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Deputy Majority Whip
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BANKI KUU YA KENYA

Central Bank of Kenya

Thirty-First Bi-Annual Report of the Monetary Policy Committee

October 2023

LETTER OF TRANSMITTAL

In accordance with Section 4D of the Central Bank of Kenya Act, it is my pleasure to present to you, Honourable Cabinet Secretary of the National Treasury and Economic Planning, the 31st Monetary Policy Committee Report. The Report outlines the monetary policy formulation, developments in the key indicators of the economy, and other activities of the Committee in the six months to October 2023.

Dr. Kamau Thugge, CBS

Governor

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EXECUTIVE SUMMARY

The thirty-first bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments that affected the economy in the six months to October 2023. The conduct of monetary policy during the period was aimed at achieving and maintaining overall inflation within the target range of 2.5 percent on either side of the 5 percent medium-term target, which is consistent with the price stability objective of the Central Bank of Kenya (CBK).

To enhance monetary policy transmission and in line with the reforms outlined in the White Paper on *Modernization of the Monetary Policy Framework and Operations*, the MPC adopted a new monetary policy implementation framework in August 2023. The framework is based on inflation targeting and an interest rate corridor around the Central Bank Rate (CBR) set at ± 250 basis points. Consistent with the new framework, monetary policy operations are aimed at ensuring the interbank rate, as an operating target, closely tracks the CBR. Additionally, to improve access to the Discount Window, the MPC reduced the applicable interest rate to 400 basis points above CBR.

Monetary policy in the period was conducted against a backdrop of a weak global economic outlook, reflecting the impact of monetary policy tightening in advanced economies, weakening demand particularly in China and the Eurozone, and heightened geopolitical tensions. Most currencies in emerging market and frontier economies weakened against the U.S. Dollar, mainly due to the tightening of U.S. monetary policy. Inflation in advanced economies continued to ease, reflecting effects of monetary policy tightening and lower energy prices. Nevertheless, core inflationary pressures remained elevated.

The MPC held four meetings between May and October 2023, to review the outcome of its previous policy decisions and economic developments, and to put in place appropriate measures aimed at maintaining price stability. The MPC retained the CBR at 9.50 percent in May 2023, noting that the impact of the further tightening of monetary policy in March 2023 to anchor inflationary expectations was still transmitting in the economy. This policy action was complemented by Government measures to allow duty-free imports on specific food items, particularly sugar. The MPC tightened monetary policy further in June 2023 by raising the CBR to 10.50 percent, noting sustained inflationary pressures and increased risks to the inflation outlook. The MPC retained the CBR at 10.50 percent in August and October 2023, noting that the impact of the tightening of monetary policy in June 2023 to anchor inflationary expectations was still transmitting in the economy.

Overall inflation declined to 6.9 percent in October 2023 from a peak of 9.6 percent in October 2022, supported by monetary policy measures, and easing food prices following improved supply attributed to harvest of key food items, particularly maize, and government measures to zero-rate key food imports. Food inflation eased to 7.8 percent in October 2023 compared to a peak of 15.8 percent in October 2022, with declines in prices of edible oils, wheat products, maize and milk products that had exerted pressure on inflation. Fuel inflation increased to 14.8 percent in October from 12.6 percent October 2022, reflecting higher energy prices following increases in global oil prices, upward review of electricity tariffs in April 2023, and implementation of 16 percent VAT on pump prices. Non-food non-fuel (NFNF) inflation remained stable, declining marginally to 3.6 percent in October from 3.8 percent in October 2022. CBK continued to monitor the overall liquidity in the economy as well as any threats that could fuel demand driven inflationary pressures.

The performance of the Kenyan economy remained strong in the period, supported by resilient services sector, the rebound in agriculture, and implementation of measures by the Government to boost economic activity in priority sectors. Real GDP grew by 5.4 percent in the first half of 2023 compared to 5.7 percent in the first half of 2022. Agriculture sector rebounded due to favorable weather conditions, growing by 6.9 percent in the first half of 2023 from a contraction of 2.1 percent in the first half of 2022. The services sector grew by 6.1 percent, supported by robust activity in information and communication, transport and storage, financial and insurance, and accommodation and food services. Leading indicators of economic activity pointed to continued strong performance of the economy in the third quarter of 2023.

The foreign exchange market remained relatively stable, despite increased uncertainties in the global financial markets and a stronger U.S. Dollar. The current account deficit was estimated at 3.7 percent of GDP in the 12 months to October 2023 compared to 5.4 percent of GDP over a similar period in 2022, mainly reflecting strong remittances and lower imports of machinery and transport equipment. The CBK foreign exchange reserves, which stood at USD 6,807 million (3.65 months of import cover) at the end of October 2023, continued to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market.

The banking sector remained stable and resilient in the six months to October 2023, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans stood at 15.3 percent in October 2023. Banks have continued to make adequate provisions for the NPLs. Growth in private sector credit remained resilient at 12.5 percent in October 2023, with strong credit growth in manufacturing, transport and communication, trade, and consumer durables.

The Governor held virtual meetings with CEOs of banks and non-bank private sector firms after every MPC meeting, to provide the background to its decisions and obtain feedback. The Governor's post-MPC media briefings provided the basis of policy decisions and updates on the economy. The meetings continued to enhance the understanding of monetary policy formulation and implementation by the public.

The Bank continued to monitor and remained vigilant to the risks posed by developments in the domestic and global environment, including the Israel-Palestine conflict and war in Ukraine, on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The global economy continued to recover in the six months to October 2023 albeit at a slower pace. Growth remained resilient despite the disruption in energy and food markets caused by the war, and the unprecedented tightening of global monetary conditions to combat decades-high inflation. According to the IMF World Economic Outlook (WEO) October 2023 updates, annual global growth was expected to remain subdued at 3.0 percent in 2023 and 2.9 percent in 2024, from a growth of 3.5 percent in 2022, reflecting reduced economic activities in the Euro Area and China.

Growth in the advanced economies is expected at 1.5 percent in 2023 and 1.4 percent in 2024, amid stronger growth momentum in the US but weaker-than-expected growth in the euro area. Growth in most economies in this group is forecast to slowdown in 2023: Euro Area (0.7 percent), UK (0.5 percent), and Japan (2.0 percent). The US growth is projected to stabilize at 2.1percent.

In the emerging market and developing economies (EMDEs), growth is projected to decline modestly from 4.1 percent in 2022 to 4.0 percent in 2023 and 2024, with a downward revision of 0.1 percentage point in 2024, reflecting the property sector crisis in China. In Sub-Saharan Africa (SSA), economic activity is projected to decline to 3.3 percent in 2023 before picking up to 4.0 percent in 2024, with 0.2 percentage point and 0.1 percentage point downward revisions for 2023 and 2024, respectively. The projected decline is attributed to the worsening weather shocks, the global slowdown, and the domestic supply issues mostly in the electricity sector for South Africa. Nigeria, South Africa, and Kenya are expected to grow by 2.9 percent, 0.9 percent, and 5.0 percent in 2023, respectively. In 2024, they are expected to grow by 3.1 percent (Nigeria), 1.8 percent (South Africa), and 5.3 percent (Kenya).

Global financial conditions eased after Swiss and US authorities took strong action in March to contain turbulence in their banking sectors. Global headline inflation continued to ease and is expected to steadily decline from its peak of 8.7 percent in 2022 (annual average) to 6.9 percent in 2023 and 5.8 percent in 2024, due to the monetary tightening in major economies.

Global commodity market pressures are expected to continue to ease as nonfuel and fuel commodity prices decline. Oil prices are expected to fall by about 17 percent, with the decreases mainly reflecting the slowdown in global economic activity to average $80.5 a barrel in 2023 (from $96.4 in 2022), while nonfuel commodity prices are expected to fall by 6.3 percent in 2023. Global demand is expected to pick up, reflecting increased consumer spending, particularly in the service sector as demand for travel, tourism, and recreational activities rises. The world trade growth is expected at 0.9 percent in 2023, reflecting normalization of supply chain networks.

Official preliminary GDP estimates released for the third quarter of 2023 show estimated growth in the US stood at 5.2 percent, Euro Area (-0.1 percent), Germany (-0.1 percent). However, GDP estimates show improved growth for China (4.9 percent). Despite the positive developments in the global economy, numerous adverse risks to global growth remain. There are risks emanating from climate and geopolitical shocks hence commodity prices becoming more volatile, and concerns from the slowing of the China economic growth. However, continued pick up in global service demand, and inflation pressures abating in major economies will boost global economic recovery.

2.1 Overall Economy

The economy recorded strong growth in the first half of 2023, mainly supported by a rebound of the agriculture sector and resilient services sector. Real GDP grew by an average of 5.4 percent compared to 5.7 percent in the first half of 2022. The agriculture sector rebounded, growing by 6.9 percent compared to a contraction of 2.1 percent in a similar period of 2022, driven by favorable weather conditions experienced in most parts of the country. Service sectors demonstrated remarkable resilience and remain the main driver of growth. The sector grew by 6.1 percent, supported by robust activity in information and communication, transport and storage, financial and insurance, and accommodation and food services. Industrial sectors posted a positive but lower performance at 2.2 percent compared to 5.3 percent in the first half of 2022, reflecting high input costs.

