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LETTER OF TRANSMITTAL

In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Minister for Finance, the Annual Report of the Central Bank of Kenya for the Fiscal Year 2011/12. The Annual report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Fiscal Year ended June 30, 2012.

Njuguna Ndung'u

Governor

PREFACE

The world economy grew at 3.9 percent in 2011 from 5.1 percent growth in 2010. This slowdown was mainly attributed to cntinued deleveraging by banks, high unemployment rate, fiscal austerity response and bank exposure to sovereign debt especially in the Euro area.

The Kenyan economy performed modestly in 2011 and realized growth in gross domestic product (GDP) of 4.4 percent compared with expansion of 5.8 percent in 2010 and 2.7 percent in 2009. Agriculture and Forestry, Electricity and Water Supply, Mining and Quarrying, Financial Intermediation, Wholesale and Retail Trade, Repairs, and Transport and Communication continued to boost the economic growth. In the first three months of 2012 the economy performed sluggishly registering real growth of 3.5 percent, or 140 basis points below 4.9 percent growth in the corresponding period in 2011. Real GDP growth is projected to stabilize at 5.2 percent in 2012.

Monetary policy focused on achieving and maintaining low inflation. The twelve month inflation rate slowed down from 18.31 percent in January 2012 to 10.1 percent in June 2012 on account of reduced food inflation and fuel inflation in the year to June 2012 and prudent monetary policy stance. The annual average inflation, however, rose to 16.0 percent in June 2012 from 15.1 percent in January 2012 and 6.9 percent in June 2011. Monetary policy tightening started in March 2011 and was sustained through June 2012 to contain domestic inflation. Money supply, M3, growth decelerated to 15.5 percent from 19.3 percent in September 2011, and reserve money grew by 17.6 percent in the year to June 2012; against target growths of 18.7 percent and 14.2 percent, respectively. The expansion in M3 in the year ending June 2012 was reflected in stronger growth in net foreign assets of the banking sector.

The Central Bank Rate (CBR) continued to signal the direction of monetary policy. At the beginning of the fiscal year 2011/12, the MPC initially adopted a gradual approach by raising CBR by 75 basis points from 6.25 percent in July 2011 to 7.0 percent in September 2011. Persistent risk in inflation and exchange rate stability prompted the MPC to tighten further the CBR by 400 basis points to 11.0 percent in October 2011, followed by 550 basis points to 16.5 percent in November 2011 and further by 150 basis points to 18 percent in December 2011. To reinforce the monetary policy stance the cash reserve requirement was raised from 4.75 percent to 5.25 percent in December 2011.

The average interbank rate surged upwards from 8.61 percent in July 2011 to 28.9 percent in November 2011 and thereafter, declined to 17.9 percent in June 2012. The 91-day Treasury bill rate increased continuously for seven months in fiscal year 2011/12 before declining in the second half of 2011/12. The average lending rates rose from 14.14 percent in July 2011 to 20.41 percent in June 2012. Similarly the average deposit rate rose from 3.85 percent in July 2011 to 7.88 percent in June 2012. The spread on commercial bank lending rates remained above 10 percent throughout the fiscal year reflecting risk perception by banks on the economy.

The Government budgetary operations in the fiscal year 2011/12 resulted in a budget deficit of Ksh 181.5 billion (5.5 percent of GDP) on commitment basis in the fiscal year 2011/12. The deficit was within the target of 7.2 percent of GDP. Government revenues increased by Ksh 54.9 billion to Ksh 734.4 billion during the year but fell short of target due to underperformance in all the revenue categories. Government expenditure and net lending increased by 12.1 percent to Ksh 915.9 billion, but fell short of target partly on account of a low absorption rate on development expenditure. The share of the development budget increased from 28.8 percent in fiscal year 2010/11 to 30.2 percent in fiscal year 2011/12 in line with fiscal objective of prioritizing infrastructural development to crowd in private investment.

The Kenya Shilling strengthened against major world trading currencies in fiscal year 2011/12. The Kenyan Shilling appreciated by 1.8 percent to the US dollar to exchange at an average of

Ksh 84.8 in June 2012 compared to Ksh 89.0 in June 2011. This reflects the tight monetary policy stance adopted by the MPC during the year. The surplus on the balance of payments increased from US$ 261 million in the fiscal year 2011/12 to US 841 million in the twelve months to June 2012. The current account deficit, however, widened by 39 percent to US$ 3,895 million from US$ 2,800 million in the year to June 2011. The wider current account deficit was financed largely by short term inflows. During the year under review, the Central Bank increased its holding of foreign exchange reserves from US$ 4,142 million (3.8 months of import cover) as at June 2011 to US$ 5,283 million (4.3 months of import cover) as at June 2012. The buildup of official reserves was achieved through domestic interbank purchases by the Central Bank, program disbursement under the 3 Year Extended Credit Facility (2011-14) negotiated with the International Monetary Fund and the disbursement of the syndicated loan to the government amounting to US$ 600 million in June 2012.

The Banking Sector recorded improved performance in the fiscal year 2011/12. The sector's total assets increased by 15.8 percent from Ksh 1,873.8 billion in June 2011 to Ksh 2,195 billion in June 2012. The major components of the balance sheet were loans and advances, government securities and placements, which accounted for 56.6 percent, 19.5 percent and 7.3 percent of total assets, respectively. Gross loans and advances grew by 19.0 percent to Ksh 1,289 billion in June 2012. The stock of gross non-performing loans (NPLs) declined by 1.4 percent to Ksh 57.5 billion in June 2012 thereby lowering the ratio of gross NPLs to gross loans from 5.4 percent to 4.5 percent over the period under review. Deposits from customers, which accounted for 75.5 percent of total funding liabilities, increased by 21.4 percent to Ksh 1,667 billion in June 2012 mainly due to branch expansion, remittances and receipts from exports. Other developments in the banking sector include increased uptake of customer credit history by banks; additional approvals to banks to roll out the agency banking model; and the licensing of a deposit taking microfinance institution.

During the year to June 2012, the Central Bank of Kenya recorded total operating income of Ksh 23,154 million (compared to Ksh 10,551 million in 2011) which included a surplus of Ksh 7,530 million (compared to Ksh 13,698 million in 2011) from revaluation of noncurrent assets. Total expenditure amounted to Ksh 8,554 million (compared to Ksh 8,560 million in 2011) and comprised operating expenses of Ksh 7,674 million and monetary policy expenses of Ksh 880 million (compared to Ksh 8,530 million and Ksh 30 million in 2011, respectively). Reflecting these outcomes, the Bank recorded a net loss of Ksh 13,638 million including unrealized foreign currency revaluation loss amounting to Ksh 28,238 million. The comparative position for the previous year is a net surplus of Ksh 40,925 million (inclusive of foreign currency translation gain of Ksh 38,934 million).The foreign currency revaluation losses in the year to June 2012 are attributed to appreciation of Kenya Shilling against major convertible currencies, particularly towards the end of the year in comparison with values prevailing at June 30, 2011. Without the translation losses and the gain on revaluation of noncurrent assets, the Bank recorded a much higher operating net surplus at Ksh 7,070 million compared with Ksh 622 million in the previous year. The improvement owe to higher than normal income in 2012 from higher lending to Government (following shortfall in Government revenue) and to commercial banks (following tight liquidity in the market early in 2012). The lending all took place at an unprecedented higher Central Bank Rate (CBR) that was at 18 percent from December 1, 2011. Meanwhile, higher than expected income from foreign currency sales in the wake of depreciating local currency in the last quarter of 2011 also contributed to the higher income in 2012. However, an increase in monetary policy expenses following tightening of monetary policy to stabilize the local currency in the second half of 2011 moderated the positive income performance. Overall, the financial performance of the Bank has over the last two years been about 60 percent lower than normal owing to the effects of the sluggish World economy which has adversely affected the Bank's foreign currency investment income. On account of the improved net operating surplus, the Board of Directors recommended a dividend of Ksh 2.5 billion to be paid to the Treasury compared with nil in the year to June 2011.

DIBAJI

Uchumi wa ulimwengu ulikua kwa asilimia 3.9 katika mwaka wa 2011 kutoka ukuaji wa asilimia 5.1 katika mwaka wa 2010. Kudorora huku kulitokana na kuendelea kupungua kwa viwango vya madeni ya mabenki, viwango vya juu vya ukosefu wa ajira, mabadiliko kwenye sera za bajeti na kuwepo kwa viwango vya juu vya madeni (ya serikali) ya fedha za kigeni katika mabenki hasa katika eneo la Bara Ulaya.

Uchumi wa Kenya ulikua kwa kiwango wastani katika mwaka wa 2011 na kupata ukuaji wa pato la taifa (GDP) kwa asilimia 4.4 ukilinganishwa na upanuzi wa asilimia 5.8 mwaka wa 2010 na asilimia 2.7 mwaka wa 2009. Kilimo na misitu, utoaji wa umeme na usambazaji wa maji, uchimbaji wa madini na matimbo, sekta ya kifedha, biashara za rejareja na zile za jumla, ukarabati na uchukuzi na mawasiliano uliendelea kuimarisha ukuaji wa uchumi. Katika miezi mitatu ya kwanza ya mwaka wa 2012 uchumi ulidorora na kukua kwa kiwango cha asilimia 3.5 ikilinganishwa na ukuaji wa asilimia 4.9 katika kipindi kama hicho cha mwaka wa 2011. Pato la taifa (GDP) linakadiriwa kuimarika kwa asilimia 5.2 katika mwaka wa 2012.

Sera za kifedha zililenga kuafikia na kudumisha kiwango cha chini cha mfumuko wa bei. Kiwango cha mfumuko wa bei kilipungua kutoka asilimia 18.31 katika mwezi wa Januari 2012 hadi asilimia 10.1 katika mwezi wa Juni 2012, kutokana na kupungua kwa bei za vyakula na mafuta na msimamo bora wa sera za kifedha. Kiwango cha wastani cha mfumuko wa bei, hata hivyo, kiliongezeka hadi asilimia 16.0 katika mwezi wa Juni 2012 kutoka kwa asilimia 15.5 katika mwezi wa Januari 2012 na asilimia 6.9 katika mwezi wa Juni 2011.

Mkazo wa sera za kifedha ulianza mwezi wa Machi 2011 na ukatumika hadi mwezi wa Juni 2012 ili kuthibiti mfumuko humu nchini. Usambazaji wa hela nchini wa M3 uliongezeka kwa asilimia 15.5 katika miezi kumi na miwili hadi Juni 2012 kutoka asilimia 19.3 katika mwezi wa Septemba 2011 na hifadhi ya pesa ikaongezeka kwa asilimia 17.6 katika mwezi wa Juni 2012; dhidi ya kiwango cha ukuaji kilicholengwa cha asilimia 18.7 na asilimia 14.2, mtawalia. Kupanuliwa kwa M3 katika miezi kumi na miwili hadi Juni 2012 kulionekana katika ukuaji imara wa jumla wa rasilimali za kigeni kwenye sekta ya benki.

