This will be achieved through limiting growth in reserve money to 16.2 percent and growth in broad money to 17.1 percent by June 2009 (Table 7 and Appendix 2). Given the 5 percent inflation objective, the set expansion in money supply is in line with the expected growth in real GDP of 4.5 percent and 7.9 in 2008 and 2009, respectively.

**Table 7: Growth Target for Monetary Aggregates for 2007/08 - 2008/09
(end of period)**

	Dec'08	Jun'08	Sep'08	Jun'09
	Actual	Actual	Target	
Reserve money (Ksh million)	155.6	150.8	152.3	173.5
NFA of CBK (Ksh million)	211.3	213.9	211.6	228.9
Memo:				
Annual change in reserve money	25.3	19.3	16.0	16.2
Annual change in broad money (M3)	20.9	19.3	17.3	17.1
Real GDP growth		3.2		5.8
Overall inflation		29.3		7.5

Source: Central Bank of Kenya

On policy management, there is increased scope for effective monetary policy with operationalization of the Monetary Policy Committee, and broader reforms on the monetary framework over the medium term.

There are potential short term risks to the monetary policy outlook. The unpredictable international oil prices means that volatile movements in world crude prices are bound to impact on domestic prices and through spill over effects on other goods and services. The outlook is also contingent on how the subprime crisis will affect Kenya. The monetary policy outlook also assumes normal weather so that a recurrence of drought conditions leads to a spike in food prices.

As emphasized in previous statements, the Bank will continue to monitor these developments so as to respond promptly to inflation pressures. 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 - 2008/09)*

	2006/07 <i>Prov.</i>	2007/08 <i>Est.</i>	2008/09 <i>Projections</i>
<i>Annual percentage change, unless otherwise indicated</i>			
National accounts and prices			
Real GDP	6.7	5.7	5.8
GDP per capita	3.7	2.8	2.9
GDP deflator	7.1	12.1	11.1
CPI (end of period)	13.6	28.5	7.5
Money and credit (end of period)			
Net domestic credit to Government	33.3	16.9	14.8
Credit to the rest of the economy	11.4	17.6	16.3
M3 (percent change)	18.9	17.5	17.1
Reserve money (percent change)	17.4	18.0	16.2
<i>As percentage of GDP, unless otherwise indicated</i>			
Investment and saving			
Investment	19.1	21.9	22.3
Central Government	4.6	8.2	8.6
Other	14.5	13.6	13.7
Gross National Saving	15.2	15.9	15.3
Central Government	1.7	0.4	1.6
Other	13.5	15.5	13.7
Central government budget			
Total revenue	21.7	21.3	21.4
Total expenditure and net lending	23.7	29.4	28.3
Overall balance (commitment basis) incl. grants	-2.2	-6.2	-5.4
Net external borrowing	-0.1	1.2	1.2
Infrastructure bonds	0.0	0.0	0.8
Net domestic borrowing	2.0	1.7	1.5
Total donor support (grant & loans)	1.5	3.8	3.6
Balance of payments			
Exports value, goods and services	26.8	23.5	23.1
Imports value, goods and services	37.6	35.5	36.0
Current external balance, including official transfers	-4.0	-6.0	-7.0
Gross international reserve coverage in months of next year imports (end of period)	2.9	3.2	3.4
Memorandum items:			
Nominal GDP (in Ksh millions)	1717.5	2036.0	2393.2

* **Provisional**

Sources: The Treasury/Central Bank of Kenya

Appendix 2: Depository Corporations Survey 2006/07- 2008/09

	2006/07 <i>Act.</i>	2007/08 <i>Est.</i>	2008/09 <i>Projection</i>
Central Bank of Kenya (CBK)			
Net Foreign Assets 1/	174.1	220.6	265.6
Net Domestic Assets	-47.7	-71.4	-92.2
Net credit extended	-19.1	-43.0	-63.9
Net claims on Government	-3.5	-1.8	0.9
Claims on banks	-15.7	-41.3	-64.9
Other assets, net	-28.5	-28.4	-28.2
Reserve money (RM)	126.5	149.2	173.5
Monetary Survey			
Net Foreign Assets (NFA) 1/	239.8	286.3	331.3
Central Bank (CBK)	174.1	220.6	265.6
Banks	65.6	65.6	65.6
Net Domestic Assets (NDA)	480.0	559.2	659.1
Domestic Credit	607.1	712.7	825.9
Claims on Government (net)	157.2	183.7	210.9
Central Bank	-3.5	-1.8	0.9
Banks	160.6	185.5	210.0
Claims on Private Sector	450.0	529.0	615.0
Other items (net)	-127.1	-153.5	-166.8
Broad Money (M3)	719.8	845.5	990.4
of which:			
Residents' foreign-currency deposits	114.3	134.2	157.2
(ratio of FX deposits/M3)	15.9%	15.9%	15.9%
Memorandum items:			
Reserve money annual % change	17.4	18.0	16.2
M3 annual % change	18.9	17.5	17.1
Velocity (GDP/M3 _{exp})	2.4	2.4	2.4
Velocity (GDP/M3 _{avg})	2.6	2.6	2.6
Multiplier (M3/RM)	5.7	5.7	5.7
Credit to private sector	11.4	17.6	16.3

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 (2008)

January 2008	The Monetary Policy Committee becomes operational.
February 2008	The Central Bank of Kenya releases the 21st Monetary Policy Statement (December 2007), setting out the monetary program to be pursued for the remainder of the financial year 2007/08 (January-June).
May 2008	Introduction of a new instrument – Term Auction Deposit.
June 2008	<ul style="list-style-type: none">• The Monetary Policy Committee holds its inaugural meeting on June 5th and adjusts the Central Bank Rate (CBR) upwards from 8.75 percent to 9 percent.• An IMF mission visits the country for regular Article IV Consultations.• Release of First Quarter 2008 GDP.

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 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.

Term Auction Deposits

Term Auction Deposit: Deposit product of the Central Bank of Kenya transacted with commercial banks under Open Market Operations through a competitive auction bidding system. Deposits are held to maturity and qualify for liquidity ratio purposes.