Leading indicators of economic activity pointed to continued strong performance of the economy in the third quarter of 2023. **(Table 1)**.

Table 1: Kenya's Real GDP Growth across the Main Sectors (Percent)

	2021	2022	2022Q1	2022Q2	2022Q3	2022Q4	2023Q1	2023Q2
Agriculture	-0.4	-1.6	-1.7	-2.4	-1.3	-0.9	6.0	7.7
Non-Agriculture (o/w)	9.5	6.3	8.2	7.1	5.3	4.6	5.3	4.9
Industry	7.5	3.9	5.6	5.0	2.6	2.4	2.5	2.0
Services	9.8	7.0	8.9	8.0	5.9	5.2	6.3	5.9
Taxes on Products	11.9	7.0	9.5	6.1	7.3	5.3	5.3	3.8
Real GDP Growth	**7.6**	**4.8**	**6.2**	**5.2**	**4.3**	**3.7**	**5.5**	**5.4**

Source: Kenya National Bureau of Statistics and Central Bank of Kenya

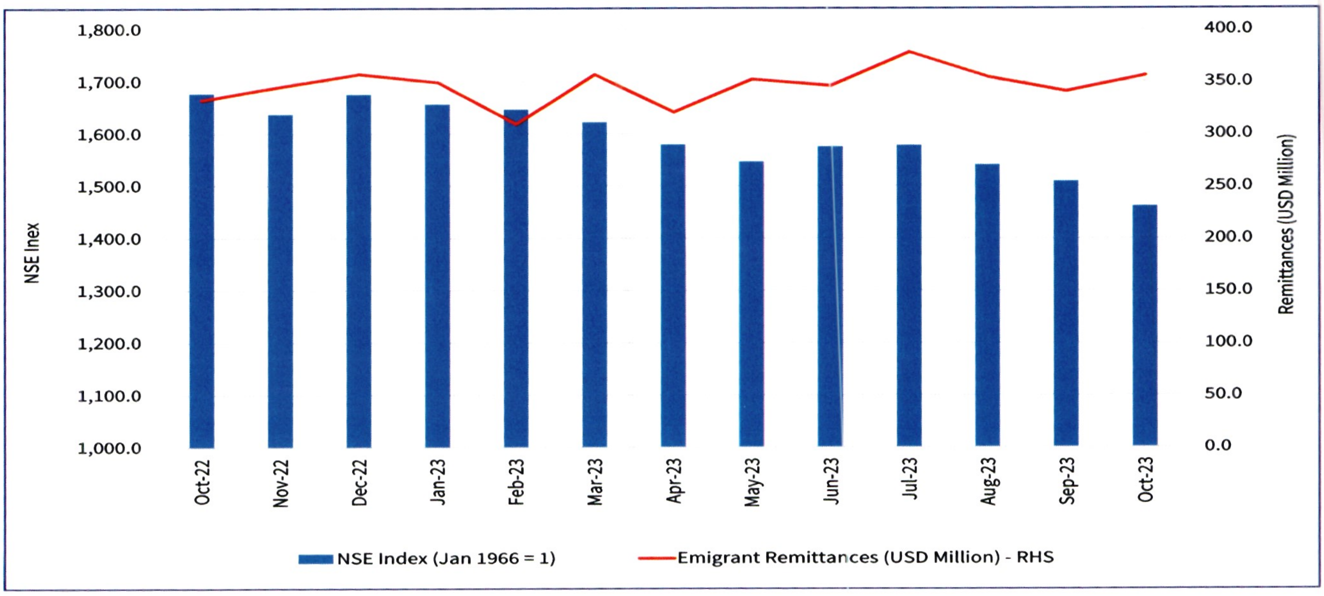
2.2 Financial Market Developments

During the six months to October, global financial stability risks remained elevated. The persistence in global underlying inflation signaled higher-for-longer policy rates, with the potential to trigger a correction in financial markets and capital flow volatility. Commodity prices faced threats of volatility due to climate and geopolitical shocks. The risk of a further deterioration in China's property sector by spreading to the financial sector and to local governments with significant dependence on property-related revenues, weighed on the already weakening recovery. Further, the risk of further debt distress in EMDEs heavily reliant on external borrowing indicated that the presence of a weak tail of banks in some major economies also posed vulnerabilities.

Backed by a strong economy and rising U.S. Treasury yields, the U.S. Dollar remained resilient against most major currencies, albeit with bouts of weakness. The US Dollar Index strengthened, between mid-July and early October, as positive economic data from the US fueled expectations the Federal Reserve would keep interest rates high. Consequently, the euro fell versus the dollar in the third quarter and was roughly 2 percent higher compared to where it ended 2022. The Sterling Pound fell in October on concerns about the economic outlook and expectations that the Bank of England might be done with rate hikes.

In the domestic economy, diaspora remittances remained strong over the period (**Chart 1a**). Nevertheless, activity at the Nairobi Securities Exchange (NSE) remained subdued amidst a challenging economic environment with the NSE 20-Share index declining from 1,866.6 points in April 2021 to 1,462.32 in October 2023.

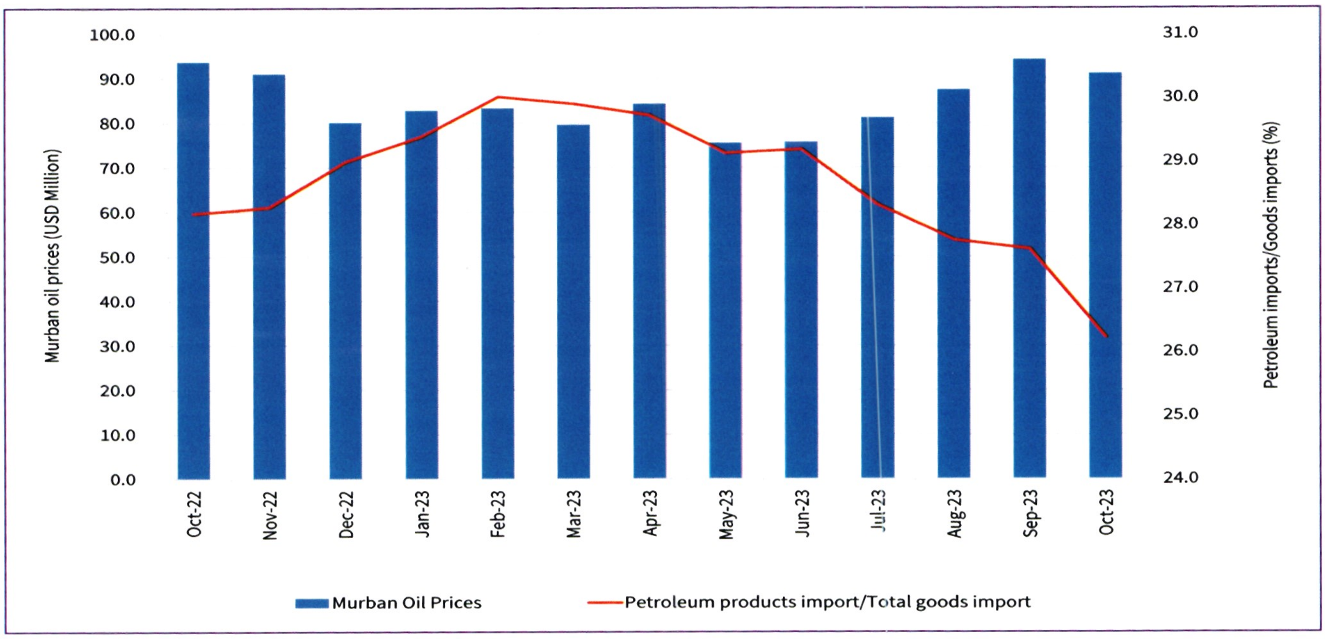
Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE Index (Jan 1966=100)



Source: Central Bank of Kenya and Nairobi Securities Exchange

Developments in international oil prices have implications on the balance of payments position particularly when the proportion of imports of petroleum products in total imports is high. After rising for several months between July and September, international oil prices declined beginning October 2023 as concerns about demand continued to replace the fear of production outages related to the Middle East conflict. (**Chart 1b**).