Kiwango cha riba cha Benki Kuu ya Kenya (CBR) kiliendelea kuashiria mwelekeo wa sera za kifedha. Mwanzoni mwa mwaka wa kifedha wa 2011/2012, kamati inayohusika na sera za fedha (MPC) ilitekeleza mtazamo wa hatua kwa hatua kwa kupandisha kiwango cha CBR kwa alama 75 za kimsingi kutoka asilimia 6.25 katika mwezi wa Julai 2011 mpaka asilimia 7.0 katika mwezi wa Septemba 2011. Hatari zilizoendelea kuthihirika za mfumuko wa bei na kuimarika kwa kiwango cha ubadilishaji kilichochea MPC kuongeza kiwango cha CBR kwa alama 400 zaidi hadi asilimia 11.0 katika mwezi wa Oktoba 2011, ikifuatiwa na alama za kimsingi 550 hadi asilimia 16.5 katika mwezi wa Novemba 2011 na baada ya hapo alama zaidi za kimsingi 150 hadi kufikia asilimia 18 katika mwezi wa Desemba 2011. Ili kuimarisha mipango ya sera ya kifedha, mahitaji ya uhifadhi wa fedha yaliongezwa kutoka asilimia 4.75 hadi asilimia 5.25 katika mwezi wa Desemba 2011.

Kiwango cha wastani cha riba cha benki kwa benki kilipanda haraka kutoka asilimia 8.61 katika mwezi wa Julai hadi asilimia 28.9 katika mwezi wa Novemba 2011 na baadaye, kikashuka hadi asilimia 17.9 katika mwezi Juni 2012. Kiwango cha riba cha hawala za kifedha cha siku 91 kiliendelea kuongezeka kwa muda wa miezi saba katika mwaka wa kifedha 2011/2012 kabla ya kushuka katika sehemu ya pili ya 2011/2012. Viwango vya ukopeshaji viliongezeka kutoka asilimia 14.14 katika mwezi wa Julai 2011 hadi asilimia 20.41 katika mwezi wa Juni 2012. Hali kadhalika, kiwango cha wastani cha kuweka pesa kwenye benki kilipanda kutoka asilimia 3.85 katika mwezi wa Julai 2011 hadi asilimia 7.88 katika mwezi wa Juni 2012. Kuenea kwa viwango vya ukopeshaji vya benki za kibiashara ulibakia katika ngazi ya asilimia 10, huku ukidhihirisha hatari ambayo ilizikumba benki nyingi kwenye nyanja ya kiuchumi.

Shughuli za serikali za kifedha ziliimarika na kuafikia kiwango kidogo cha nakisi ya bajeti ya shilingi bilioni 181.5 (sawa na asilimia 5.5 ya pato la taifa) katika mwaka wa kifedha 2011/12 ikilinganishwa na asilimia 7.2 ya pato la taifa kwenye bajeti. Mapato ya serikali yaliongezeka kwa shilingi bilioni 54.9 hadi shilingi bilioni 734.4 katika mwaka huo lakini hayakufikia malengo kwa sababu ya utendakazi chini ya kiwango kinachotakikana katika mifumo yote ya mapato. Matumizi ya serikali na ukopeshaji halisi uliongezeka kwa asilimia 12.1 hadi shilingi bilioni 915.9, lakini hayakufikia malengo yaliyotazamiwa kwa sababu ya utwekaji mdogo wa matumizi ya maendeleo. Sehemu ya bajeti ya maendeleo iliongezeka kutoka asilimia 28.8 katika mwaka wa biashara 2010/2011 mpaka asilimia 30.2 katika mwaka wa kifedha 2011/2012, sambamba na malengo ya kifedha ya kutoa kipaumbele kwa miundombinu ya maendeleo ili kutumika katika uwekezaji ya kibinafsi.

Shilingi ya Kenya iliimarika dhidi ya sarafu zingine zinazotumika ulimwenguni katika mwaka wa kifedha 2011/2012. Shilingi ya Kenya iliimarika kwa asilimia 1.8 dhidi dola ya kimarekani ikibadilishwa kwa kiwango cha wastani cha shilingi 84.4 katika mwezi wa Juni 2012 ikilinganishwa na shilingi 89.0 mwezi Juni 2011. Haya yanaonyesha msimamo thabiti wa sera ya kifedha ulioidhinishwa na MPC katika kipindi cha mwaka huo. Ziada katika salio la malipo iliongezeka kutoka dola milioni 261 za Marekani katika mwaka wa 2011/2012 hadi dola milioni 841 za Marekani katika kipindi cha miezi kumi na miwili mpaka mwezi Juni 2012.

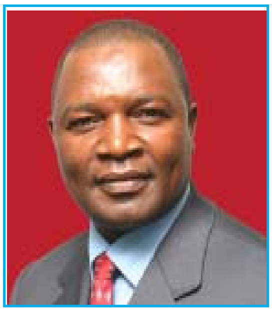
Hata hivyo, mapungufu katika akaunti ya kifedha ya kutoa pesa wakati wowote iliongezeka kwa asilimia 39 hadi dola milioni 3,895 za Marekani kutoka dola milioni 2,800 za mwaka huo wa kifedha hadi mwezi Juni 2011. Nakisi hiyo ilifadhiliwa na mitaji ya muda mfupi kutoka nchi za kigeni. Katika kipindi cha mwaka unaofanyiwa utathmini, Benki Kuu iliongeza umiliki wake wa hifadhi ya sarafu za kigeni kutoka dola milioni 4,142 za Marekani (sawa na malipo ya maagiza ya miezi 3.8) kufikia mwezi Juni 2011 mpaka dola milioni 5,283 za Marekani (sawa na malipo ya maagiza ya miezi 4.3) kufikia Juni 2012. Kuongezeka kwa hifadhi rasmi kulifikiwa kupitia ununuzi kati ya benki mbali mbali humu nchini, malipo ya mkopo unaofadhiliwa na Shirika la Fedha Duniani (2011-2014) na ulipaji wa mkopo wa muungano kwa serikali wa dola milioni 600 za Marekani katika mwezi wa Juni 2012.

Sekta ya benki ilipata matokeo bora ya kiutendakazi katika mwaka wa kifedha 2011/2012. Jumla ya rasilimali ya sekta hii iliongezeka kwa asilimia 15.8 kutoka shilingi bilioni 1,873.8 katika mwezi wa Juni 2011 hadi shilingi bilioni 2,195 katika mwezi wa Juni 2012. Vipengele muhimu vya maelezo ya hesabu kwenye loho vilikuwa vile vya mikopo na advansi ama karadha, dhamana za kiserikali na mipangilio iliiyofikia asilimia 56.6, 19.5 and 7.3 ya jumla ya mali, mtawalia. Mikopo na karadha iliongezeka kwa asilimia 19.0 hadi kufikia shilingi bilioni 1,289 katika mwezi Juni 2012. Mikopo ambayo haijalipiwa kwa kipindi kinachostahili (NPLs) ilishuka kwa asilimia 1.4 hadi shilingi bilioni 57.5 katika mwezi wa Juni 2012. Hivyo basi, kushusha ngawira ya jumla NPLs hadi mikopo ya jumla kutoka asilimia 5.4 hadi asilimia 4.5 wakati wa kipindi hicho cha mwaka huo wa ukaguzi. Pesa zillizowekwa benki na wateja, sawa na asilimia 75.5 ya jumla ya madeni yaliyokopwa, ziliongezeka kwa asilimia 21.4 hadi shilingi bilioni 1,667 mwezi wa Juni 2012 kutokana na kuongezeka kwa matawi ya benki, malipo na risiti za mahuruji. Maendeleo mengine katika sekta ya benki ni pamoja na ongezeko la mabenki kupata historia kuhusu ulipaji wa madeni na wateja, hasa ile ya kutoa mikopo kwa wateja wake; maidhinisho ya ziada kwenye benki ili kuendeleza mifumo ya benki ya kutumia mawakala; na kutoa leseni za asasi ama benki ndogo za utoaji wa mikopo kwa wananchi wa kima cha chini.

Katika kipindi cha mwaka hadi mwezi Juni 2012, Benki Kuu ya Kenya iliandikisha mapato ya uendeshaji biashara wa jumla ya milioni 23,154 (ikilinganishwa na shilingi milioni 10,551 mwaka wa 2011) ambayo ilihusisha ongezeko la shilingi milioni 7,530 (ikilinganiswa na shilingi milioni 13,698 mwaka wa 2011) kutoka kwa ukadiriaji wa mali zisizotumika. Jumla ya matumizi yalifikia shilingi milioni 8,554 (ikilinganishwa na shilingi milioni 8,560 katika mwaka wa 2011) na ilihusisha gharama za matumizi ya shilingi milioni 7,674 na matumizi ya sera za kifedha ya shilingi milioni 880 (ikilinganishwa na shilingi milioni 8,530 na shilingi milioni 30 katika mwaka wa 2011, mtawalia). Kwa kuyaakisi matokeo haya, benki iliandikisha hasara halisi ya shilingi milioni 13,638 ikiwa ni pamoja na hasara ya shilingi milioni 28,238 ambayo haikukadiriwa ya sarafu za kigeni. Hali ya ulinganishi ya mwaka uliotangulia ilionyesha ongezeka halisi la shilingi milioni 40,925 (ikiwa ni pamoja na faida iliyotokana na ubadilishaji wa sarafu za kigeni ya shilingi milioni 38,934). Hasara isiyokadirika ya sarafu za kigeni katika mwaka huo hadi mwezi wa Juni 2012 ilichangiwa na kuimarika kwa shilingi ya Kenya dhidi ya sarafu maalumu zinazobadilishika hasa mwishoni mwa mwaka, ikilinganishwa na thamani iliyokuwepo kufikia tarehe 30 mwezi Juni 2011. Bila kupigia darubini hasara na faida ya mali zisizoweza kukadirika, Benki iliandikisha ongezeko halisi la juu la shilingi milioni 7,070 ikilinganishwa na shilingi milioni 622 kwenye mwaka uliotangulia. Ongezeko hili ni zaidi ya mapato ya kawaida ya mwaka wa 2012 na lilisababishwa na kutoa mikopo kwa serikali (kutokana na kupungua kwa mapato ya Serikali) na kwa benki za kibiashara (kufuatia mikingamo ya kifedha katika mwaka wa 2012). Wakati huo huo, kiasi cha juu cha mapato ya mauzo ya fedha za kigeni katika kipindi kilichoshuhudia kudorora kwa thamani ya sarafu ya hapa nchini kwenye robo ya mwisho ya mwaka wa 2011, hali kadhalika, ilichangia kuongezeka kwa mapato ya mwaka wa 2012.

Hata hivyo, ongezeko la matumizi katika sera ya kifedha, kwa lengo la kudhibiti mfumko na thamani ya sarafu ya Kenya katika nusu ya pili ya mwaka wa 2011, ilisawazisha matokeo ya mapato chanya. Kwa ujumla, matokeo ya kifedha ya Benki kwa kipindi cha miaka miwili iliyopita imekuwa ya takribani asilimia 60 kiwango chini kuliko hali ya kawaida, kutokana na kuzorota kwa uchumi wa ulimwengu ambao uliathiri pakubwa mapato ya sarafu za kigeni ya uwekezaji wa Benki. Kutokana na uimarikaji wa ongezeko halisi la mapato ya utendakazi, Bodi ya Wakurugenzi ilipendekeza mgao wa shilingi bilioni 2.5 ulipwe kwa Wizara ya Fedha, ikilinganishwa na mgao kapa wa mwaka hadi kufikia mwezi wa Juni mwaka 2011.

