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THE CENTRAL BANK OF KENYA
MONETARY POLICY STATEMENT, DECEMBER, 2007

The Principal objectives of the Central Bank of Kenya (CBK) are:

1. To formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices.
2. To foster the liquidity, solvency and proper functioning of a stable market-based financial system.
3. Subject to (1) and (2), the Bank shall support the economic policy of the Government, including its objectives for growth and employment.

Without prejudice to the generality of the above, the Bank also seeks to:

- Formulate and implement foreign exchange policy;
- Hold and manage its foreign exchange reserves;
- License and supervise authorized dealers in the money market;
- Promote the smooth operation of payments, clearing and settlement systems;
- Act as banker and adviser to, and as fiscal agent of the Government; and
- Issue currency notes and coins.

Objectives of Monetary Policy

The CBK formulates and conducts monetary policy with the aim of keeping inflation low and stable, thereby contributing to a favourable macroeconomic environment for sustainable economic growth and employment creation. Low and stable inflation facilitates higher levels of domestic savings and private investment and therefore leads to better economic outcomes including improved economic growth, higher real incomes and increased employment opportunities.

The Bank's monetary policy is thus designed to support the economic growth and employment objectives of the Government through achieving low and stable inflation.

Instruments of Monetary Policy

he CBK pursues its monetary policy objectives using the following instruments:

- **Open Market Operations** (OMO) whereby the CBK either buys or sells Treasury bills and any other eligible securities to achieve a desired level of money in the economy. The CBK injects money to the economy when it buys Treasury bills from commercial banks through repurchase order agreement (Repos), and withdraws money when it sells them.
- **Standing Facilities** which the CBK, as lender of last resort, provides secured loans to commercial banks on an overnight basis at a rate known as the Central Bank Rate (CBR). The value of the CBR is based on the average of the interbank and the Repo rates plus a margin to be determined and announced by the CBK every eight weeks. Commercial banks facing temporary liquidity needs may also rediscount their Treasury bills holdings at the CBR.
- **Reserve Requirements**, which is the proportion of commercial banks' deposits to be held as cash (CRR) at the CBK in accordance with the law. An increase in CRR reduces the capacity of commercial banks to extend credit. A reduction in the CRR enhances the capacity of commercial banks to expand credit. The CRR has been maintained at 6 percent of commercial banks' deposits since July 2003.
- **Foreign Exchange Market Operations** whereby the CBK either injects or withdraws liquidity by engaging in foreign exchange transactions. The participation by CBK in the foreign exchange market is in most cases geared to forestalling excessive speculative activities rather than influencing domestic liquidity, although it has the scope to do so.

Monetary Policy Statement

1. Section 4B of the CBK Act requires the Bank to submit to the Minister for Finance, at intervals of not more than six months, a Monetary Policy Statement for the next twelve months which shall-
 - i) Specify policies and the means by which the Bank intends to achieve the policy targets;
 - ii) State reasons for adopting such monetary policies and means; and
 - iii) Contain a review and assessment of the progress made in the implementation by the Bank of monetary policy during the period to which the preceding Monetary Policy Statement relates.
2. The Minister is required by the law to lay every Statement submitted under subsection (1) before the appropriate committee of the National Assembly not later than the end of the subsequent session of Parliament after the Statement is so submitted.
- 3 a. The Bank is required by the law to publish in the Kenya Gazette:
 - i) Its Monetary Policy Statement; and
 - ii) Its Monthly Balance Sheet.
- 3b. The Bank is further required to disseminate key financial data and information on monetary policy to the public.
4. In subsection (2), the expression "appropriate committee" means the committee of the National Assembly appointed to investigate and inquire into matters relating to monetary policy.

M1	Currency outside banking system + demand deposits
M2	M1 + time and savings deposits + certificates of deposits + deposits Liabilities of Non-Bank Financial Institutions (NBFIs)
M3	M2 + residents' foreign currency deposits

Central Bank Rate (CBR)

The rate of interest at which the CBK lends to commercial banks. It is determined and announced by the CBK every eight weeks, based on the average of the interbank and Repo rates plus a margin.

Open Market Operations (OMO)

The act of buying or selling treasury bills in the secondary market by the Central Bank in order to achieve a desired level of currency in circulation and bank reserves. OMO is done in the context of an auction where commercial banks bid through the Reuters screen.

Repurchase Agreement (REPO)

REPOs are agreements between the CBK and commercial banks to purchase/sell government securities from/to commercial banks at agreed interest rate (REPO rate) for a specified period with an understanding that the commercial bank will repurchase/resell the security to the CBK at the end of the period.

Reserve Money Program

This is the desired expansion in the reserve money operating target to achieve the money supply growth target (intermediate target) that is consistent with the inflation target (ultimate target).

Cash Reserve Requirement

This is the legally required position of commercial banks and nonbank financial institutions deposits held with the CBK. The CBK is empowered by the Act to demand that a certain proportion of commercial banks' deposits to be held as reserves at the CBK. The ratio currently stands at 6 percent.