Chart 1b: Murban Oil Prices and the ratio of 12-Month Cumulative Petroleum Product Imports to Total Imports of Goods (percent)



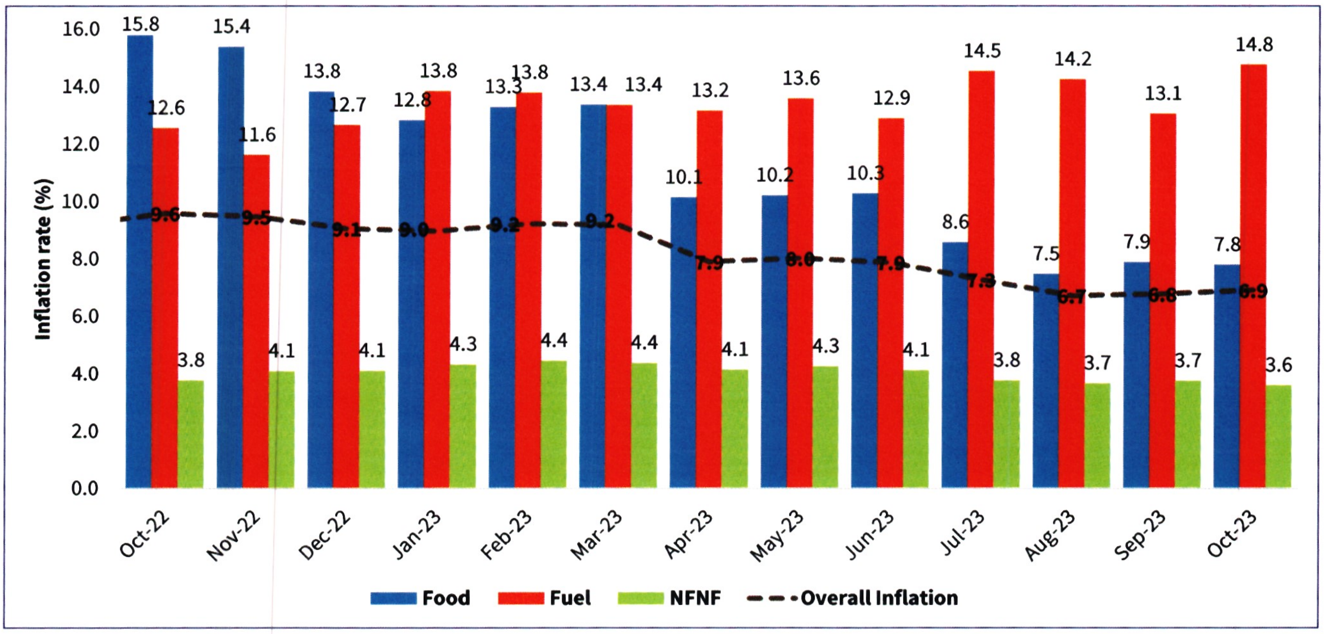
Source: Oil price.com and Kenya Revenue Authority

2.3 Developments in Key Economic Indicators

2.3.1 Inflation

Overall inflation declined from 7.9 percent in April 2023 to 6.7 percent in July 2023 and has since remained within the target band of 5±2.5 percent, mainly driven by the impact of monetary policy measures and easing food prices. However, it edged up slightly to 6.9 percent in October 2023, largely on account of elevated energy prices. Food inflation declined to 7.8 percent from 10.1 percent between April and October 2023, reflecting easing food prices as supply improved following favorable weather conditions, coupled with lower international food prices. The decline was also supported by increased food imports following the zero rating of import duty on key food items. Fuel inflation increased over the same period, in line with global trends in international oil prices, elevated electricity prices, and increased VAT on pump prices, which led to increased domestic energy and transport costs. As a result, fuel inflation increased to 14.8 percent in October 2023 from 13.2 percent in April 2023. Non-Food-Non-Fuel (NFNF) inflation remained low and stable reflecting muted demand pressures and the impact of monetary policy actions. It declined to 3.6 percent from 4.1 percent over the same period **(Chart 2a)**.

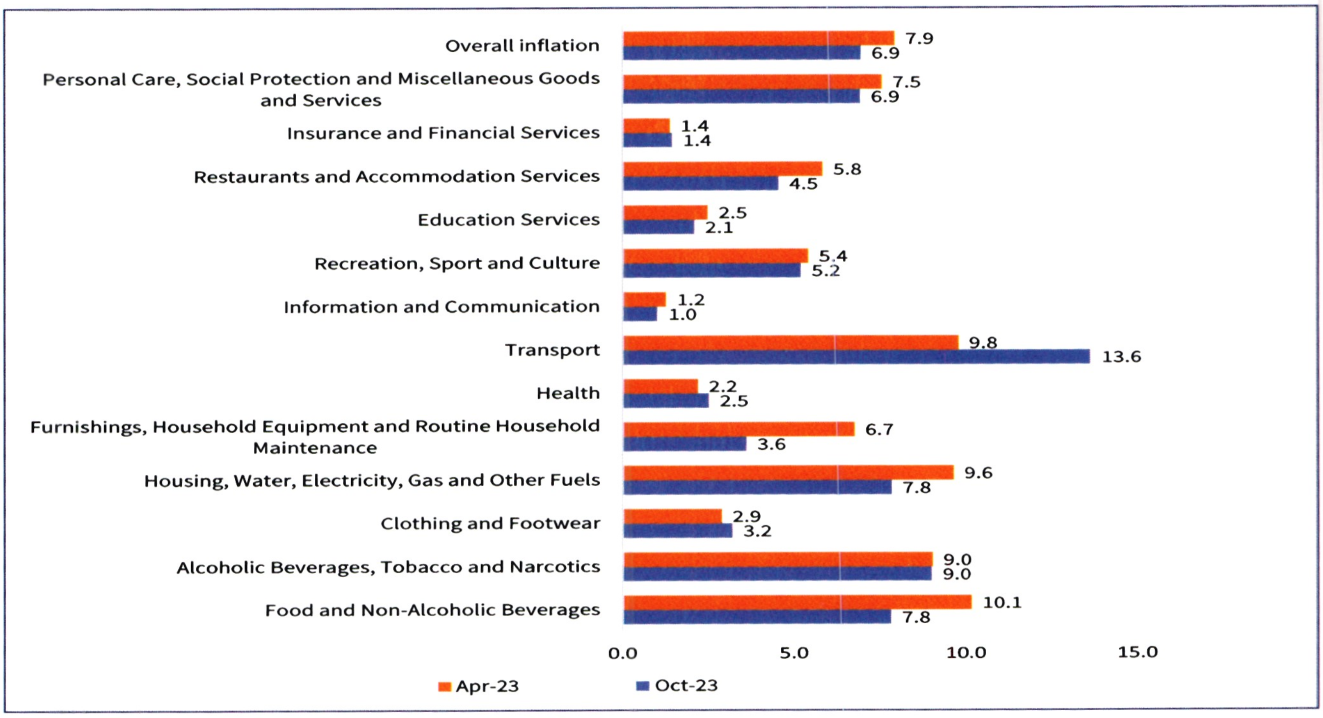
Chart 2a: Trends in Broad Categories of Inflation



Source: Kenya National Bureau of Statistics and Central Bank of Kenya

The inflation for the broad CPI basket categories except transport; housing, water, electricity, gas and other fuels; alcoholic beverages, tobacco and narcotics and food and non-alcoholic beverages were within the target range in October 2023 **(Chart 2b)**.

Chart 2b: Inflation by CPI basket categories (y/y, percent)



Source: Kenya National Bureau of Statistics and Central Bank of Kenya

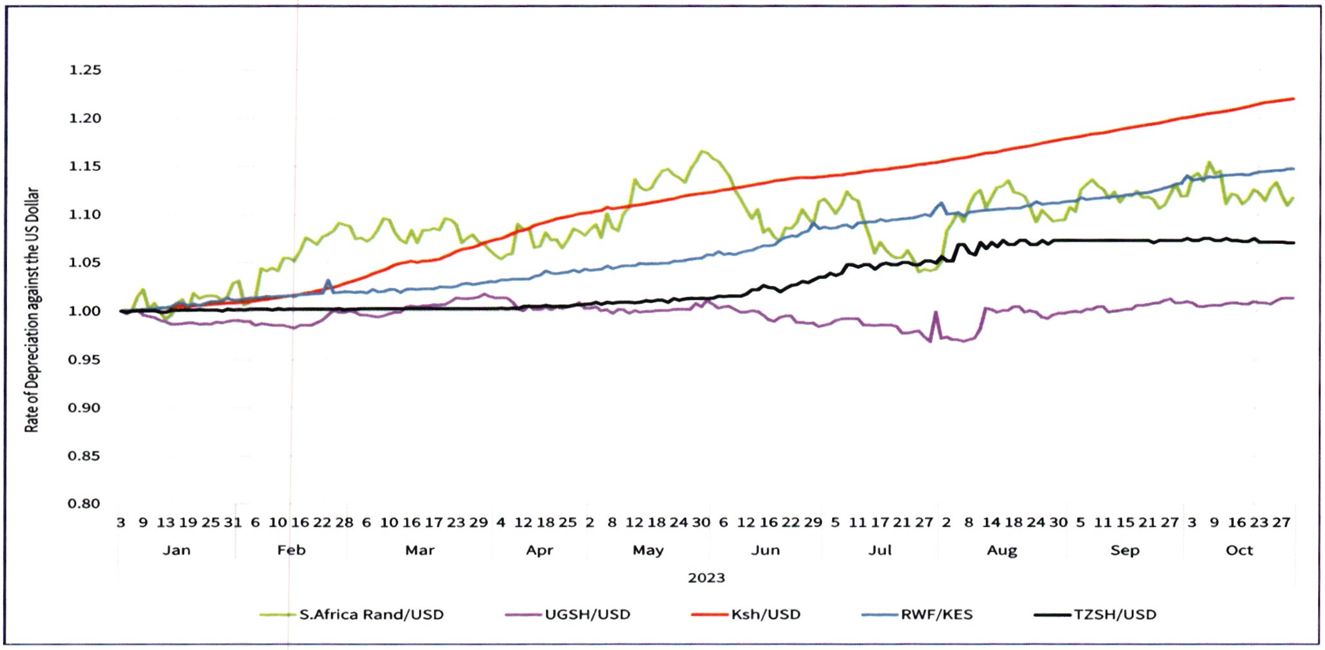
2.3.2 Foreign Exchange Market Developments

The foreign exchange market remained relatively stable in the six months to October 2023, supported mainly by resilient from exports of goods and services as well as resilient remittances. However, there was pressure from the strengthening of the U.S dollar against major currencies in the international markets as well as geopolitical tensions. Diaspora remittances totaled USD 355.6 million in October 2023 compared to USD 332.6 million in October 2022.