BOARD OF DIRECTORS

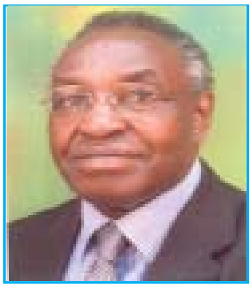


PROF. NJUGUNA NDUNG'U (CBS)
Governor and Chairman
Central Bank of Kenya

MR. JOSEPH M. KINYUA
Permanent Secretary,
Ministry of Finance

DR. HARON SIRIMA (OGW)
Deputy Governor
Central Bank of Kenya

MS. VIVIENNE A.Y. APOPO



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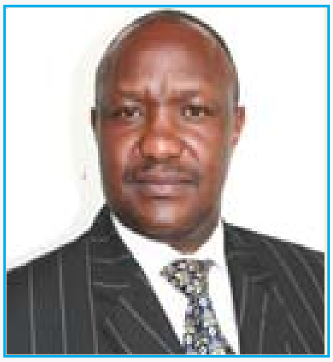

MR. WILLIAM NYAGAKA
Director, Internal Audit & Risk Management

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Governor, Chairman

Dr. Haron Sirima (OGW)
Deputy Governor, Vice-Chairman

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PS, Treasury
Treasury Representative

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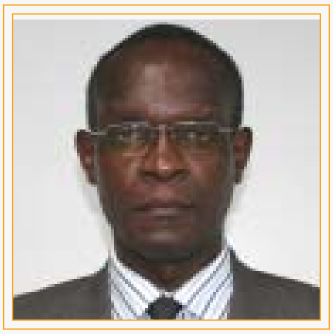

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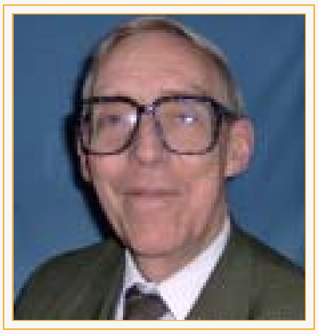


Prof. Terry C. I. Ryan
Member

Mrs. Farida Abdul
Member

Mr. John Birech
Member

Human Resources Help Desk: "ASK HR"

The Bank continually strives to improve services to both its internal and external clients. To this end, on July 1, 2011, HR in collaboration with IMS launched an HR Help Desk icon labelled ASK HR, an online HR support facility on the intranet enabling staff to raise and receive swift responses to queries on any HR related issues.

The National Manpower Survey

In an effort to support one of the key flagship projects of the country's long-term development blue print, the Vision 2030, the Bank participated in a National Manpower Survey organised by the Ministry of Labour in collaboration with Kenya National Bureau of Statistics. The purpose of the survey was to take stock of skills in the labour market to facilitate the proper planning, development and utilization of existing skills in various sectors of the economy.

CBK's Participation in Agricultural Society of Kenya Shows

The Bank continues to participate in shows organized by the Agricultural Society of Kenya. In this regard, the Bank teamed up with other financial sector regulators to showcase its services and products in the Nairobi, Mombasa, Kisumu and Eldoret shows. The Bank has also initiated participation in other ASK shows organized in the towns where Currency Centres have recently been opened. The last engagement was at the Meru ASK Show held from May 30 to June 2, 2012.

Review of the House and Development Loans Schemes

In line with the Bank's commitment to improving the general welfare of staff, the Board of Directors approved a review of the House and Development Loans Schemes by increasing the zones/ municipalities where staff can purchase residential properties to include Thika, Ruiru, Juja, Athi River, Kitengela, Ngong, Kiserian, Ong'ata Rongai, Kikuyu, Kiambu and Machakos and made changes to the development loan to eliminate queuing for the facility by staff.

Year 2011 Inter-Branches/Financial Institutions (KIB) Sports Competitions

The Bank, being a leading financial institution and key member of the Kenya Institute of Bankers (KIB), participated in the Annual Inter-Banks and Financial Institutions Games held from September 10 to 17, 2011. This was the 27th edition of the games which have now become a very important annual event in the calendar of the KIB. The event enables members of the banking community to interact in a friendly, social and sporting atmosphere.

Appointment of Deputy Governor

Following the retirement of Dr. Hezron Nyangito, the immediate former Deputy Governor from the Bank, His Excellency the President, Hon. Mwai Kibaki, CGH, MP appointed Dr. Haron Sirima as the new Deputy Governor of the Central Bank of Kenya with effect from October 24, 2011.

Corporate Participation – Standard Chartered Nairobi Marathon 2011

In a bid to reinforce the Bank's Corporate Social Responsibility (CSR) and build the corporate brand as well as enhance staff welfare initiatives and supplement change management efforts aimed at building team work for developing a results oriented culture, the Bank sponsored corporate participation in the 2011 Standard Chartered Nairobi Marathon.

Conferment of Awards and Honours on Jamuhuri Day

During the last Jamhuri Day celebrations held on December 12, 2011, the Bank was honoured when His Excellency the President, Hon. Mwai Kibaki, CGH, MP conferred four members of staff awards and honours for distinguished service and outstanding contribution to the nation.

Bank Organizational Development Review (ODR)

The Bank engaged a consultant to undertake an organizational development review to ensure that its skills are relevant, suitably aligned, appropriate and responsive to the changing environment of global banking. The outcome of the exercise will be a revised organization structure based on best practice accompanied by requisite job descriptions/job specifications and grades to support the new structure.

Establishment of the Financial Reporting Centre

The Anti-Money Laundering Advisory Board, which is tasked with the mandate of advising the Financial Reporting Centre (FRC), the body established pursuant to Section 21 of the Proceeds of Crime and Anti-Money Laundering Act, 2009, approved the operationalization of the Centre beginning from April 12, 2012. Consequently, the Ministry of Finance and the Central Bank of Kenya provided the FRC with the initial office space and staff. In this regard, on April 16, 2012, the Bank seconded four members of staff, including an interim director, to commence operations of the FRC.

1. WORLD ECONOMY

The world economic situation and prospects continues to be challenging. This follows a marked slowdown in the global economic growth in 2011. According to the April 2012 update of the World Economic Outlook by the International Monetary Fund, the world economy grew by 3.9 percent in 2011 compared with 5.1 percent in 2010. The slow down was mainly attributed to continued deleveraging by banks, high unemployment rate, fiscal austerity responses and bank exposure to sovereign debts especially in the Euro area. In the baseline outlook, global recovery remains weak in 2012, but there are some indications of recovery in 2013. World output is projected to slowdown further to 3.5 percent in 2012 because of weak activity during the second half of 2011 and the first half of 2012. However, this is expected to bottom-up to 4.1 percent in 2013 (Table 1.1).

TABLE 1.1: ACTUAL, AND PROJECTED OUTPUT OF SELECTED COUNTRIES/REGIONS 2010 - 2013

Country/Region	2010	2011	2012	2013
World	5.3	3.9	3.5	4.1
Advanced economies	3.2	1.6	1.4	2.0
USA	3.0	1.7	2.1	2.4
Euro area	1.9	1.4	- 0.3	0.9
UK	2.1	0.7	0.8	2.0
Emerging and developing economies	7.5	6.2	5.7	6.0
Developing Asia	9.7	7.8	7.3	7.9
China	10.4	9.2	8.2	8.8
India	10.6	7.2	6.9	7.3
Latin America and the Caribbean	6.2	4.5	3.7	4.1
Brazil	7.5	2.7	3.0	4.1
Sub-Saharan Africa	5.3	5.1	5.4	5.3
South Africa	2.9	3.1	2.7	3.4

Source: IMF, Update World Economic Outlook Database Apr 2012

Global recovery remains unbalanced with weak recovery in advanced economies and relatively strong recovery in the emerging and developing economies. Growth in Advanced economies is expected to decelerate to 1.4 percent in 2012 from 1.6 percent in 2011. This slowdown reflects problems in Europe; the euro area is still projected to go into a mild recession in 2012 as a result of the sovereign debt crisis and a general loss of confidence, the effects of bank deleveraging on the real economy, and the impact of fiscal consolidation in response to market pressures.

Real GDP growth in the emerging and developing economies is projected to decelerate from 6.2 percent in 2011 to 5.7 percent in 2012 and to recover to 6 percent in 2013, supported by easing of macroeconomic policies and strengthening of foreign demand.

Sub-Saharan Africa continues to record strong economic growth, despite the weaker global economic environment. The region's output rose by 5.1 percent in 2011, with growth set to increase slightly in 2012, helped by still-strong commodity prices, new natural resources exploitation, and improved domestic conditions. However, the unstable commodity prices and the weaknesses in advanced economies heighten downside risks in a number of SSA countries.

Capital Flows

Net capital flows to developing countries increased by 68 percent in 2010 to US$ 1.1 trillion from US$ 675 billion in 2009. The rebound in capital flows was concentrated in East Asia and the Pacific, Europe and Central Asia and Latin America and the Caribbean region where net capital flows in 2010 rose by an average of 90 percent, 66 percent and 83 percent, respectively. Net capital flows to SSA region rose by 15 percent while net flows to the Middle East and North African region (MENA) declined by 10 percent to US$ 26.2 billion (Table 1.2).

TABLE 1.2: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES 2005-2010

USD Billion	2005	2006	2007	2008	2009	2010
by region:						
East Asia and the Pacific	209	238.6	301.6	211.7	235.3	447.1
Europe and Central Asia	135.3	248.9	424.1	313	104	172.8
Latin America and the Caribbean	93.8	68.7	208.3	181.9	173.7	318.6
Middle East and North Africa	19.4	14.5	29.6	21	29.2	26.2
South Asia	28.7	77.1	116.3	64.8	86.2	111.6
Sub-Saharan Africa	33.6	38.7	53.4	42.6	46.4	53.4
Total Net private and official inflows	**519.8**	**686.5**	**1133.3**	**835**	**674.8**	**1129.7**

Source: Global Development Finance (2012)

Net equity flows which comprise FDI flows and portfolio flows accounted for 56 percent of the total capital flows and increased by 24 percent to US$ 634.5 billion in 2010. Net Foreign Direct Investment (FDI) flows to developing countries increased by 26 percent in 2010 to US$ 506 billion from US$ 400 billion in 2009. Debt related flows accounted for 44 percent of the total capital flows and increased by almost 200 percent from US$ 166 billion in 2009 to US $ 495 billion in 2010. The increase in debt flows was mainly as a result of increased net private creditors' inflows of US $ 424 billion in 2010 from US$ 86 billion. Flows from official creditors declined by 11.6 percent to US $ 71.2 billion in 2010 (Table 1.3).

TABLE 1.3: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES BY CATEGORY (US$ Billion)

	2005	2006	2007	2008	2009	2010
Net Capital Flows	**519.7**	**686.4**	**1133.2**	**835.1**	**674.9**	**1129.7**
of which						
1. Net equity inflows	382	495.2	667.1	570.7	508.7	634.5
Net FDI inflows	314.5	387.5	534.1	624.1	400	506.1
Net portfolio equity inflows	67.5	107.7	133	-53.4	108.8	128.4
2. Net debt flows	137.7	191.2	466.1	264.4	166.2	495.2
Official creditors	-64.3	-69	1.5	29.5	80.5	71.2
Private creditors	202	260.2	464.6	234.9	85.7	424

Source: Global Development Finance (2012)

Remittances to Developing Countries

Remittances to developing countries increased by 12.1 percent to US$ 372 billion in 2011 from US$ 332 billion in 2010. Remittance flows proved to be resilient during the global financial crisis and had become even more important as a source of external financing in many developing countries. The remittance flows was higher in 2011 than in 2010 for all regions with Eastern Europe and Central Asia regions accounting for the largest share of 28.8 percent (US$ 107 billion) while Sub-Saharan Africa region accounted for 6 percent (US$ 22 billion) (Table 1.4).

