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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING

The Monetary Policy Committee (MPC) met on September 25, 2018, to review the outcome of its previous policy decisions and recent economic developments. The meeting was held against a backdrop of macroeconomic stability, sustained optimism on the economic growth prospects, and increased uncertainties in the global financial markets.

- Month-on-month overall inflation remained within the target range in July and August 2018, largely due to lower food prices. The inflation rate fell to 4.0 percent in August from 4.4 percent in July, following decreases in food prices which offset the increase in energy prices, including the increase in the price of charcoal. Non-food-non-fuel (NFNF) inflation remained below 5 percent, indicating that demand-driven inflationary pressures remain muted. Overall inflation is expected to rise in the near term, following the implementation of VAT on petroleum products in September 2018 and its impact on other prices, as well as increases in international oil prices. However, it is expected to remain within the target range due to lower food prices reflecting favorable weather.
- The foreign exchange market remains stable supported by a continued narrowing in the current account deficit and balanced flows. The current account deficit narrowed to 5.3 percent in the 12 months to July from 5.6 percent in June 2018. It is expected to narrow to 5.4 percent of GDP in 2018 from 6.7 percent in 2017, with strong performance of agricultural exports particularly tea and horticulture, resilient diaspora remittances, and improved receipts from services particularly tourism. Lower imports of food compared with 2017 are expected to moderate the impact on the current account of a higher petroleum products import bill and the expected front-loading of imports with respect to the ongoing SGR project.
- The CBK foreign exchange reserves, which currently stand at USD8,507 million (5.6 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 4.3 percent in the 12 months to August 2018. Notably, credit to the manufacturing, building and construction, consumer durables, and trade sectors grew by 13.3 percent, 14.9 percent, 11.5 percent, and 7.0 percent, respectively. Growth in private sector credit is expected to continue to pick up gradually.

- The stability and resilience of the banking sector was further enhanced by the transfer of assets and liabilities from Chase Bank (Kenya) Limited (In Receivership) to SBM (Kenya) Limited on August 17, 2018. Average commercial banks' liquidity and capital adequacy ratios stood at 48.4 percent and 17.9 percent, respectively, in August 2018. The ratio of gross non-performing loans (NPLs) to gross loans rose to 12.7 percent in August from 12.0 percent in June 2018. Half of the increase in NPLs was related to the Chase Bank (Kenya) Limited (In Receivership)/SBM (Kenya) Limited transaction. Excluding this transaction, the NPL ratio rose marginally to 12.1 percent in August from 12.0 percent in June 2018. The balance of this increase in NPLs was mainly attributable to delayed payments from government and private sector.
- The MPC Private Sector Market Perception Survey conducted in September 2018 showed that inflation expectations were well anchored within the target range in the near term on account of lower food prices. However, respondents expected inflation to rise slightly due to higher energy prices attributed to the impact of the VAT on petroleum products and increases in international oil prices. 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, pick-up in private sector economic activity, focus by the Government on the *Big 4* priority sectors, strong forward hotel bookings, renewed business confidence due to the ongoing war against corruption, and a stable macroeconomic environment. The optimism was tempered by the expected impact of the VAT on petroleum products on the cost of doing business.
- Although global growth has continued to strengthen in 2018, risks have increased particularly with regard to escalation of international trade tensions, the resolution of Brexit, and the pace of normalization of monetary policy in the advanced economies. Increased volatility in the global financial markets could lead to further turbulence in emerging market economies.

The Committee noted that inflation expectations remained well anchored within the target range, but concluded that there was need to monitor the second-round inflationary effects arising from the VAT on petroleum products, and any perverse response to its previous decisions. The Committee therefore decided to retain the CBR at 9.00 percent.

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

September 25, 2018