The CBK foreign exchange reserves, which stood at USD 6,807 million (3.65 months of import cover) as at end October, continued to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market.

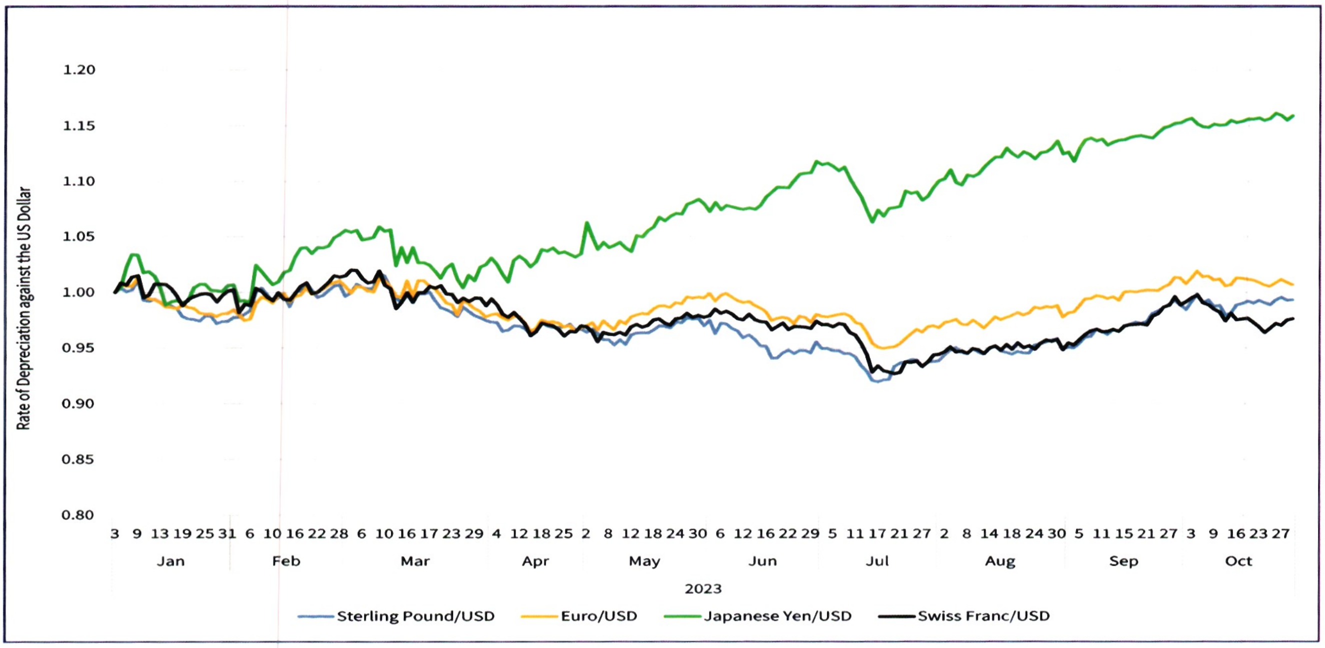
Global financial markets remained volatile during the period under review due the ongoing war in Ukraine and high inflation in the advanced economies. **(Charts 3a and 3b)**. Kenya external balance continued to support the stability of the Kenya Shilling.

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (January 3, 2023, = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (January 3, 2023, = 1)



Source: Central Bank of Kenya

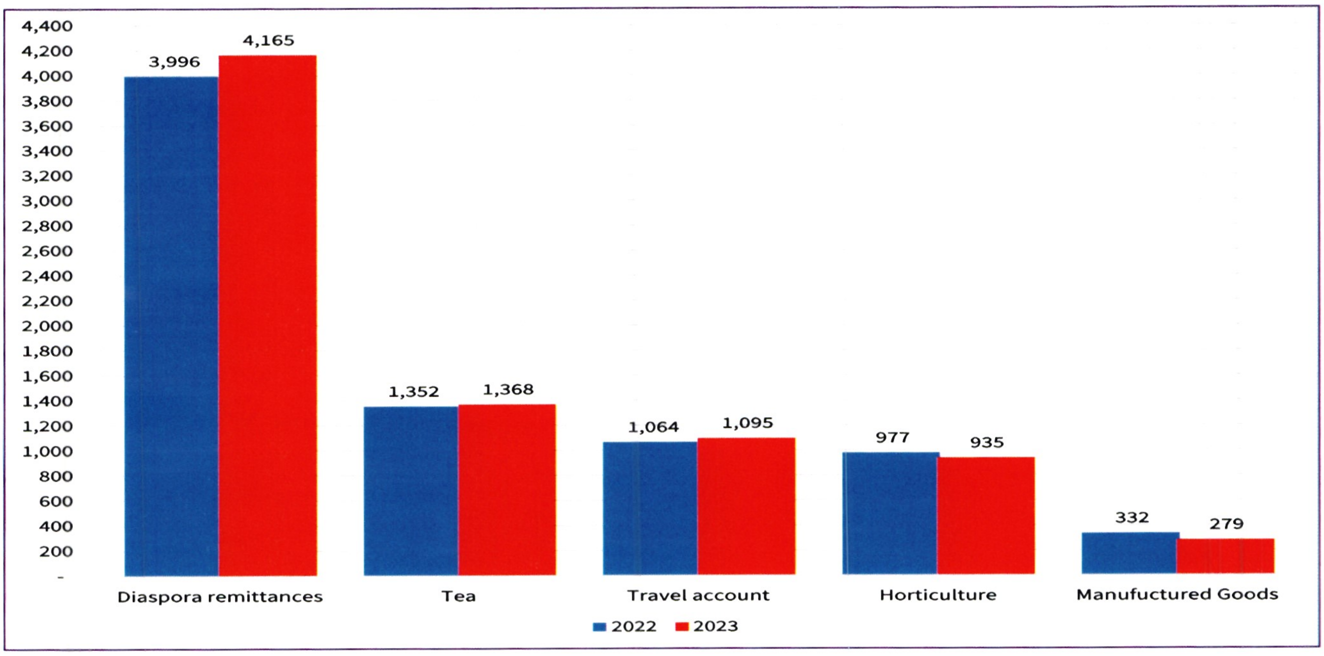
2.3.3 Balance of Payments Developments

In the 12-months to October 2023, the current account balance was a deficit of USD 4,010 million (3.7 percent of GDP), compared to a deficit of USD 6116 million (5.3 percent of GDP) in a similar period in 2022. The current account deficit in percent of GDP narrowed due to slow growth of imports as well as resilient remittances.

The deficit in the goods account narrowed to USD 9,357 million in the year to October 2023, largely reflecting lower imports of infrastructure related equipment due to completed projects. The performance of exports declined by 2.0 percent to USD 7,291 million in the year to October 2023, on account of low earnings from horticulture exports due to poor earnings in destination markets. However, receipts from tea, manufactured goods and chemicals exports increased by one percent,14 percent and five percent, respectively during the period. Imports dropped by 14.9 percent in the 12 months to October 2023 compared to an increase of 14.7 percent in a similar period in 2022. The decline in imports was across all categories with the exception of food and crude materials. Receipts from service exports also declined in the period under review. **(Chart 4a and Chart 4b)**.