TABLE 1.4: REMITTANCE FLOWS TO DEVELOPING COUNTRIES: 2008-2011 (US$ billion)

	2008	2009	2010	2011[e]
Developing Countries	**324**	**308**	**332**	**372**
East Asia and Pacific	85	86	95	107
Europe and Central Asia	45	36	37	41
Latin America and Caribbean	64	57	57	62
Middle-East and North Africa	36	34	40	42
South Asia	72	75	82	97
Sub-Saharan Africa	**22**	**20**	**21**	**22**

Source: World Bank

DOMESTIC ECONOMY - OVERVIEW

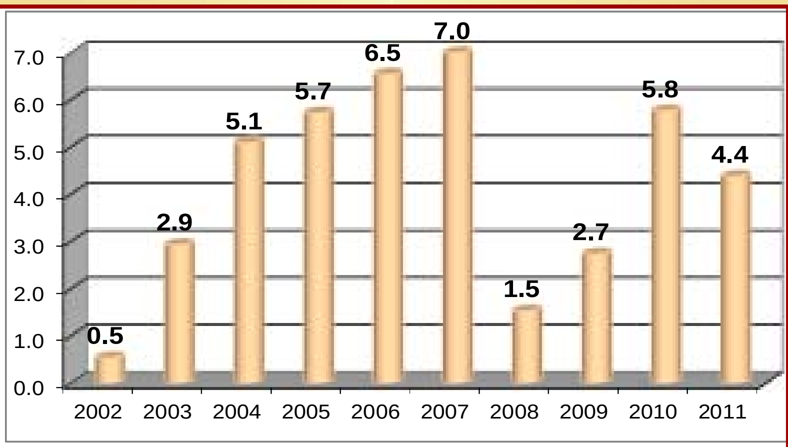
The Kenyan economy grew by 4.4 percent in 2011 compared with growth of 2.7 percent in 2009 and 5.8 percent in 2010 (Chart 2A). Real output amounted to Ksh 1,539 billion in 2011, an increase of 4.4 percent from Ksh 1,475 billion in 2010. All activities in the economy except for electricity and water, registered positive growth rates in 2011. Of the total volume produced in 2011, Agriculture and Forestry contributed 21.0 percent while Transport and Communication, Wholesale and Retail Trade, and Manufacturing contributed 12.4 percent, 10.8 percent and 9.6 percent, respectively.

The economy, however, performed sluggishly in the first three months of 2012, registering real output growth of 3.5 percent. The weak growth was attributed to adverse weather conditions which impacted negatively on agricultural output and generation of hydroelectric power; and a severe frost that affected tea and horticultural output.

2. REAL SECTOR

Kenya's gross domestic product increased by 4.4 percent in 2011 compared with growth of 5.8 percent in 2010 and 2.7 percent in 2009 (Chart 2A). The deceleration is attributed to higher fuel prices, weaker shilling and unfavourable weather conditions. Real output at market prices amounted to Ksh 1,539 billion in 2011 compared with Ksh 1,475 billion in 2010. Of the total volume produced in 2011, 21.0 percent was accounted for by Agriculture and Forestry. Other key sectors of the economy: Transport and Communication, Wholesale and Retail Trade, and Manufacturing contributed 12.4 percent, 10.8 percent and 9.6 percent to total output in 2011, respectively.

CHART 2A: REAL GDP GROWTH RATES, 2002 - 2011 (%)



Sources: Economic Survey

TABLE 2.1: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES

MAIN SECTORS	Share in 2011 Nominal GDP (%)	Share in 2011 Real GDP (%)	2005	2006	2007	2008	2009	2010	*2011
Agriculture and Forestry	***24.01***	***21.01***	299,749	312,926	320,423	307,354	299,431	318,586	323,465
Fishing	***0.50***	***0.38***	5,751	6,249	6,181	5,363	5,564	5,713	5,891
Mining and Quarrying	***0.68***	***0.47***	5,334	5,554	6,272	6,453	6,163	6,763	7,246
Manufacturing	***9.45***	***9.61***	115,699	122,953	130,673	135,291	137,060	143,263	147,989
Electricity and Water Supply	***0.86***	***2.11***	27,898	27,288	29,769	31,341	30,397	33,335	32,465
Construction	***4.13***	***3.49***	35,446	37,649	40,405	43,735	49,270	51,486	53,713
Wholesale and Retail Trade, Repairs	***10.61***	***10.80***	106,009	118,361	131,754	138,044	143,460	154,942	166,205
Hotels and Restaurants	***1.67***	***1.35***	15,572	17,894	20,814	13,298	18,993	19,796	20,792
Transport and Communication	***9.67***	***12.37***	122,243	136,306	156,845	161,615	171,994	182,181	190,382
Financial Intermediation	***6.38***	***4.23***	43,869	47,170	50,306	51,659	55,375	60,379	65,095
Real estate, Renting and Business Services	***4.45***	***5.25***	65,882	68,446	70,860	73,503	75,674	78,089	80,888
Public Administration and Defence	***5.00***	***3.14***	46,461	45,974	45,031	45,317	46,031	47,085	48,270
Education	***5.84***	***5.90***	72,908	73,188	76,257	80,771	82,952	86,651	90,873
Health and Social Work	***2.48***	***2.14***	27,249	28,075	28,983	30,035	31,352	31,786	32,896
Other Community, Social and Personal Services	***3.19***	***3.64***	45,876	47,814	49,420	50,829	52,156	53,557	55,988
Private Households with Employed Persons	***0.44***	***0.29***	4,011	4,091	4,173	4,256	4,342	4,428	4,517
less: Financial Services Indirectly Measured	***(1.05)***	***(0.77)***	(11,261)	(11,835)	(12,174)	(10,484)	(11,945)	(11,260)	(11,843)
All Industries at Basic Prices	***88.31***	***85.42***	1,028,696	1,088,103	1,155,991	1,168,382	1,198,270	1,266,782	1,314,832
Taxes less Subsidies on Products	***11.69***	***14.58***	144,088	161,367	180,855	188,882	196,117	207,981	224,474
Real GDP at market prices	***100.00***	***100.00***	1,172,784	1,249,470	1,336,846	1,357,263	1,394,387	1,474,763	1,539,306
GDP Deflator (2001 =100)			121	130	137	155	170	173	197

Growth Rates in percent

	Share in 2011 Nominal GDP (%)	Share in Real GDP in 2011 (%)	2005	2006	2007	2008	2009	2010	*2011
Agriculture and Forestry	24.01	21.01	6.9	4.4	2.4	-4.1	-2.6	6.4	1.5
Fishing	0.50	0.38	9.6	8.7	-1.1	-13.2	3.7	2.7	3.1
Mining and Quarrying	0.68	0.47	2.7	4.1	12.9	2.9	-4.5	9.7	7.1
Manufacturing	9.45	9.61	4.7	6.3	6.3	3.5	1.3	4.5	3.3
Electricity and Water Supply	0.86	2.11	0.1	-2.2	9.1	5.3	-3.0	9.7	(2.6)
Construction	4.13	3.49	7.6	6.2	7.3	8.2	12.7	4.5	4.3
Wholesale and Retail Trade, Repairs	10.61	10.80	5.5	11.7	11.3	4.8	3.9	8.0	7.3
Hotels and Restaurants	1.67	1.35	13.3	14.9	16.3	-36.1	42.8	4.2	5.0
Transport and Communication	9.67	12.37	8.9	11.5	15.1	3.0	6.4	5.9	4.5
Financial Intermediation	6.38	4.23	2.8	7.5	6.6	2.7	7.2	9.0	7.8
Real estate, Renting and Business Services	4.45	5.25	3.4	3.9	3.5	3.7	3.0	3.2	3.6
Public Administration and Defence	5.00	3.14	-1.3	-1.0	-2.1	0.6	1.6	2.3	2.5
Education	5.84	5.90	0.9	0.4	4.2	5.9	2.7	4.5	4.9
Health and Social Work	2.48	2.14	3.2	3.0	3.2	3.6	4.4	1.4	3.5
Other Community, Social and Personal Services	3.19	3.64	3.1	4.2	3.4	2.9	2.6	2.7	4.5
Private Households with Employed Persons	0.44	0.29	2.0	2.0	2.0	2.0	2.0	2.0	2.0
less: Financial Services Indirectly Measured	-1.05	-0.77	4.3	5.1	2.9	-13.9	13.9	(5.7)	5.2
All Industries at Basic Prices	88.31	85.42	5.1	5.8	6.2	1.1	2.6	5.7	3.8
Taxes less Subsidies on Products	11.69	14.58	10.2	12.0	12.1	4.4	3.8	6.0	7.9
Real GDP at market prices	100.00	100.00	5.7	6.5	7.0	1.5	2.7	5.8	4.4

* Provisional

Sources: Economic Survey 2010

AGRICULTURE

Real output from agriculture and forestry increased by 1.5 percent in 2011, a slowdown from 6.4 percent growth in 2010. The sector's contribution to real GDP also decreased from 21.6 percent in 2010 to 21.0 percent in 2011 (Table 2.1). The reduced performance in the sector in 2011 was attributed to unfavourable weather conditions and rising costs of inputs arising from higher fuel prices. Lower growth in output from agriculture was manifested in reduced production of maize, coffee, tea, horticulture, wheat and sugar.

TABLE 2.2: OUTPUT GROWTH IN KEY CROPS

	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12
Tea								
Production (Tonnes)	321,465	295,889	375,225	328,213	327,712	377,927	364,456	357,625
Annual Growth, %	*-1.8%*	*-8.0%*	*26.8%*	*-12.5%*	*-0.2%*	*15.3%*	*-3.6%*	*-1.9%*
Coffee								
Sales (Tonnes)*	51,136	47,995	50,899	39,842	53,701	34,651	30,574	41,343
Annual Growth, %	*-13.0%*	*-6.1%*	*6.1%*	*-21.7%*	*34.8%*	*-35.5%*	*-11.8%*	*35.2%*
Horticulture								
Exports (Tonnes)	167,371	186,356	218,848	283,780	244,717	248,664	258,388	234,764
Annual Growth, %	*-1.3%*	*11.3%*	*17.4%*	*29.7%*	*-13.8%*	*1.6%*	*3.9%*	*-9.1%*
Sugar Cane								
Deliveries (Tonnes)	4,731,787	5,086,359	4,953,858	3,796,562	5,392,907	5,429,438	6,039,241	5,376,060
Annual Growth, %	*3.6%*	*7.5%*	*-2.6%*	*-23.4%*	*42.0%*	*0.7%*	*11.2%*	*-11.0%*
Milk								
Intake (Million Litres)	284	352	402	397	391	495	504	501
Annual Growth, %	*17.8%*	*23.7%*	*14.3%*	*-1.2%*	*-1.6%*	*26.6%*	*1.8%*	*-0.4%*

*Jul/Jun 2011/2012 reflects data for the year to May 2012

Source: Kenya National Bureau of Statistics

Inadequate and delayed rainfall in July - December 2011 negatively impacted on agricultural production in the year to June 2012. Production of tea decreased by 2.2 percent from 364.5 thousand tonnes in July-June 2010/11 to 356.4 thousand tonnes produced in July-June 2011/12, while export of fresh horticultural crops declined from 258.4 thousand tonnes to 234.8 thousand tonnes in the same period (Table 2.2). The amount of sugar cane delivered to factories amounted to 5,376.1 thousand tonnes in July-June 2011/12 or 11.0 percent lower than 6,039.2 thousand tonnes in July-June 2010/11. The amount of raw milk delivered for processing declined marginally from 504 million litres in July-June 2010/11 to 501 million litres delivered in July-June 2011/12.

