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PRESS RELEASE

MONETARY POLICY COMMITTEE MEETING

The Monetary Policy Committee (MPC) met on May 28, 2018, to review the outcome of its previous policy decisions and recent economic developments. The meeting was held against a backdrop of sustained macroeconomic stability, favourable weather conditions, increased optimism on domestic economic growth prospects, and rising international oil prices.

- Month-on-month overall inflation fell to 3.7 percent in April 2018 from 4.2 percent in March 2018 largely due to lower food prices particularly for Irish potatoes, cabbages, and sugar. The decrease in food prices outweighed the increases in energy prices. Non-food-non-fuel (NFNF) inflation rose slightly, but remained below 5 percent indicating that demand driven inflationary pressures are muted. The rising international oil prices and the impact on domestic fuel prices are expected to continue exerting moderate upward pressure on inflation. Nevertheless, overall inflation is expected to remain within the Government target range mainly due to the expected further decline in food prices following improved weather conditions.
- The domestic foreign exchange market remains stable supported by a narrowing in the current account deficit, to 6.1 percent of GDP in the 12 months to March 2018, from 6.7 percent in 2017. This is expected to narrow further to 5.4 percent of GDP in 2018, supported by stronger growth in agricultural exports, higher diaspora remittances and tourism receipts. Lower imports of food and SGR-related equipment in 2018 are expected to moderate the impact of higher international oil prices on the petroleum products import bill.
- The CBK foreign exchange reserves remain at all-time highs. Currently, they stand at USD9,049 million (6.1 months of import cover) and continue to provide an adequate buffer against short-term shocks in the foreign exchange market. The precautionary arrangement with the International Monetary Fund equivalent to USD989.8 million, will provide an additional buffer against exogenous shocks.
- Private sector credit grew by 2.8 percent in the 12 months to April 2018, slightly higher than 2.1 percent in February 2018. In particular, lending to the manufacturing, building and construction, finance and insurance, and trade sectors grew by 10.1 percent, 14.1 percent, 10.1 percent, and 5.0 percent, respectively. This offset the substantial loan repayments recorded in the transport and communication sector in the first quarter of 2018.

- The banking sector remains stable and resilient. Average commercial banks' liquidity and capital adequacy ratios stood at 47.2 percent and 17.9 percent, respectively, in April 2018. The ratio of gross non-performing loans (NPLs) to gross loans increased to 12.4 percent in April from 11.4 percent in February 2018 largely due to increased NPLs in the real estate, trade and manufacturing sectors. A recent CBK survey revealed that a significant share of the NPLs was due to delayed payments from the national and county governments, and the private sector.
- The recently released *Economic Survey 2018* confirmed that the economy was resilient in 2017, as real GDP grew at 4.9 percent despite the adverse effects of the drought on agricultural production, weak private sector credit growth, and a prolonged elections period. This outcome was driven by the strong performance of the services sector, particularly information and communications, wholesale and retail trade, transport and communications, and tourism. Stronger growth is expected in 2018 supported by a recovery in agriculture, a resilient services sector, and the stable macroeconomic environment.
- The MPC Private Sector Market Perception Survey conducted in May 2018 showed that inflation was expected to decline in the near term on account of lower food prices. The Survey revealed sustained optimism for stronger growth in 2018 and improved business environment. Respondents attributed this optimism to, among others, a stable macroeconomic environment, favourable weather conditions, continued public spending on infrastructure, focus by the Government on the *Big 4* priority areas, and the expected direct flights to the U.S. However, respondents' optimism was tempered by concerns that recent floods in many parts of the country may negatively affect crop yields and tourism in the short term.
- Global growth is expected to continue strengthening in 2018, but uncertainties remain particularly with regard to the U.S. economic and trade policies, rising international oil prices, and the pace of monetary policy normalization in advanced economies. These conditions have also led to the return of volatility in the global financial markets, particularly in the emerging market economies.

The MPC noted that inflation expectations were well anchored within the Government target range, economic output was below its potential level, and there was some room for accommodative monetary policy. The Committee assessed that the policy action at its March meeting (a reduction of the Central Bank Rate by 50 basis points) was yet to be fully transmitted to the economy, including a determination of any perverse outcomes. The Committee therefore decided to retain the CBR at 9.50 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

May 28, 2018