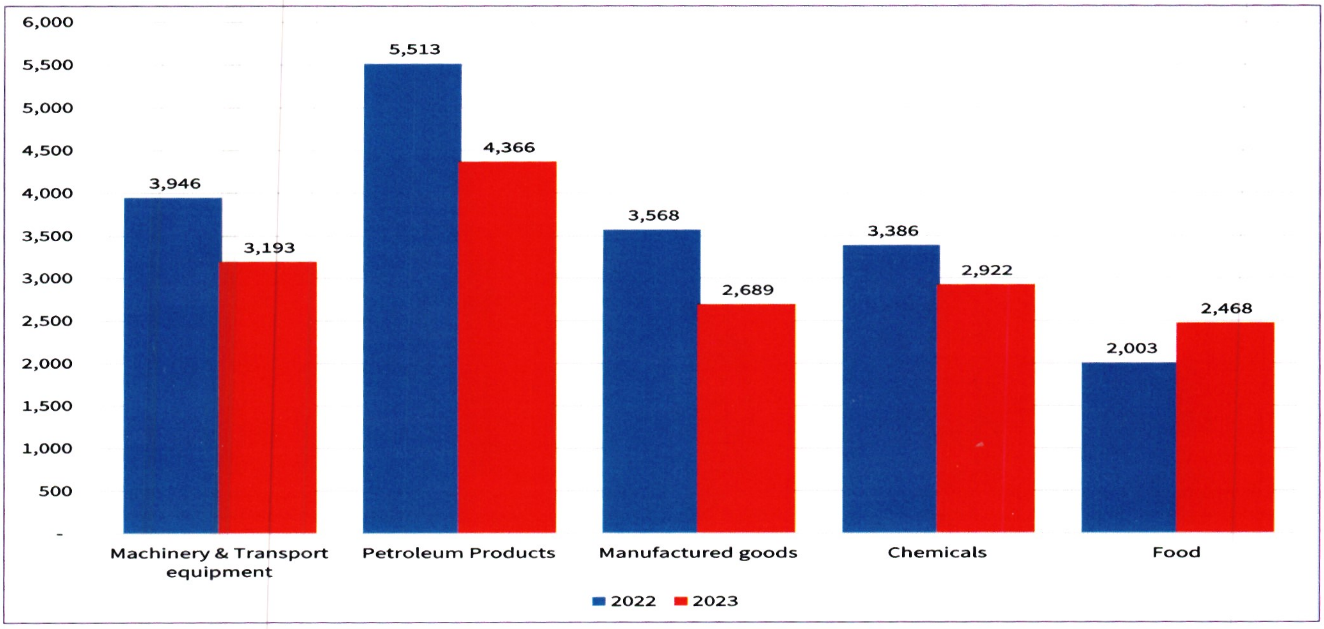
Financial account net inflows totaled USD 3,934 million in the 12-months to October 2023 from USD 4,604 million over a similar period in 2022. This largely reflected a decline in other investment inflows. The capital account on the other hand, recorded a surplus of USD 140.0 million in the 12-months to October 2023. Imports from China accounted for 19.8 percent of the total imports in the 12 months to October 2023, while United Arabs Emirates, India, the United States, and the United Kingdom accounted for 19.4 percent, 11.1 percent, 4.9 percent, and 1.6 percent, respectively.

Chart 4a: Foreign Exchange Inflows from Diaspora Remittances and Major Export Categories in the 12-Months to October (USD Million)



Source: Central Bank of Kenya

Chart 4b: Imports by Major Categories in the 12-Months to October (USD Million)



Source: Central Bank of Kenya

The U.K. and U.S. accounted for 5.2 percent and 6.8 percent, respectively, of Kenya's total exports in the 12-months to October 2023. Exports to other trading blocs such as the EAC, COMESA and the EU accounted for 27.3 percent, 28.1 percent, and 20.5 percent, respectively, of total exports over the period, compared to 26.3 percent, 27.2 percent and 20.3 percent of total exports in the 12-months to October 2022 respectively.

2.3.4 Banking Sector Developments

The banking sector remained stable and resilient in the period ended October 2023, with strong liquidity and capital adequacy ratios. The average commercial banks liquidity and capital adequacy ratios stood at 49.4 percent and 18.5 percent in October 2023. These were above the minimum statutory limits of 20.0 percent and 14.5 percent respectively.

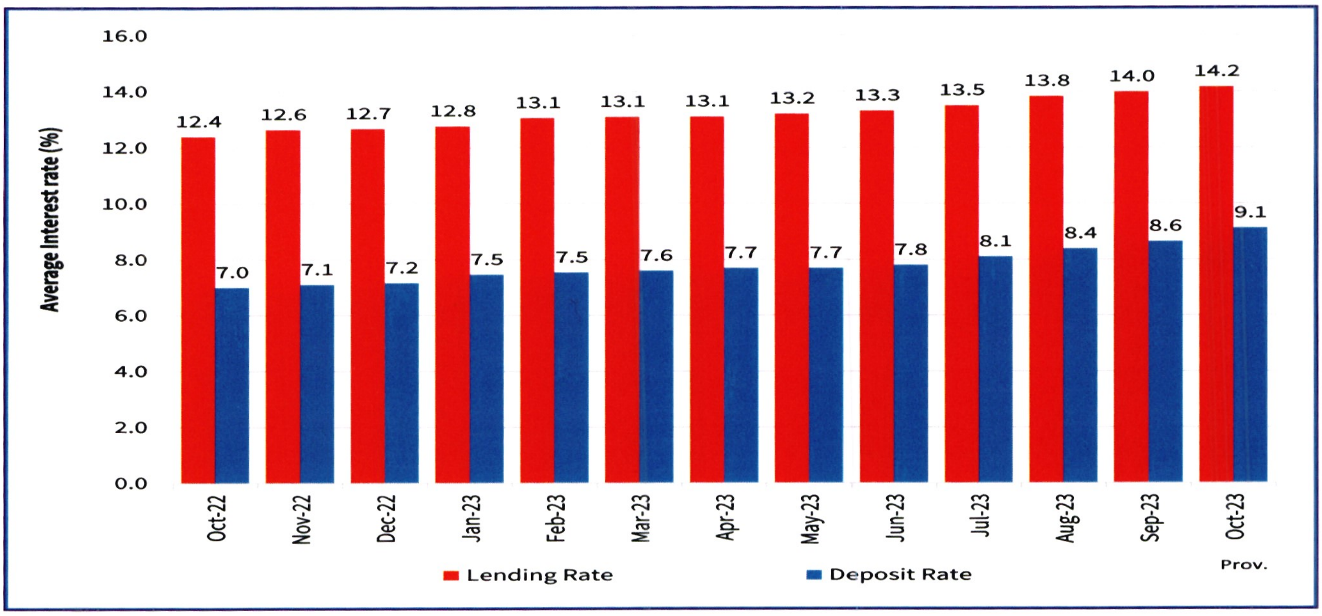
Credit risk was elevated, with the ratio of gross non-performing loans (NPLs) to gross loans standing at 15.3 percent in October 2023, an increase from 14.5 percent in April 2023. Gross NPLs increased by 10.7 percent from Ksh.572.7 billion in April 2023, to Ksh.634.0 billion in October 2023 mainly due to adverse business conditions. The main sectors with increased NPLs are manufacturing, trade, building and construction, personal and household, mining and quarrying and real estate.

The total banking sector lending increased by 18.4 percent to Ksh.4,144.4 billion in October 2023, from Ksh.3,500.4 billion in April 2023. This was mainly driven by increased demand for loans in the trade, transport and communication, manufacturing, personal and household, real estate and agriculture sectors.

Customer deposits remained the main source of funding to the banks accounting for 74.5 percent of the banking sector's total liabilities and shareholders' funds as at October 2023. This was a slight increase from 71.1 percent in April 2023. Customer deposits increased by 15.2 percent to Ksh.5,564.4 billion in October 2023, from Ksh.4,832.2 billion in April 2023.

Commercial banks' average lending rate increased during the review period, partly reflecting the tight monetary policy stance. The weighted average lending rate increased to 14.2 percent in October 2023 from 13.1 percent in April 2023, while the weighted average deposit rate increased to 9.1 percent from 7.7 percent **(Chart 5)**.

Chart 5: Commercial Banks' Average Interest rates (%)



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Private sector credit growth remained resilient and stood at 12.5 percent in October 2023 compared to 13.2 percent in April 2023. Strong credit growth was observed in manufacturing, transport and communications, trade and consumer durables **(Table 2)**. The number of loan applications and approvals remained strong, reflecting sustained demand. Growth in private sector credit is expected to remain relatively stable, supported by, among other factors, resilient economic activity, and the implementation of the Credit Guarantee Scheme for the vulnerable MSMEs.

Table 2: 12-Month Growth in Private Sector Credit (%)