However, coffee production recovered with sales of coffee increasing from 30.6 thousand tonnes in July-June 2010/11 to 41.3 thousand tonnes in the year to May 2012.

MANUFACTURING

Real output from the manufacturing sector recorded a slower growth of 3.3 percent in 2011 compared with 5.4 percent in 2010, and this was reflected in the contribution of the sector to GDP that declined from 9.7 percent in 2010 to 9.6 percent in 2011. Available data indicate the sector's performance decelerated during the July-June 2011/12 relative to July-June 2010/11 (Table 2.3). For instance, production of cement slowed down to 3.8 percent compared to 12.6 percent in July-June 2010/11. Production of galvanized sheets increased less rapidly by 10.2 percent compared with 21.0 percent increase in July-

June 2011/12, while tonnage of processed sugar declined by 20.6 percent compared with 12.6 percent growth in July-June 2010/11. However, the units of motor vehicles assembled edged up by 14.7 percent from 5.9 percent growth in July-June 2010/11.

TABLE 2.3: PRODUCTION OF SELECTED MANUFACTURED GOODS

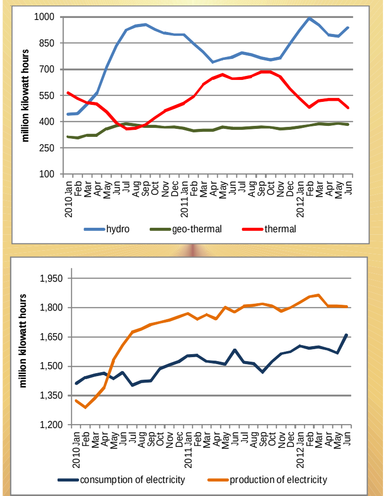
	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12
Processed Sugar								
Production (Tonnes)	507,306	504,589	474,944	530,129	536,893	507,217	572,800	454,718
Annual Growth, %	*-3.4%*	*-0.5%*	*-5.9%*	*11.6%*	*1.3%*	*-5.5%*	*12.9%*	*-20.6%*
Soft Drinks								
Production ('000 Litres)	212,388	279,234	285,993	319,850	368,957	363,501	368,134	369,587
Annual Growth, %	*34.5%*	*31.5%*	*2.4%*	*11.8%*	*15.4%*	*-1.5%*	*1.3%*	*0.4%*
Galvanised Sheets								
Production (Tonnes)	163,303	171,687	179,176	191,939	183,769	196,193	237,370	261,657
Annual Growth, %	*3.3%*	*5.1%*	*4.4%*	*7.1%*	*-4.3%*	*6.8%*	*21.0%*	*10.2%*
Cement								
Production (Tonnes)	1,975,464	2,104,918	2,370,982	2,633,494	3,123,473	3,485,639	3,926,193	4,073,845
Annual Growth, %	*22.9%*	*6.6%*	*12.6%*	*11.1%*	*18.6%*	*11.6%*	*12.6%*	*3.8%*
Assembled Vehicles								
Production (Units)	6,200	4,920	5,945	6,535	5,249	5,286	5,600	6,425
Annual Growth, %	*12.6%*	*-20.6%*	*20.8%*	*9.9%*	*-19.7%*	*0.7%*	*5.9%*	*14.7%*

Source: Kenya National Bureau of Statistics

ENERGY SECTOR DEVELOPMENTS

Total production of electricity increased by 4.0 percent to 7,287 million kilowatt hours in July-June 2011/12 from 7,006 million kilowatt hours in July-June 2010/11(Table 2.4). Production of hydro-electric sources increased by 2.3 percent to 3,505 million kilowatt hours in July-June 2011/12, while production from thermal sources increased by 7.2 percent to 2,277 million kilowatt hours in the same period (Chart 2B). The balance on the amount of electricity generated was from geo-thermal sources. Consumption of electricity increased by 4.1 percent in July-June 2011/12 from 6,056 million kilowatt hours in July-June 2010/11 to 6,302 million kilowatt hours.

CHART 2B: PERCENTAGE SHARE OF ELECTRICITY SOURCES



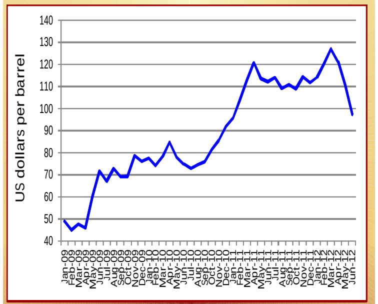
Source: Kenya Power & Lighting Co.

TABLE 2.4: PERFORMANCE OF ENERGY SUB-SECTORS

	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12
Electricity Generation								
Output (Million KWH)	5,246	5,654	6,097	6,067	5,544	5,557	7,006	7,287
Annual Growth, %	*7.9%*	*7.8%*	*7.9%*	*-0.5%*	*-8.6%*	*0.2%*	*26.1%*	*4.0%*
Of which:								
Hydro-power Generation (Million KWH)	2,868	3,025	3,300	3,488	2,849	2,155	3,427	3,505
Annual Growth, %	*-12.0%*	*5.5%*	*9.1%*	*5.7%*	*-18.3%*	*-24.4%*	*59.0%*	*2.3%*
Geo-Thermal Generation (Million KWH)	1,034	1,003	1,015	1,021	1,179	1,524	1,454	1,504
Annual Growth, %	*31.3%*	*-3.0%*	*1.1%*	*0.6%*	*15.5%*	*29.3%*	*-4.6%*	*3.5%*
Thermal (Million KWH)	1,344	1,625	1,783	1,558	1,516	1,877	2,125	2,277
Annual Growth, %	*64.5%*	*20.9%*	*9.7%*	*-12.6%*	*-2.7%*	*23.8%*	*13.2%*	*7.2%*
Consumption of Electricity (Million KWH)	4,351	4,606	4,966	5,243	5,328	5,602	6,056	6,302
Annual Growth, %	*7.0%*	*5.8%*	*7.8%*	*5.6%*	*1.6%*	*5.1%*	*8.1%*	*4.1%*

Sources: Kenya National Bureau of Statistics

CHART 2C: SAUDI ARABIAN CRUDE OIL PRICE



Source: Ministry of Energy

International crude oil prices remained high through most of July-June 2011/12 (Chart 2C). The price of murban adnoc crude oil imported to Kenya increased from US$ 112.2 per barrel in June 2011 to US$ 127.0 per barrel in March 2012 before declining to US$ 97.4 per barrel in June 2012.

BUILDING AND CONSTRUCTION

Cement consumption, a key indicator for building and construction showed improved performance during the period July-June 2011/12 compared with the same period in 2010/11. Consumption of cement increased from 3,302,747 metric tonnes in the year to June 2011 to 3,460,994 metric tonnes in the year to June 2012, an increase of 4.8 percent.

TRANSPORT AND COMMUNICATION

Performance in the transport sector improved in the July-June 2011/12 compared with performance recorded in the same period 2010/11. The number of passengers passing through the Jomo Kenyatta International Airport, Nairobi increased by 23.5 percent compared with 35.7 percent a year earlier. In absolute terms the flow increased from 3,585,897 in July-June 2010/11 to 4,416,420 in July-June 2011/12. The volume of fuel put through the Kenya Pipeline increased by 9.3 percent to 4,536.1 million litres in July-June 2011/12 (Table 2.5).

TABLE 2.5: PERFORMANCE OF TRANSPORT SUB-SECTORS

Activity	Jul/Jun 2004/05	Jul/Jun 2005/06	Jul/Jun 2006/07	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12
Passengers through JKIA								
Total passenger flows	2,613,544	2,802,707	3,010,624	2,866,801	2,866,915	2,681,851	3,585,897	4,416,420
Number of incoming passengers	1,292,399	1,401,225	1,509,378	1,415,364	1,424,993	1,335,443	1,811,770	2,219,345
Growth %	17.81%	8.42%	7.72%	-6.23%	0.68%	-6.28%	35.67%	22.50%
Number of outgoing passengers	1,321,145	1,401,482	1,501,246	1,451,437	1,441,922	1,346,408	1,774,127	2,197,075
Growth %	18.91%	6.08%	7.12%	-3.32%	-0.66%	-6.62%	31.77%	23.84%
Throughput by Kenya Pipeline								
Output ('000 litres Equivalent)	3,459,298	3,627,232	3,963,076	3,873,855	4,058,727	4,317,439	4,149,757	4,536,099
Output Growth %	*11.83%*	*4.85%*	*9.26%*	*-2.25%*	*4.77%*	*6.30%*	*-3.88%*	*9.31%*

Sources: Kenya Ports Authority, Kenya Pipeline and Kenya National Bureau of Statistics

TOURISM

The number of tourists arriving in Kenya in July - June 2011/12 rose by 10.3 percent compared with 13.7 percent growth in the previous year. The number of tourists arriving through the Jomo Kenyatta International Airport (JKIA) accounted for 83.9 percent of the tourist arrival, while the Moi International Airport, Mombasa (MIAM) accounted for 16.4 percent (Table 2.6). The number of visitors arriving aboard cruise ships was 270 in July-June 2011/12. The slowdown in growth in total tourist arrivals in 2011/12 reflected slower growth in arrivals from Europe and Asia of 4.5 percent and 3.6 percent, respectively, in 2011/12 compared with growths of 14.1 percent and 10.1 percent in 2010/11.

CHART 2D: TOURIST ARRIVALS

Source: Kenya Tourist Board

TABLE 2.6: TOURIST ARRIVALS BY POINT OF ENTRY

	FY 2004/05	FY 2005/06	FY 2006/07	FY 2007/08	FY 2008/09	FY 2009/10	FY 2010/11	FY 2011/12
Cruise ships	5,615	6,161	5,849	3,531	15,518	287	586	270
Growth %	*172.18%*	*9.72%*	*-5.06%*	*-39.63%*	*339.48%*	*-91.87%*	*104.18%*	*-53.92%*
JKIA	553,437	637,545	731,252	667,640	691,244	819,843	913,789	1,070,776
Growth %	*33.98%*	*15.20%*	*14.70%*	*-8.70%*	*3.54%*	*22.80%*	*11.46%*	*17.18%*
MIAM	194,572	243,425	273,877	179,285	156,991	201,611	247,032	209,842
Growth %	*20.62%*	*25.11%*	*12.50%*	*-34.54%*	*-12.43%*	*12.45%*	*22.53%*	*-15.05%*
Total	753,624	884,728	1,010,978	850,456	863,753	1,021,741	1,161,407	1,280,888
Growth %	*30.74%*	*17.40%*	*14.28%*	*-19.40%*	*1.56%*	*20.14%*	*13.67%*	*10.29%*

FY - Fiscal year
Source: Kenya Tourist Board

USE OF AVAILABLE RESOURCES

Total resources available to the economy measured as gross national disposable income increased from 106.7 percent of GDP in 2010 to 108.7 percent of GDP in 2011 (Table 2.7). Most of these resources were spent on final consumption, which amounted to 95.5 percent of GDP in 2011 compared with 95.4 percent of GDP in 2010. The increase in total consumption was attributed to the Government, whose share increased from 17.6

percent of GDP in 2010 to 17.8 percent of GDP in 2011. The share of private consumption however declined from 77.8 percent of GDP in 2010 to 77.7 percent of GDP in 2011. The share of gross domestic investment in GDP increased from 19.8 percent in 2010 to 20.9 percent in 2011. Gross national savings as a percent of GDP increased from 11.3 percent in 2010 to 13.2 percent in 2011. The Savings-Investment gap therefore narrowed from 8.5 percent of GDP in 2010 to 7.7 percent of GDP in 2011.

