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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING

The Monetary Policy Committee (MPC) met on November 25, 2019, to review the outcome of its previous policy decisions and recent economic developments. The meeting was held against a backdrop of domestic macroeconomic stability, the recent repeal of interest rate caps, and heightened global uncertainties and volatility in international markets.

- Month-on-month overall inflation remained well anchored within the target range in September and October 2019, largely due to relatively stable food prices and lower cost of energy. The inflation rate stood at 4.9 percent in October compared to 3.8 percent in September, mainly reflecting temporary effects of increases in the prices of maize grain and sifted flour. Non-food-non-fuel (NFNF) inflation remained below 5 percent, indicative of muted demand pressures and limited spillover effects of the excise tax indexation in July. Overall inflation is expected to remain within the target range in the near term due to lower food prices following improved weather conditions, and lower electricity prices. The November excise tax adjustments in the Finance Act 2019 are expected to only have a marginal impact on inflation.
- The foreign exchange market has remained stable, supported by the narrowing current account deficit and increased portfolio and other investment inflows. The current account deficit narrowed to 4.1 percent of GDP in the 12 months to September 2019 from 5.1 percent in September 2018. This largely reflected strong receipts from transport and tourism services, resilient diaspora remittances and lower imports of food and SGR-related equipment. The current account deficit is expected to narrow to 4.3 percent of GDP in 2019 from 5.0 percent in 2018.
- The CBK foreign exchange reserves, which currently stand at USD8,794 million (5.5 months of import cover), continue to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.
- Private sector credit grew by 6.6 percent in the 12 months to October, compared to 7.0 percent in September. Strong growth in credit to the private sector was observed in the following sectors: trade (8.5 percent); finance and insurance (15.1 percent); consumer durables (28.6 percent); and private households (6.9 percent). Growth in private sector credit particularly to Micro, Small and Medium-sized Enterprises (MSMEs) is expected to increase due to the deployment of innovative credit products targeting the sector, and the repeal of interest rate caps.
- The banking sector remains stable and resilient. Average commercial banks' liquidity and capital adequacy ratios stood at 51.2 percent and 18.3 percent, respectively, in October. The ratio of gross non-performing loans (NPLs) to gross loans declined marginally to 12.3 percent in October from 12.6 percent in August. In particular, there were decreases in

NPLs in the real estate, transport and communication, and building and construction sectors reflecting increasing repayments and the enhanced recovery efforts by banks.

- The Committee welcomed the repeal of the interest rate caps on commercial bank loans, noting that they had led to a significant rationing of credit, particularly to the most vulnerable. It noted that this reform should restore the clarity of monetary policy decisions and strengthen the transmission of monetary policy. Further, banks have adopted the Banking Sector Charter, which defines a commitment to entrench a responsible and disciplined banking sector which is cognizant of, and responsive to, the needs of their customers.
- The economy remained resilient in the first half of 2019 despite the slowdown in agricultural production following the delayed onset and below average rainfall. Real GDP grew by 5.6 percent in the first half of 2019 supported by the non-agriculture sector particularly services. Leading indicators of economic activity suggest stronger growth in the second half of 2019, supported by agricultural production, growth of MSMEs, implementation of the *Big 4* agenda, foreign direct investment and a stable macroeconomic environment.
- The MPC Private Sector Market Perception Survey conducted in November 2019 indicates that inflation expectations remain well anchored, mainly due to lower food prices following improved weather conditions. Respondents remained optimistic on economic prospects due to, among other factors, improved weather conditions, payments of pending bills by the government, growth in tourism, the expected increase in lending to MSMEs following the repeal of interest rate caps, implementation of the *Big 4* agenda projects, ongoing public infrastructure investments, and a stable macroeconomic environment. Nevertheless, the optimism is moderated by concerns about the delay in the clearance of pending bills, reduced demand of some products, and the slowdown in global growth.
- Global growth has weakened further in 2019, largely due to continued uncertainties with regard to the trade tensions between the U.S. and China, other geopolitical developments and the uncertainties about Brexit. Central banks in major advanced economies have continued to implement more accommodative monetary policy to support growth and financial stability. The risk of increased volatility in the global financial markets remains high.

The MPC noted that inflation expectations remained well anchored within the target range, and assessed that the economy was operating below its potential level. Furthermore, the Committee noted the ongoing tightening of fiscal policy and concluded there was room for accommodative monetary policy to support economic activity. The MPC therefore decided to lower the Central Bank Rate (CBR) to 8.50 percent from 9.00 percent. The Committee will closely monitor the impact of this change in its policy stance.

The MPC will continue to closely monitor developments in the global and domestic economy, and stands ready to take additional measures as necessary.

Dr. Patrick Njoroge
CHAIRMAN, MONETARY POLICY COMMITTEE

November 25, 2019