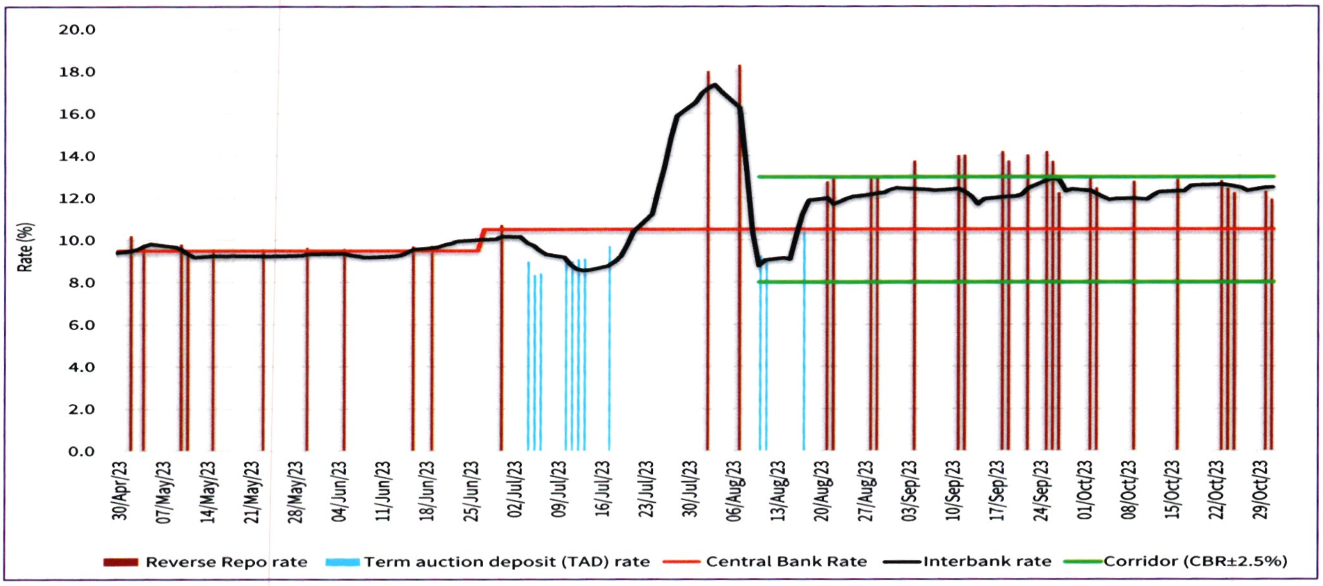
	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23
Total Credit to Private Sector	**13.3**	**12.5**	**12.5**	**11.5**	**11.7**	**11.6**	**13.2**	**13.2**	**12.2**	**10.3**	**12.6**	**12.2**	**12.5**
Agriculture	21.7	20.3	22.3	20.7	18.0	14.9	16.9	18.3	18.6	19.0	14.9	15.3	18.5
Manufacturing	17.5	14.9	13.8	13.8	15.2	15.8	21.7	19.3	18.0	14.7	19.6	22.0	18.4
Trade	15.3	14.3	11.4	11.1	11.8	11.9	13.7	15.4	10.2	7.4	9.4	7.1	9.9
Building & construction	8.0	6.0	8.2	5.8	3.0	5.8	4.2	5.1	4.9	1.9	2.7	7.9	13.0
Transport & communication	22.8	21.8	23.5	16.6	16.5	17.4	18.0	22.0	19.8	16.4	24.9	18.5	16.2
Finance and insurance	5.4	4.4	7.6	6.7	21.1	28.4	32.3	32.7	29.7	35.4	38.7	40.8	41.6
Real estate	1.6	2.8	3.2	3.3	2.9	2.3	2.4	1.9	3.7	3.0	3.7	7.6	6.5
Mining & quarrying	53.5	58.3	31.3	54.2	97.7	83.2	55.6	41.3	24.0	16.7	23.7	20.7	5.9
Private households	5.9	6.0	8.2	7.8	7.8	7.2	5.0	7.0	8.4	7.0	7.8	7.0	8.3
Consumer durables	14.0	12.6	12.9	12.5	12.4	12.7	13.3	11.9	12.0	12.9	12.7	10.5	10.8
Business services	13.2	14.5	13.7	13.7	13.5	9.3	12.5	13.5	12.1	10.7	8.1	11.7	8.3
Other activities	49.8	44.8	41.8	33.3	15.3	11.9	20.6	6.8	8.7	0.5	10.8	-0.8	7.1

Source: Central Bank of Kenya

2.3.6 Interest rates

Short-term money market interest rates increased in the six months to October 2023, partly reflecting the tight monetary policy stance and liquidity conditions in the money market. Following the introduction of an interest rate corridor around the CBR set at CBR± 250 basis points by the MPC in August 2023, the monetary policy operations aimed at ensuring the interbank rate, as an operating target, closely tracks the CBR. As a result, the interbank weighted average rate has aligned with the policy corridor. Open market operations remained active **(Chart 6a)**.

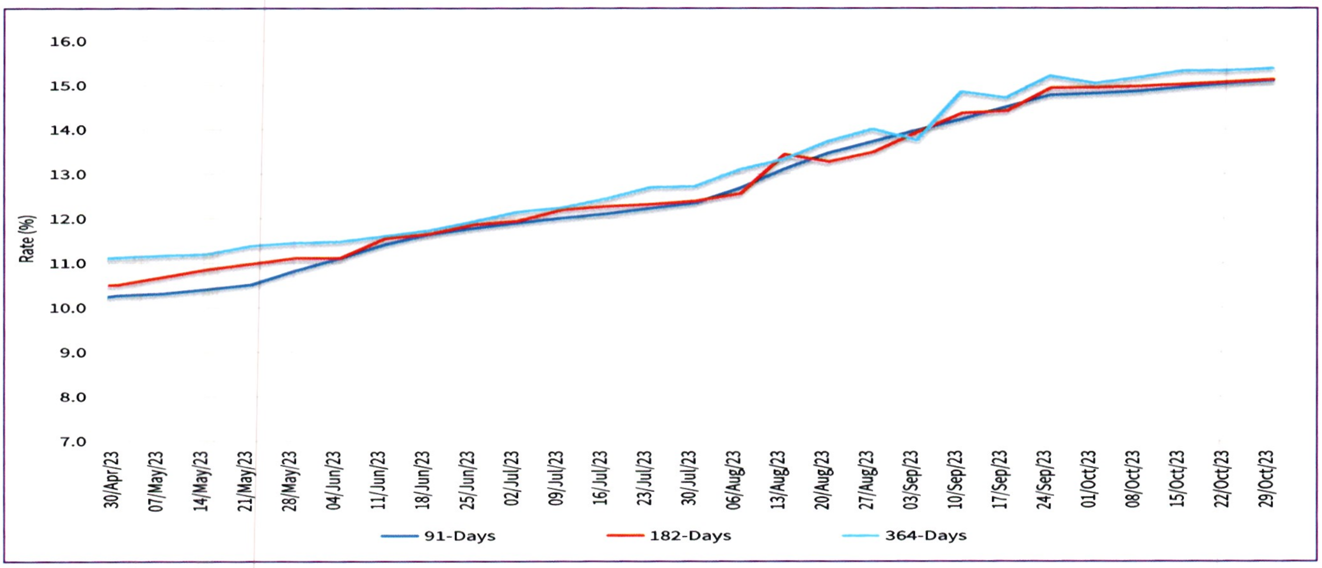
Chart 6a: Trends in Short Term Interest Rates (%)



Source: Central Bank of Kenya

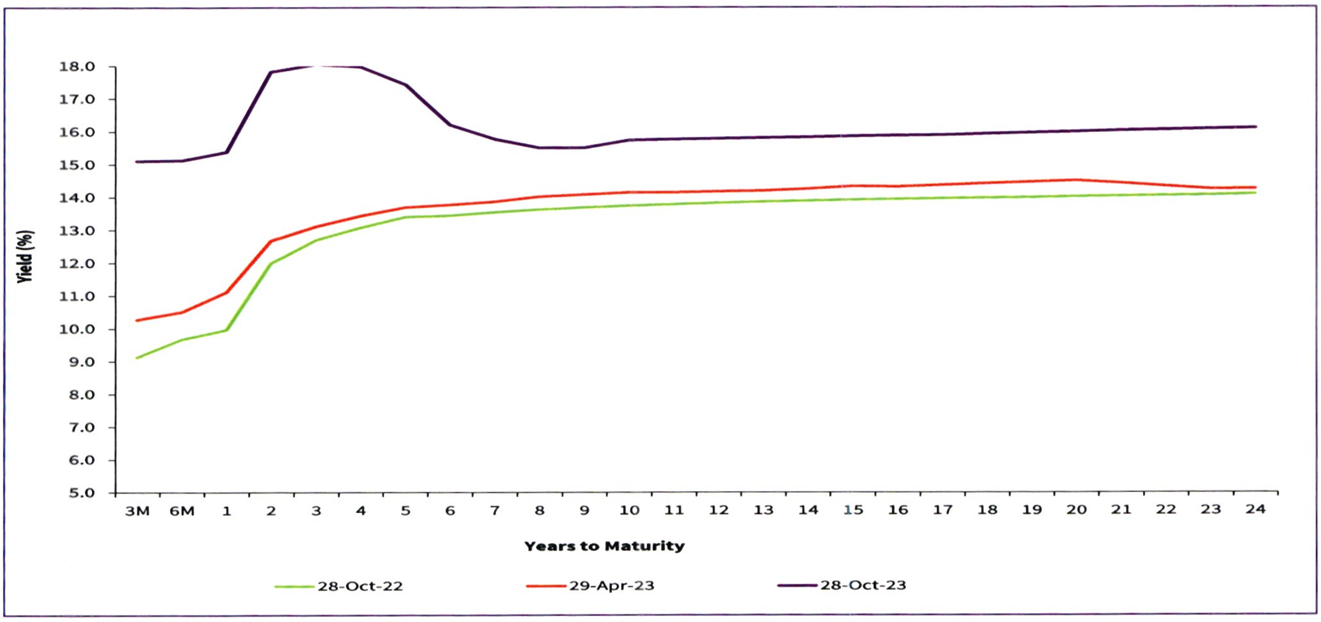
Interest rates on Government securities increased during the period and have broadly tightened at the short end of the yield curve, partly reflecting the tight liquidity conditions. The effective coordination of monetary and fiscal policies, particularly in the implementation of the Government domestic borrowing programme continue to support the yield curve **(Chart 6b and 6c)**.

Chart 6b: Interest rates on Treasury Bills (%)



Source: Central Bank of Kenya

Chart 6c: Government Securities Yield Curve



Source: Central Bank of Kenya

3.1 Attainment of Monetary Policy Objectives and Targets

During the six months to October 2023, the MPC formulated monetary policy to achieve and maintain overall inflation within the target range as provided by the Cabinet Secretary for the National Treasury at the beginning of every fiscal year. The inflation target provided by the Cabinet Secretary for the National Treasury at the beginning of FY2022/23 and FY2023/24 was 5 percent with an allowable margin of 2.5 percent on either side.