In the external sector, the share of exports of goods and services in GDP increased from 27.8 percent in 2010 to 28.7 percent in 2011, while the share of imports of goods and services increased by a wider margin from 40.1 percent to 45.4 percent in the same period. The current account deficit as a percent of GDP therefore widened from 5.6 percent in 2010 to 7.9 percent in 2011.

TABLE 2.7: USE OF RESOURCES (KSH MILLION)

	2006	2007	2008	2009	2010	2011
Gross national disposable income	1,747,428	1,966,957	2,265,727	2,538,760	2,720,593	3,289,330
Net current transfers (T R(F))	129,916	143,152	161,265	174,702	182,465	273,954
Gross national income	1,617,512	1,823,805	2,104,462	2,364,058	2,538,128	3,015,376
Net factor income payments (Y(f))	-5,053	-9,706	-3,127	- 2,926	- 11,697	- 9,406
Gross domestic product (at market prices)	1,622,565	1,833,511	2,107,589	2,366,984	2,549,825	3,024,782
Total Consumption (C)	1,507,708	1,711,521	1,930,913	2,233,429	2,432,835	2,888,670
Government consumption - C(g)	285,056	327,918	347,262	383,847	449,339	538,541
Private consumption - C(p)	1,222,652	1,383,603	1,583,651	1,849,582	1,983,496	2,350,129
Gross domestic investment (I)	291,209	348,850	405,477	471,476	504,489	632,519
Gross fixed capital formation	309,592	355,090	409,597	465,111	518,504	608,982
Increase/Decrease in stocks	-18,383	-6,240	-4,120	6,365	-14,015	23,537
Exports of goods and nfs (X)	439,906	490,987	581,806	571,305	709,209	869,222
Imports of goods and nfs (M)	-613,856	-691,220	-879,821	-886,480	-1,021,873	-1,374,101
Discrepancy	-2,401	-26,627	69,214	-22,745	-74,834	8,471
GDP deflator (2001=100)	129.86	137.15	155.28	169.75	172.90	196.50
Real GDP	1,249,470	1,336,846	1,357,263	1,394,387	1,474,763	1,539,306
Real GDP growth (annual in %)	6.30%	6.99%	1.53%	2.74%	5.76%	4.38%
Gross National savings	239,720	255,436	334,814	305,331	287,758	400,660
Gross Domestic Savings	109,804	112,284	173,549	130,629	105,293	126,706
Total National Balance(S-I)	-51,489	-93,414	-70,663	-166,145	-216,731	-231,859
CAB (X-M+Y(f)+TR(f))	-49,087	-66,787	-139,877	-143,399	-141,896	-240,331
Discrepancy	-2,402	-26,627	69,214	-22,746	-74,835	8,472
CAB + DISCREPANCY	-51,489	-93,414	-70,663	-166,145	-216,731	-231,859
Kenya - National Accounts						
In shares of GDP	2006	2007	2008	2009	2010	2011
Gross national disposable income	107.70%	107.28%	107.50%	107.26%	106.70%	108.75%
Net current transfers (T R(f))	8.01%	7.81%	7.65%	7.38%	7.16%	9.06%
Gross national income	99.69%	99.47%	99.85%	99.88%	99.54%	99.69%
Net factor income payments (Y(f))	-0.31%	-0.53%	-0.15%	-0.12%	-0.46%	-0.31%
Gross domestic product (GDP)						
Gross Domestic Product (expend)						
Total Consumption (C)	92.92%	93.35%	91.62%	94.36%	95.41%	95.50%
Government consumption - C(g)	17.57%	17.88%	16.48%	16.22%	17.62%	17.80%
Private consumption - C(p)	75.35%	75.46%	75.14%	78.14%	77.79%	77.70%
Gross domestic investment (I)	17.95%	19.03%	19.24%	19.92%	19.79%	20.91%
Gross fixed capital formation	19.08%	19.37%	19.43%	19.65%	20.33%	20.13%
Increase/Decrease in stocks	-1.13%	-0.34%	-0.20%	0.27%	-0.55%	0.78%
Exports of goods and services (X)	27.11%	26.78%	27.61%	24.14%	27.81%	28.74%
Imports of Goods and services (M)	-37.83%	-37.70%	-41.75%	-37.45%	-40.08%	-45.43%
Gross National savings	14.77%	13.93%	15.89%	12.90%	11.29%	13.25%
Gross Domestic Savings	6.77%	6.12%	8.23%	5.52%	4.13%	4.19%
Total National Balance(S-I)	-3.2%	-5.1%	-3.4%	-7.0%	-8.5%	-7.7%
Trade Balance (TB=X-M)	-10.7%	-10.9%	-14.1%	-13.3%	-12.3%	-16.7%
CAB (X-M+Y(f)+TR(f))	-3.0%	-3.6%	-6.6%	-6.1%	-5.6%	-7.9%
CAB + DISCREPANCY	-3.2%	-5.1%	-3.4%	-7.0%	-8.5%	-7.7%

Source: Economic Survey, various issues, Kenya National Bureau of Statistics

MONETARY POLICY MANAGEMENT
3. INFLATION

The Kenya consumer price index (CPI) rose by 10.05 percent to 133.1 in June 2012 from 120.9 in June 2011 (Table 3.1). Taking into account price changes throughout the year, the index rose on average by 15.97 percent by June 2012 compared with an annual average increase of 6.88 percent in June 2011.

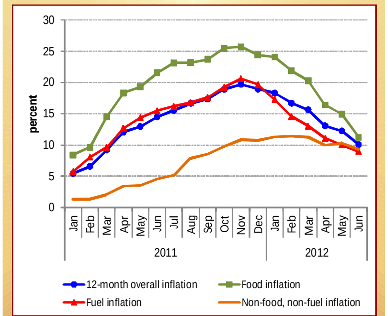
TABLE 3.1: CPI, 12-MONTH AND ANNUAL AVERAGE INFLATION (%)

	2011							2012					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Kenya CPI, Feb 2009=100	**120.9**	**122.4**	**124.0**	**125.2**	**127.2**	**129.1**	**130.1**	**130.8**	**130.8**	**132.5**	**133.7**	**134.1**	**133.1**
12-month overall inflation, percent	14.48	15.53	16.67	17.32	18.91	19.72	18.93	18.31	16.69	15.61	13.06	12.22	10.05
Annual average inflation, percent	6.88	7.88	9.00	10.18	11.49	12.82	14.02	15.10	15.93	16.45	16.50	16.40	15.97

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

Overall 12-month inflation decreased from 18.31percent in January 2012 to 10.1 percent in June 2012. The slowdown in overall 12-month inflation in the year to June 2012 largely reflected easing in both food and fuel inflation as shown in Chart 3A. The slowdown in food inflation was reflected in the 'Food and Non-Alcoholic Beverages' index, which rose by 10.5 percent from 132.1 in June 2011 to 146.0 in June 2012 compared with the previous increase of 22.5 percent from 107.8 in June 2010 to 132.1 in June 2011. Reduced food inflation in the year to June 2012 reflects improved weather conditions that supported food production. The average retail price of dry maize therefore declined from Ksh 51.2 per kilogramme in June 2011 to Ksh 42.5 per kilogramme in May 2012. This reduction was reflected in overall food inflation as the price of the staple food carries significant weighting in the 'Food and Non-Alcoholic Beverages' index.

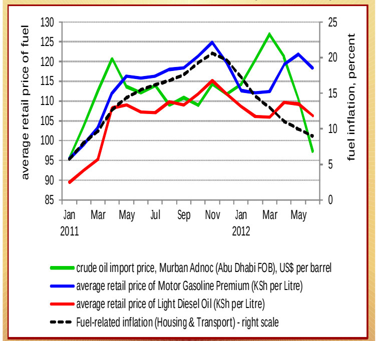
CHART 3A: FUEL INFLATION, NON-FOOD AND NON-FUEL INFLATION



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

The slowdown in fuel inflation was reflected in the 'Transport' index, which rose by 7.6 percent from 131.8 percent in June 2011 to 141.8 in June 2012, compared with an increase of 22.7 percent between June 2010 and June 2011. The 'Housing, Water, Electricity, Gas and other Fuels' index also decelerated from 11.9 percent in June 2011 to 9.7 percent in June 2012. Domestic fuel prices remained higher in 2011 than in 2010 as world oil prices rose sharply in the first quarter of 2011. The import price of Murban crude oil, however, declined somewhat from US $120.7 per barrel in April 2011 to US $109.0 per barrel in October 2011 before rising again to US $127.0 per barrel in March 2012 as shown in Chart 3B. The import

CHART 3B:TRENDS IN FUEL PRICES AND FUEL RELATED INFLATION

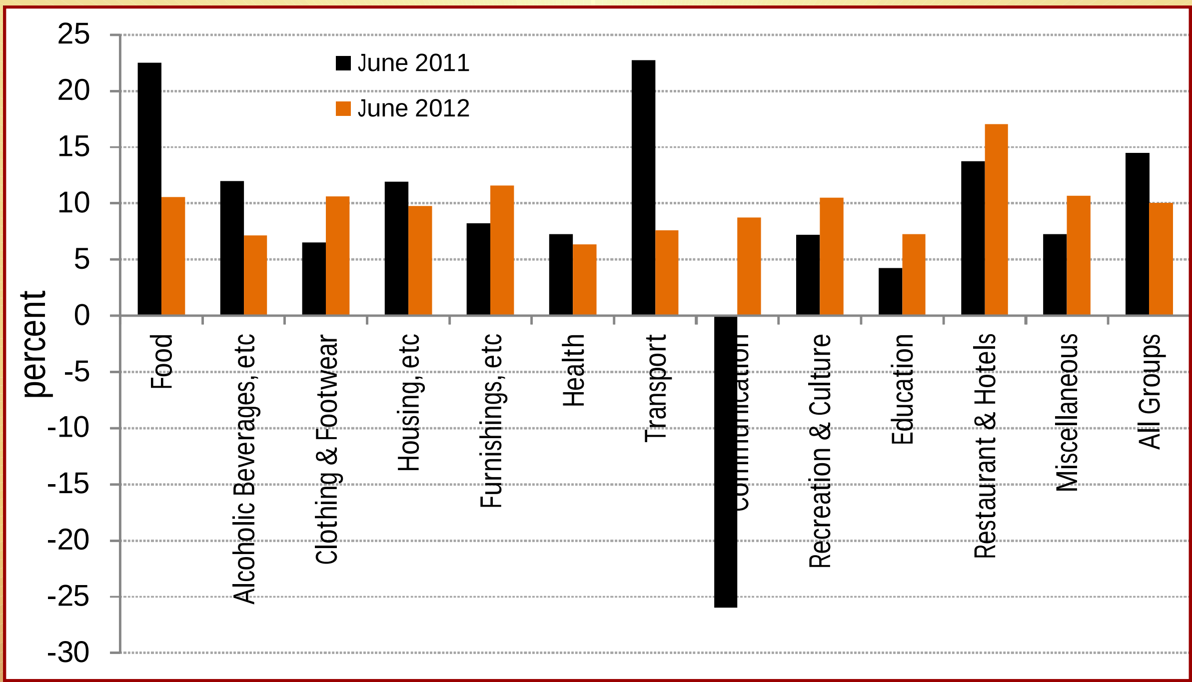


Source:Kenya National Bureau of Statistics

price, however, declined significantly after March 2012 and resulted in a fall in domestic fuel prices. Furthermore, the stabilization of the Kenya shilling exchange rate beginning November 2011 helped to dampen the rise in domestic fuel prices.

