GOVERNOR

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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING

The Monetary Policy Committee (MPC) met on July 30, 2018, to review the outcome of its previous policy decisions and recent economic developments. The meeting was held against a backdrop of sustained improvement in economic fundamentals: a strong pickup in economic activity; increased optimism on the economic growth prospects; favourable weather conditions; and continued strengthening of the global economy.

- Month-on-month overall inflation remained within the target range in May and June 2018, largely due to lower food prices. The inflation rate was 4.3 percent in June compared to 4.0 percent in May 2018, mainly reflecting increases in energy prices. Non-food-non-fuel (NFNF) inflation remained below 5 percent, indicating that demand-driven inflationary pressures are muted. Higher domestic fuel prices due to the recent increase in international oil prices, and the impact of the excise tax indexation on prices of some of the CPI items are expected to exert moderate upward pressure on inflation in the near term. Nevertheless, overall inflation is expected to remain within the target range mainly due to expectations of lower food prices reflecting favorable weather conditions.
- The foreign exchange market remains stable supported by balanced inflows and outflows, and a continued narrowing in the current account deficit. The current account deficit narrowed to 5.8 percent in the 12 months to June 2018 from 6.3 percent in March 2018. It is expected to narrow further to 5.4 percent of GDP in 2018, with strong growth of agricultural exports particularly tea and horticulture, resilient diaspora remittances, and improved tourism receipts. Although the petroleum products import bill is expected to increase due to higher international oil prices, lower imports of food and SGR-related equipment in 2018 will moderate the impact on the current account.
- The CBK foreign exchange reserves remain high, and continue to provide an adequate buffer against short-term shocks in the foreign exchange market. Currently, they stand at USD8,834 million (5.9 months of import cover). The precautionary arrangement with the International Monetary Fund equivalent to USD989.8 million, provides an additional buffer against exogenous shocks.
- Private sector credit grew by 4.3 percent in the 12 months to June 2018, compared to 2.8 percent in April 2018. Credit to the manufacturing, building and construction, and trade sectors grew by 12.3 percent, 13.5 percent, and 8.6 percent, respectively. Credit growth to other sectors was positive except for transport and communication, agriculture, and mining and quarrying. Growth in private sector credit is expected to pick up gradually with the continued recovery of the economy.

- The banking sector remains stable and resilient. Average commercial banks' liquidity and capital adequacy ratios stood at 48.0 percent and 18.0 percent, respectively, in June 2018. The ratio of gross non-performing loans (NPLs) to gross loans fell to 12.0 percent in June from 12.4 percent in April 2018, following a reduction in NPLs in the transport and communications, building and construction, tourism, personal/households, and mining and quarrying sectors, largely due to enhanced collection efforts. A CBK survey of all the commercial banks in July 2018 showed that a large proportion of the current level of NPLs was due to delayed payments from government and private sector, slowdown in business activity in some sectors following the prolonged elections period in 2017, and a slow uptake of developed housing units in the real estate sector.
- Data for the first quarter of 2018 showed a strong pickup of the economy, with real GDP growth of 5.7 percent compared to 4.8 percent in the first quarter of 2017. This outcome was driven by a strong recovery in agricultural activity due to improved weather conditions, a recovery of the manufacturing sector, and resilient performance of the services sector particularly wholesale and retail trade, real estate, and tourism. Growth in 2018 is expected to be strong, supported by continued recovery in agriculture, a resilient services sector, alignment of Government spending to the *Big 4* priority sectors, and the stable macroeconomic environment.
- The MPC Private Sector Market Perception Survey conducted in July 2018 indicated that inflation expectations were well anchored in the near term on account of lower food prices, but was expected to rise slightly due to higher energy prices and the impact of recent tax measures. The Survey indicated sustained optimism for stronger growth in 2018 and an improved business environment. Respondents attributed this optimism to, among others, a rebound in agriculture, completion of key infrastructure projects, focus by the Government on the *Big 4* priority sectors, strong forward hotel bookings, renewed business confidence, and a stable macroeconomic environment.
- Global growth is expected to continue strengthening in 2018, but with some divergence across economies. Uncertainties to the growth outlook have increased particularly with regard to the escalating trade tensions among the advanced economies, Brexit negotiations, and pace of monetary policy normalization in the advanced economies. These developments could lead to further volatility in the global financial markets, particularly in emerging market economies.
- A preliminary assessment of the impact of the lowering of the CBR in March 2018 showed that this change under the interest rate capping regime had a smaller and slower impact on key macroeconomic variables such as credit and economic growth. Additionally, the risk of perverse outcomes was not ruled out.

The MPC noted that inflation expectations were well anchored within the target range, and that economic growth prospects were improving. Furthermore, economic output was below its potential level, and there was some room for further accommodative monetary policy. Consequently, while noting the risk of perverse outcomes, the Committee decided to lower the Central Bank Rate (CBR) to 9.00 percent from 9.50 percent.

The MPC will closely monitor the impact of this change in its policy stance. Other developments in the domestic and global economy will also be observed, and the MPC stands ready to take additional measures as necessary.

Dr. Patrick Njoroge
CHAIRMAN, MONETARY POLICY COMMITTEE

July 30, 2018