The CBR remained the base for monetary policy operations and its adjustments both in direction and magnitude signaled the stance of monetary policy. The monetary policy stance was operationalized through various instruments including Open Market Operations (OMO), changes in cash reserve requirements at CBK, and the CBK Standing Facility (Overnight Discount Window which is a lender of last resort facility). To ensure that the interbank rate remains within the corridor, OMO was conducted using Repurchase Agreements (Repos) and Term Auction Deposits (TAD). Monetary policy was conducted in the context of a flexible exchange rate regime.

3.2 Implementation of Monetary Policy Reforms

The MPC continued to implement the reforms outlined in the White Paper on *Modernization of the Monetary Policy Framework and Operations* aimed at enhancing the effectiveness of monetary policy and supporting the anchoring of inflation expectations. In August 2023, the MPC approved a new monetary policy implementation framework designed to enhance monetary policy transmission. This new framework is based on inflation targeting and introduces an interest rate corridor around the Central Bank Rate (CBR) set at ± 250 basis points. Monetary policy operations will be aimed at ensuring the interbank rate, as an operating target, closely tracks the CBR. In addition, to improve access to the Discount Window, the Committee agreed to reduce the applicable interest rate from the current 600 basis points above CBR to 400 basis points above CBR. The Bank also rolled out the DhowCSD system which will improve the functioning of the interbank market by minimising segmentation.

3.3 Monetary Policy Committee Meetings and Decisions

Over the six months to October, the MPC held meetings on May 29, June 26, August 9, and October 3, 2023. These meetings were held against a backdrop of against a backdrop of continued global uncertainties, a weak global growth outlook, easing inflationary pressures, geopolitical tensions, and measures taken by authorities around the world in response to these Developments. The meetings reviewed the outcomes of the MPC's previous decisions and measures implemented to mitigate the adverse economic impact and financial disruptions.

In the May 2023 meeting, the MPC noted that the global economic outlook remained uncertain, reflecting continued concerns about financial sector stability in the advanced economies, continuing geopolitical tensions particularly the ongoing war in Ukraine, and the pace of monetary policy tightening in the advanced economies. However, commodity prices in the global markets, particularly of oil and food, continued to ease. Overall inflation declined to 7.9 percent in April 2023 from 9.2 percent in March, mainly driven by lower food prices. Food inflation declined to 10.1 percent in April from 13.4 percent in March, due to lower prices of vegetables attributed to the ongoing rains, and improved supply of select non-vegetable food items. Fuel inflation remained elevated at 13.2 percent in April, largely reflecting increases in electricity prices due to higher tariffs, and the scaling down of the fuel subsidy. Food inflation was expected to moderate in the coming months following the long rains, and lower global food prices. Nevertheless, the recent increases in electricity prices, the removal of the fuel subsidy, and a sharp rise in sugar prices were expected to exert moderate upward pressure on overall inflation. The MPC noted the data from the Economic Survey 2023 which showed that the Kenyan economy remained resilient in 2022, despite the subdued agriculture performance due to unfavorable weather conditions during the period. Real GDP grew by 4.8 percent in 2022, reflecting robust performance of the services sector, particularly transport and storage, financial and insurance, information and communication, and accommodation and food services. Leading indicators pointed to strong economic performance in the first quarter of 2023, mainly driven by activity in the services sector and recovery in agriculture. The economy was expected to continue to strengthen in 2023, supported by the resilient services sector and expected recovery in agriculture. The Committee noted that the impact of the further tightening of monetary policy in March 2023 to anchor inflationary expectations was still transmitting in the economy. Additionally, the MPC noted that this action would be complemented by the recently announced Government measures to allow duty-free imports on specific food items particularly sugar, which were expected to moderate prices and ease domestic inflationary pressures. In view of these developments, the MPC decided to retain the Central Bank Rate (CBR) at 9.50 percent.

The June 2023 meeting was held against the backdrop against a backdrop of continued global uncertainties, persistent inflationary pressures, a weak global growth outlook, geopolitical tensions, and measures taken by authorities around the world in response to these developments. The global economic outlook remained uncertain, reflecting persistent volatility in the financial markets, continued concerns about financial sector stability in the advanced economies, continuing geopolitical tensions particularly the ongoing war in Ukraine, and the pace of monetary policy tightening in the advanced economies. Additionally, inflation in advanced economies remained persistently high, even as commodity prices in the global markets, particularly of oil and food, continued to ease. Overall inflation increased to 8.0 percent in May 2023 from 7.9 percent in April, mainly driven by food and fuel prices. Food inflation increased to 10.2 percent in May from 10.1 percent in April, mainly due to a sharp rise in sugar prices attributed to low cane deliveries following reduced production. Sugar prices accounted for 2.1 percentage points of the food inflation in May compared to 0.9 percentage points in April. Vegetable inflation moderated in May, due to improved supply attributed to the long rains. Fuel inflation increased to 13.6 percent in May from 13.2 percent in April, mainly due to the removal of the fuel subsidy and increases in electricity prices following upward adjustment of tariffs in April. Additionally, a mini-Survey of the Agriculture Sector conducted in the first half of June revealed that prices of maize remain elevated. Overall inflation was expected to remain elevated in the near term, largely due to the recent increase in electricity prices, the removal of the fuel subsidy, implementation of the tax measures in the FY2023/24 Government Budget, and higher prices of sugar. Leading indicators of the Kenyan economy pointed to strong economic performance in the first half of 2023, driven by activity in the services sector and recovery in agriculture. Despite global uncertainties, the economy was expected to remain resilient in 2023, supported by continued strong performance of the services sector and recovery in agriculture. The Committee noted the sustained inflationary pressures and risks to inflation, the elevated global risks and their potential impact on the domestic economy and concluded that there was scope for a further tightening of the monetary policy in order to anchor inflation expectations. In view of these developments, the MPC decided to raise the Central Bank Rate (CBR) from 9.50 percent to 10.50 percent.

The August meeting was held against a backdrop of continued global uncertainties, persistent inflationary pressures, a weak global growth outlook, geopolitical tensions, and measures taken by authorities around the world in response to these developments. Overall inflation declined to 7.3 percent in July 2023 from 7.9 percent in June, driven by food and non-food non-fuel (NFNF) prices. The inflation rate therefore returned to the target range of 2.5–7.5 percent. Food inflation eased to 8.6 percent in July from 10.3 percent in June, reflecting declines in prices of key vegetable and non-vegetable food items following improved supply attributed to the long rains, and lower global food prices. Fuel inflation rose to 14.5 percent in July from 12.9 percent in June, mainly reflecting the impact of the removal of the fuel subsidy, increases in electricity prices following upward adjustment of tariffs in April, and implementation of the 16 percent VAT on petroleum prices. The NFNF inflation declined to 3.8 percent in July from 4.1 percent in June, indicating easing underlying inflationary pressures attributed to the recent monetary policy measures. Overall inflation was expected to continue to moderate in the near term, supported by lower food prices attributed to improving supply of key food items particularly maize, and the zero-rating of VAT on cooking gas (LPG) prices. The global growth outlook remained uncertain, reflecting a slower growth momentum in advanced economies, increased borrowing costs attributed to monetary policy tightening, and escalation of geopolitical tensions particularly the ongoing war in Ukraine. Additionally, headline inflation rates in advanced economies continued to ease, but remained above the respective targets with persistent core inflationary pressures. Commodity prices in the global markets, particularly of oil and food, remained below the peak levels witnessed in 2022. The GDP data for the first quarter of 2023 showed continued strong performance of the Kenyan economy, with real GDP growing by 5.3 percent. This performance reflected a strong rebound in agriculture sector due to favorable weather conditions, and resilient performance of the services sector. Leading indicators of economic activity pointed to continued strong performance in the second quarter of 2023. The Committee considered two proposed measures by CBK aimed at enhancing the monetary policy implementation framework and improving the transmission of monetary policy, in line with the White Paper on Modernization of the Monetary Policy Framework and Operations published in July 2021. The Committee adopted the proposed policy measures as follows: first, conduct of monetary policy operations with the objective of keeping the interbank interest rate within a prescribed band/corridor around the CBR. The width of the corridor is initially set at ±2.5 percentage points of the CBR; second, reactivation of the overnight lending window and commercial banks allowed to borrow from the CBK through a standing facility on an overnight basis and as a lender of last resort (LOLR). Further, the committee approved the revision of the applicable interest rate on the standing facility from 6.0 percentage points above the CBR to 4.0 percentage points. The Committee noted that the impact of the further tightening of monetary policy in June 2023 to anchor inflationary expectations was still transmitting in the economy. The MPC noted that this action would be complemented by the improved supply of key food items particularly maize, which was expected to continue to moderate food prices and ease domestic inflationary pressures. In view of these developments, the MPC decided to retain the Central Bank Rate (CBR) at 10.50 percent.