Non-food, non-fuel inflation however rose to 9.3 percent in June 2012 from 4.5 percent in June 2011 as shown in Chart 3A. This outcome reflected the higher 12-month inflation in 'Communication', 'Clothing and Footwear', 'Miscellaneous Goods and Services', 'Furnishings, Household Equipment and Routine Household Maintenance', 'Restaurants and Hotels', 'Recreation and Culture' and 'Education' consumption baskets of 8.7 percent, 10.6 percent, 10.6 percent, 11.6 percent, 17.0 percent, 10.5 percent and 7.3 percent, respectively, in June 2012 compared with -26.0 percent, 6.5 percent, 7.2 percent, 8.2 percent, 13.7 percent, 7.2 percent and 4.3 percent, respectively in June 2011 (Chart 3C). 12-month inflation in the 'Health' and 'Alcoholic Beverages, Tobacco and Narcotics' baskets however declined to 6.4 percent and 7.2 percent, respectively, in June 2012 compared with 7.3 percent and 12.0 percent in June 2011.

CHART 3C: 12-MONTH INFLATION RATES FOR GOODS AND SERVICES - JUNE 2012



Source: Kenya National Bureau of Statistics

In terms of the distribution of inflationary pressures, Nairobi was marginally lower than in other urban centres (Table 3.2). Within Nairobi, inflation was mostly on the prices of food, housing and recreation, while outside Nairobi, inflation was mostly on food, household goods, clothing, recreation and communication.

TABLE 3.2: 12-MONTH INFLATION ACROSS INCOME GROUPS BY LOCATION JUNE 2012

	Nairobi			Total	Rest of
	lower income	middle income	upper income	Nairobi	Kenya
Food & Non-Alcoholic Beverages	9.1	14.0	11.5	10.3	10.7
Alcoholic Beverages, Tobacco & Narcotics	5.4	7.6	9.2	6.1	7.9
Clothing & Footwear	10.0	6.8	5.0	9.0	11.7
Housing, Water, Electricity, Gas & other Fuels	12.5	8.0	4.7	11.2	8.7
Furnishings, Household Equipment & Routine Household Maintenance	8.9	9.3	2.9	8.7	13.6
Health	3.9	8.0	3.7	4.9	7.4
Transport	6.2	7.2	4.2	6.4	8.5
Communication	6.4	7.7	5.9	6.8	10.1
Recreation & Culture	11.0	10.5	6.3	10.7	10.3
Education	3.5	4.1	6.8	3.8	9.8
Restaurant & Hotels	22.9	11.7	12.5	20.1	14.8
Miscellaneous Goods & Services	11.6	5.9	3.9	9.9	11.1
All Groups	10.1	9.2	5.5	9.7	10.3

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

TABLE 3.3: ESTIMATED CONTRIBUTIONS TO OVERALL 12-MONTH INFLATION, PERCENT

	FY 2010/11	FY 2011/12
Food & Non-Alcoholic Beverages	**60.8**	**50.5**
Housing, Water, Electricity, Gas & other Fuels	**13.5**	**15.4**
Transport	14.3	10.5
Restaurants & Hotels	5.2	5.5
Clothing & Footwear	5.5	4.8
Furnishings, Household Equipment & Routine Household Maintenance	5.3	4.5
Miscellaneous Goods & Services	2.4	2.9
Alcoholic Beverages, Tobacco & Narcotics	2.8	1.7
Recreation & Culture	1.3	1.5
Health	3.0	1.4
Education	1.5	1.1
Communication	-15.6	0.3

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

Much of the inflationary pressures experienced during the fiscal year 2010/11 was attributed to supply side factors including high oil prices and food shortages. The inflationary pressures eased in the fiscal year 2011/12. Table 3.3 shows that the average contribution of inflation in the 'Food and Non-Alcoholic Beverages' category to overall 12-month inflation reduced from 60.8 percent in fiscal year 2010/11 to 50.5 percent in fiscal year 2011/12, while the average contribution of inflation in the 'Transport' category to overall inflation also declined from 14.3 percent to 10.5 percent during the period in review. Monetary policy during the fiscal year 2011/ 2012 was primarily set to reduce inflationary pressures driven by monetary conditions. The tightening of policy helped to slow the rise in non-food, non-fuel inflation and to also stabilize the Shilling exchange rate.

Inflation Outlook

Overall inflation eased in the fiscal year 2011/2012 following a decline in food and fuel prices. Effects of improved supply side conditions are expected to carry over into the fiscal year 2012/ 13 and yield lower inflationary pressures. The non-food, non-fuel component of inflation however continued to rise through to June 2012. Prudent monetary policy is expected to reduce this underlying inflation. The continued stabilization of the shilling exchange rates is also expected to mitigate against unfavourable price developments in the international commodity markets.

4. MONEY AND CREDIT DEVELOPMENTS

Monetary Policy for Fiscal Year 2011/12

The Central Bank of Kenya monetary policy focused on achieving and maintaining stability in the general level of prices in the economy. The price stability objective is necessary for enhancing investment and supporting economic growth and employment creation. In this regard, the CBK formulates monetary policy to achieve the inflation target set by the Minister for Finance. The inflation target for the fiscal year 2011/12 was 9 percent and that for the medium term 5 percent. Inflation as measured by the GDP deflator was projected to increase from 6.7 percent in June 2011 to 13.4 percent in June 2012. The pick-up reflects the acceleration effects of inflation that had peaked at 19.7 percent by November 2011. The real GDP growth was projected at 4.5 percent for 2011 and 5.2 percent in for 2012 with the average real GDP for the year to June 2012 at 4.8 percent. Accordingly, the Central Bank of Kenya set out the optimal path for both reserve money and money supply expansion consistent with Government inflation target and the expected economic growth. Money supply, M3, and reserve money were targeted to grow by 18.7 percent and 14.2 percent, respectively, in the year to June 2012 (Table 4.1).

TABLE 4.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2011/12 MONETARY PROGRAMME

	Jun'11	Sep'11	Dec'11	Mar'12	Jun'12
Broad money supply (M3) (Ksh billion)	1,380.7	1,435.4	1,528.0	1,558.6	1,638.6
Reserve money (Ksh billion)	220.4	224.9	249.3	241.7	251.8
NFA of CBK (Ksh billion)	285.3	278.3	295.8	288.4	322.4
Memo:					
Annual change in reserve money	4.8	7.2	20.2	15.4	14.2
Annual change in broad money (M3)	15.2	15.4	12.0	17.7	18.7
Real GDP growth	5.0		5.3		4.8
GDP Deflator	6.7		9.6		13.4

Source: Central Bank of Kenya

The Central Bank Rate (CBR) was the main instrument used to signal the direction of monetary policy. The rate was reviewed and announced at least every month beginning September 2011 as the Monetary Policy Committee (MPC) shifted from bi-monthly to monthly meeting when the inflation escalated to double digits and exchange rate instability persisted. The movement in the CBR guided the money market participants on the direction of short term interest rates. The monetary policy stance, as signaled by the movements in the CBR, was operationalised through open market operations and the CBK Standing Facility (CBK Overnight Discount Window). In the monetary policy framework, the MPC made the CBR the reference rate for pricing monetary policy operations. Whenever the CBK was injecting liquidity in the market through a Reverse Repo, the CBR was the lowest acceptable rate. Similarly, whenever the Bank was withdrawing liquidity through a vertical repo, the CBR was the highest rate that the CBK would take on any bid received. Banks utilizing the CBK Overnight Window were charged the CBR plus a penalty of six percentage points (reviewed from 3 percentage points in October 2011).

During the fiscal year 2011/12, the Monetary Policy Committee adopted a tight monetary policy stance to rein in inflation and inflationary expectations and stabilize the exchange rate volatility. The MPC attributed the high inflation and exchange rate volatility to a number of factors including: (a) Balance of payments pressures, with the current account share in GDP at 9.78 percent in 2011 and 11.43 percent by April 2012. This large exposure has the potential to weaken, and sustain volatility of the exchange rate; (b) Turbulence in the global financial markets due to the Euro Zone sovereign debt crisis which has affected peripheral countries in the Euro, but has far reaching effects for bond markets and banks in the Euro zone. This has the potential to weaken the Ksh following flight to safer international currencies or flight to familiarity, especially the US Dollar and the concomitant strengthening of the US Dollar; (c) Higher international prices for crude oil and imported oil as well as escalation of pump prices announced by the Energy Regulatory Commission. In addition, the high and rising commodities prices for maize and sugar, supply shortfalls in domestic grain production due to adverse weather in 2011 and delayed long rains in 2012 combined to sustain inflation above single digit. However weather conditions in 2012 improved leading to enhanced food supply, especially for kales and other vegetables and thereby supporting deceleration in food inflation and (d) Credit growth to the private sector that peaked at 36.3 percent in September 2011 but declined thereafter consistently to 16.5 percent and within the respective target of 16.8 percent in June 2012. The underlying demand pressures kept the non-food non-fuel inflation above the short term target of 9 percent.

At the beginning of the Fiscal year 2011/12, the MPC initially adopted a gradually approach by raising Central Bank Rate (CBR) by 75 basis points from 6.25 percent in July 2011 to 7.0 percent in September 2011. However, with persistent risks to both inflation and exchange rate stability, the Committee enhanced the tight monetary stance by raising the CBR by 400 basis points to 11.0 percent in October 2011, followed by 550 basis points to 16.5 percent in November 2012 and a further 150 basis points to 18.0 percent in December 2011. In addition the MPC raised the cash reserve requirements (CRR) by 50 basis points from 4.75 percent to 5.25 percent effective December 15, 2011 to reinforce the monetary policy stance. The Bank further introduced various regulatory measures that included:

- reduction of commercial banks' foreign exchange exposure limit from 20 percent of core capital to 10 percent;
- restricted local currency borrowing by offshore banks to a tenor of one year; restricted forward contracts with offshore banks with Kenya shilling component to a minimum period of one year and all swaps and forwards involving local corporate and banks restricted to a minimum tenor of seven days and;
- required local banks to obtain supporting documents for all transactions in the Nostro Accounts of off-shore banks. Access to the CBK Discount Window by commercial banks was also limited to twice a week with a view to restoring the lender of last resort characteristic of the Discount Window.

During the second half of the fiscal year, the Committee maintained the CBR at its December level of 18.0 percent; revised monetary policy operations framework to reduce volatility in the interbank rate and introduced longer dated term auction deposits to expand the array of monetary policy instruments. The aim of these monetary policy actions was to enhance liquidity pricing in the money market, maintain exchange rate stability and gradually reduce inflation towards Government's short-term target of 9 percent for the fiscal year 2011/12.

The monetary programme pursued by the Bank was consistent with targets outlined in the Extended Credit Facility (ECF) where the Net International Reserves (NIR) and Net Domestic Assets (NDA) were the quantitative performance criteria. During the October 2011 programme review, the Government successfully requested for augmentation of ECF with the IMF to cater for Balance of Payments pressures that were greater than initially anticipated. Following the successful conclusion of the second and third reviews in November 2011 and April 2012, respectively, the Government received the third and fourth tranches, including the augmentation, under the programme. The third tranche of SDR 92.276 million was received in

December 2011 while the fourth tranche of SDR 71. 921 million was disbursed in April 2012.