The October 2023 meeting was held against a backdrop of continued global uncertainties, persistent inflationary pressures, increase in international oil prices, a weak global growth outlook, geopolitical tensions, and measures taken by authorities around the world in response to these developments. The global growth outlook remained weak, reflecting the impact of monetary policy tightening in advanced economies, weakening demand particularly in China and the Eurozone, and heightened geopolitical tensions which continued to weigh down on economic activity. Additionally, headline inflation rates in advanced economies remained above the respective targets, due to persistent core inflationary pressures, and higher energy costs following recent increases in the price of oil. Global food prices declined from the peak levels witnessed in 2022 except for a few items such as sugar and rice. Overall inflation remained broadly unchanged at 6.8 percent in September 2023, compared to 6.7 percent in August, which is within the government's target range. Food inflation increased to 7.9 percent in September from 7.5 percent in August, largely on account of increases in the prices of a few key vegetables particularly onions, Irish potatoes, cabbages, spinach, kales (sukuma wiki), and tomatoes. Prices of key non-vegetable food items particularly maize and wheat flour declined following improved supply attributed to the ongoing harvests and government measures to zero-rate key food imports. Fuel inflation remained elevated at 13.1 percent in September, reflecting the impact of the rise in international oil prices. Non-food non-fuel (NFNF) inflation remained stable at 3.7 percent in both September and August, reflecting the impact of monetary policy measures and muted demand pressures. Overall inflation was expected to remain within the target range in the near term, supported by lower food prices with the improving supply of key food items particularly maize, and the implementation of Government measures to improve the supply of sugar through imports. Leading indicators of economic activity for Kenya pointed to strong performance in 2023, supported by the continued robust growth of the services sectors, the rebound in agriculture, and the ongoing implementation of measures to boost economic activity in priority sectors by the Government. The MPC noted that inflation was expected to remain within the target range, supported by lower food prices with the expected improved supply. Additionally, the MPC observed that NFNF inflation was expected to decline, indicative of easing underlying inflationary pressures. The Committee further assessed that the impact of the tightening of monetary policy in June 2023 to anchor inflationary expectations was still transmitting in the economy. In view of these developments, the MPC decided to retain the Central Bank Rate (CBR) at 10.50 percent.

4. IMPACT OF POLICY RESPONSES TO COVID-19 (CORONAVIRUS) PANDEMIC

As at October 2023, all emergency policy measures that effectively mitigated the impact of COVID-19 had lapsed. However, monitoring of any lag effects continues.

The Credit Guarantee Scheme (CGS) established in October 2020, continued to support additional credit uptake by vulnerable Micro, Small, and Medium-sized Enterprises (MSMEs). As at the end of October 2023, all seven banks had disbursed guaranteed loans to MSMEs amounting to Ksh.6.1 billion.

Going forward, the banking sector is projected to remain resilient and stable. Credit risk is expected to remain elevated in the short to medium term. Liquidity risk is expected to remain stable while operational risk is expected to remain elevated. Interest rate risk is expected to remain elevated.

5. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC Surveys conducted during the period as well as regular communication with the key stakeholders facilitated the MPC in its market information gathering process for effective conduct of forward-looking monetary policy. The MPC also continued to simplify its Press Releases to enhance the clarity of information communicated to the public, media, financial sector and other stakeholders.

The MPC's Private Sector Market Perceptions Survey and CEOs Survey, revealed continuing optimism about economic growth prospects for 2023. Respondents attributed this optimism largely to enhanced agricultural production, easing inflation, and improved growth prospects. Nevertheless, respondents' concerns included higher fuel and electricity prices, reduced purchasing power affecting demand for products, and the possible negative effects of the El Niño weather phenomenon. The Agriculture Sector Survey revealed that high input costs, unpredictable weather conditions, as well as transport costs were the major factors constraining agricultural production.

Among the technical analyses undertaken and presented to the MPC in the period were: (i). Assessment of Interest Rate Differentials on Portfolio Flows; (ii). Inflation Expectations; (iii). Exchange Rate Misalignment; (iv) Monetary Policy Transmission; and (v). Interest Rate Differentials and Exchange Rate;

Over the period, the MPC Chairman held virtual stakeholder meetings with the Chief Executives of commercial and microfinance banks after every MPC Meeting in order to apprise them on the background to its decisions and to obtain feedback. In addition, the Chairman of the MPC held virtual press conferences after each MPC meeting to brief the media on the background to MPC decisions and measures undertaken by the CBK to support macroeconomic stability as well as mitigate the impact of COVID-19 on the economy.

The Governor also held virtual meetings with various potential investors and representative from the private sector to brief them on economic developments and the outlook for the economy. The MPC continued to monitor the implementation of monetary policy decisions by the CBK. The Committee also continued interaction with other government agencies such as the National Treasury and Kenya National Bureau of Statistics (KNBS) on various data issues.

6. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to October 2023 continued to support price stability. The continued coordination of fiscal and monetary policies during the period also supported the achievement of price and market stability.

The CBK will continue to monitor developments in the domestic and global economy, the transmission of the monetary policy and other measures previously taken, and their effects on price stability. The MPC will also monitor developments in the exchange rate and implications for the price stability objective.The MPC will equally continue to implement the reforms outlined in the White Paper on *Modernization of The Monetary Policy Framework and Operations*, in order to enhance the effectiveness of monetary policy and support anchoring of inflation expectations.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (MAY 2023 – OCTOBER 2023)

Date	Event of Relevance to Monetary Policy
May 2023	CBR retained at 9.50 percent.
June 2023	CBR raised to 10.50 from 9.50 percent.
July 2023	Release of July 2023 IMF World Economic Outlook (WEO) Report showing that global growth was projected to fall from an estimated 3.5 percent in 2022 to 3.0 percent in both 2023 and 2024. The forecast was modestly higher than predicted in the April 2023 WEO but remained weak by historical standards. The rise in central bank policy rates to fight inflation continued to weigh on economic activity.
	Introduction of the DhowCSD system.
August 2023	CBR retained at 10.50 percent.
	The MPC approved a new monetary policy implementation framework designed to enhance monetary policy transmission. This new framework is based on inflation targeting and introduces an interest rate corridor around the Central Bank Rate (CBR) set at ± 250 basis points. The new framework aims at ensuring that the interbank rate, as an operating target, closely tracks the CBR. In addition, to improve access to the Discount Window, the Committee agreed to reduce the applicable interest rate from the current 600 basis points above CBR to 400 basis points above CBR.
October 2023	CBR retained at 10.50 percent.
	Release of October 2023 IMF World Economic Outlook (WEO) Report showing that global growth was expected to slow from 3.5 percent in 2022 to 3.0 percent in 2023 and 2.9 percent in 2024, well below the historical (2000–19) average of 3.8 percent. The outlook reflected the tight policy stances needed to bring down inflation.

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the year-on-year movement of indices of all consumer price items of goods and services sampled by the KNBS. It is affected by commodity components in the market that may experience sudden inflationary spikes such as food or energy.

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 non-bank financial institutions held with the CBK. It excludes Government deposits.

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 terms 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 + deposit Liabilities of Non-Bank Financial Institutions (NBFIs)
- M3 M2 + residents' foreign currency deposits

Central Bank Rate (CBR): This is the lowest rate of interest that the CBK charges on overnight loans to commercial banks. It is reviewed and announced by the Monetary Policy Committee at least every two months as part of its decisions. It is used by the commercial banks as a reference interest rate hence transmits to the financial sector and signals the CBK's monetary policy stance.

Cash Reserves Ratio(CRR): This is the ratio of deposits of commercial banks and non-bank financial institutions maintained with the CBK (as reserves) to commercial banks total deposit liabilities. The ratio is fixed by CBK as provided for by the law.

CBK Discount Window: The CBK Discount Window is a collateralized facility of last resort for banks. It has restrictive guidelines controlling access. The Discount Window plays a significant role in ensuring banking sector stability by offering overnight liquidity as a last resort. It is anchored on the CBR with a prescribed penalty.

Open Market Operations (OMO) : The act of buying or selling of government securities from or to commercial banks by the Central Bank in order to achieve a desired level of bank reserves. OMO is carried out in the context of an auction where commercial banks bid through the Reuters dealing system or by phone/fax.

Repurchase Agreement (Repo): Repos/reverse repos are agreements between the CBK and commercial banks to purchase/sell Government securities from/to commercial banks at agreed interest rates (REPO rate) for a specified period with an understanding that the commercial bank will repurchase/resell the security from/to the CBK at the end of the period. The period can be varied by the CBK.

Term Auction Deposits (TAD): The TAD is used in exceptional market conditions when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options. The CBK seeks to acquire deposits through a transfer agreement from commercial banks at an auction price but with no exchange of security guarantee.

Horizontal Repo: This is an interbank Repo instrument which recognises Government securities as collateral for borrowing. The instrument has a variable tenor and allows commercial banks without credit lines with other banks to access credit from the interbank market.

Interbank Market: The interbank market is a critical channel for distributing liquidity that reduces the need for banks to access the CBK Overnight Discount Window. However, since not all banks have credit lines with each other, it is not a perfectly operating market and therefore banks may come to the Window as a last resort. The interest rates charged by banks reflect an individual bank's perception of the risk of the particular bank borrower and also the tightening liquidity in the market.

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