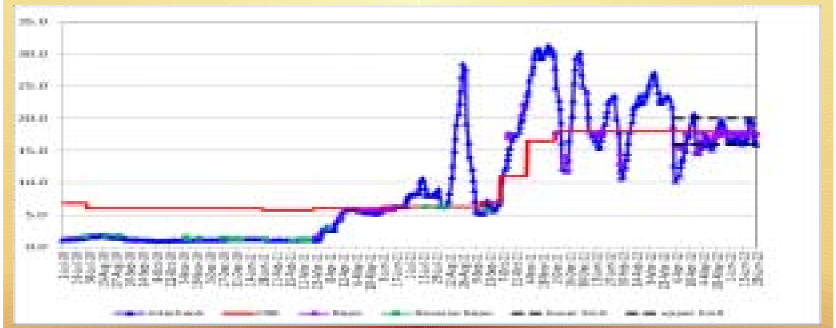
The CBK further met the NIR and NDA Performance Criteria (PC) for June 2012 that will be considered in the fourth review of the ECF supported monetary programme scheduled October 15, 2012. The approval shall unlock the disbursement of the fifth tranche of SDR 71.921 million in October 2012.

Monetary Policy Implementation

To implement monetary policy the Bank relied on open market operations (OMOs) mainly repurchase order agreement securities (REPOs) and term auction deposits and sale of foreign exchange in the interbank to stabilize volatility in the exchange rate. To address the threat posed by excess liquidity in the market the Bank enhanced mop up operations especially in April 2012 through June 2012. Consequently, the amount of repos and term auction deposits rose from Ksh 11.4 billion in April 2012 to Ksh 27.4 billion in May 2012 and Ksh 35.4 billion in June 2012. The excess liquidity was occasioned by net redemptions of government securities especially in the second half of 2011/12 after Government received funds from the syndicated loan of US$ 600 million in May and June 2012. In the period, the Bank cautiously purchased foreign exchange from the interbank market to build foreign exchange reserves.

As a reflection of the tight monetary policy stance, short term interest rates surged upwards during the first half of FY 2011/12, but stabilized during the second half of the financial year (Chart 4A). The average interbank rate rose from 5.5 percent in July 2011 to 28.9 percent in November 2011 before easing to 17.1 percent in June 2012. However, the interbank rate volatility persisted even during this phase of enhanced tightening of monetary policy, from October 2011. To mitigate this instability the MPC reviewed its monetary policy operations framework in order to align the interbank rate more closely with the CBR. Consequently, volatility of interbank rate reduced in May and June 2012.

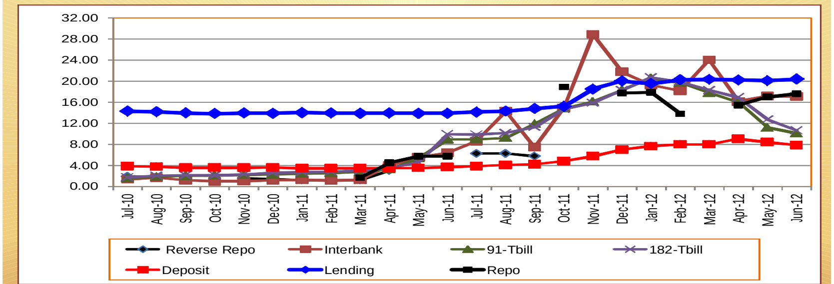
CHART 4A: REPO AND INTERBANK RATES JULY 2010 TO JUN 2012



Source: Central Bank of Kenya

Commercial banks also responded to the tight monetary policy by raising the lending rates and deposit rates (Chart 4B). The average lending rates rose from 14.14 percent in July 2011 to 20.34 percent in March 2012 and stabilized at an average of 20.2 percent in the April - June 2012 quarter. The average deposit rate increased from 3.9 percent in July 2011 to a peak 9.0 percent in April 2012 and thereafter eased to 7.8 percent in June 2012. The increase in the deposit rate reflected competition for deposits among banks and especially the middle level banks. The interest rate spread however declined between December 2011 and May 2012 partly due to the impact of the measures announced by the KBA in December 2011 to cushion borrowers from high interest rates as well as reduce the threat of accumulating non-performing loans. The CBK has also been working with the KBA to address the high spreads through the operationalization of Credit Reference Bureaus and establishment of Currency Centres around the country. This has reduced credit risk levels and the operation costs of banks.

CHART 4B: INTEREST RATES JULY 2010- JUNE 2012 (PERCENT)



Source: Central Bank of Kenya

Money Supply

Growth in broad money supply, M3, stabilised at 15.5 percent in the year to June 2012 compared with 15.2 percent growth in a corresponding period in 2011 and was within the respective target of 18.7 percent growth for the year to June 2012. The expansion in money supply in June 2012 was reflected in stronger growth in net foreign assets (NFA) of the banking sector (Table 4.2 and 4.3).

TABLE 4.2: PERFORMANCE OF MONETARY AGGREGATES JUNE 2011 - JUNE 2012 (Percent)

	RM		M3		Private Sector Credit	
	Act.	Targ.	Act.	Targ.	Act.	Targ.
2011						
Jun	4.8	2.4	15.2	16.8	30.7	23.7
Jul	11.5	11.5	16.4	15.3	32.4	31.0
Aug	14.8	10.5	18.1	16.5	32.7	30.1
Sep	12.5	7.2	19.3	15.4	36.3	29.4
Oct	8.1	7.4	20.7	15.9	35.2	33.4
Nov	9.5	3.2	18.3	20.2	32.5	30.9
Dec	14.5	12.0	19.1	20.2	30.9	28.6
2012						
Jan	17.2	13.7	17.1	20.0	28.0	27.6
Feb	10.4	15.3	15.2	19.2	26.0	24.0
Mar	23.2	15.4	14.5	17.7	24.0	24.3
Apr	14.7	15.3	15.1	18.8	22.6	19.4
May	13.2	15.0	15.6	19.3	21.8	17.4
Jun	17.6	14.2	15.5	18.7	16.5	16.8

Source: Central Bank of Kenya

The NFA of the banking sector increased by Ksh 49.8 billion or 17.7 percent in the twelve months to June 2012 compared with an increase of Ksh 1.6 billion or 0.6 percent in a corresponding period in 2011. The increase in the NFA was reflected in holdings of the Central Bank of Kenya. Growth in the net domestic assets (NDA) of the Banking sector slowed to 15.0 percent (or Ksh 164.5 billion) in the year to June 2012 from 19.6 percent (or Ksh 180.2 billion) a year earlier on account of deceleration in private sector credit growth (Table 4.3).

TABLE 4.3: MONEY SUPPLY AND ITS SOURCES (KSH BN)

	Jun 2010 Act	Jun 2011 Act	Jun 2012 Act	Absolute Change 2010/11	Absolute Change 2011/12	Annual % Change 2010/11	Annual % Change 2011/12
1.0 Liabilities							
Money Supply							
Money supply, M2 1/	1,033.7	1,183.9	1,339.4	150.2	155.6	14.5	13.1
Money supply, M3 2/	1,198.9	1,380.7	1,595.0	181.8	214.3	15.2	15.5
Overall Liquidity, L 3/	1,443.4	1,709.2	1,976.4	265.8	267.2	18.4	15.6
2.0 Assets (2.1+2.2) 4/	1,198.9	1,380.7	1,595.0	181.8	214.3	15.2	15.5
2.1 Net foreign assets 5/	280.3	281.9	331.7	1.6	49.8	0.6	17.7
Central Bank	242.9	282.8	340.4	39.9	57.6	16.4	20.4
Banking Institutions	37.4	-0.8	-8.7	-38.2	-7.9	-102.2	944.0
2.2 Net domestic assets (2.21+2.22)	918.7	1,098.8	1,263.3	180.2	164.5	19.6	15.0
2.21 Domestic Credit (2.210+2.211)	1,086.8	1,344.2	1,550.5	257.5	206.3	23.7	15.3
2.210 Government (net)	277.7	277.8	292.5	0.1	14.7	0.0	5.3
2.211 Private sector and other public sector	809.1	1,066.4	1,258.0	257.4	191.6	31.8	18.0
2.22 Other assets net	-168.1	-245.4	-287.2	-77.3	-41.8	46.0	17.0
Memorandum Item:							
Reserve Money 6/	210.3	220.4	259.3	10.2	38.8	4.8	17.6

\1 *Broad money, M2, comprises M1 and call, 7-days, savings & time deposits as well as certificates of deposits held by the private sector & parastatals with NBFIs. M2 excludes deposits of both the central & local Government with NBFIs, and all cross deposits of both commercial banks and NBFIs.*

\2 *Broad money, M3, comprises M2 plus foreign currency deposits held by residents with banking institutions.*

\3 *Overall liquidity L, comprises M3 plus non-bank holdings of government securities.*

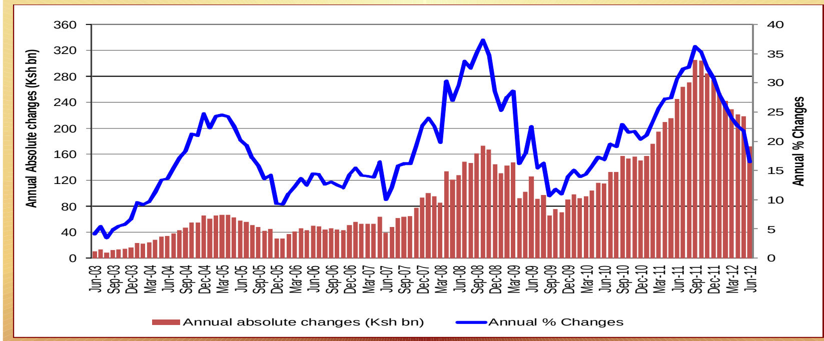
Source: Central Bank of Kenya

Domestic Credit

Domestic credit growth decelerated in the year to June 2012 compared to a similar period in 2011 due to strong reduction in credit to the private sector. In the year to June 2012 domestic credit increased by Ksh 206.3 billion or 15.3 percent compared with Ksh 257.5 billion or 23.7 percent in a similar period in 2011. Credit extended to the private sector increased by Ksh 172.2 billion (16.5 percent) in the year to June 2012 compared with Ksh 245.5 billion (30.7 percent) in the year to June 2011 and corresponding target of 16.8 percent in June 2012 (Table 4.4 and Chart 4C). During the year to June 2012 credit to private sector accelerated sharply through September 2011 attaining 36.3 percent growth. This growth threatened the external balance of the economy and coincided with 9.3 percent share of the current account deficit in GDP in September 2011. The CBK tightened monetary policy stance which helped slowdown credit growth to private sector. Meanwhile, growth in net credit to Government increased by Ksh 14.7 billion (5.3 percent) in the year to June 2012 compared with an increase of Ksh 0.1 billion (0.04 percent) in the corresponding period in 2011.

The banking system lending was largely absorbed by the private sector which accounted for 78.5 percent of total lending in June 2012 compared with the net credit to the government which accounted for 18.9 percent.

CHART 4C: ANNUAL PERCENTAGE CHANGES IN PRIVATE SECTOR CREDIT



Source: Central Bank of Kenya

The expansion in the private sector credit was more towards financing economic activities in the productive sectors of the economy. The main recipients of private sector credit flows were trade (17.0 percent), private households (13.7 percent), manufacturing (13.1 percent), real estate (12.4 percent), transport and communication (6.8 percent), business services (6.6 percent), consumer durables (6.2 percent), building and construction (4.9 percent) and Agriculture (4.5 percent) (Table 4.4). Following the enhanced tightening of monetary policy from October 2011 lending interest rate increased sharply resulting in significant reductions of credit to support private consumption and financing of import trade.

TABLE 4.4: CREDIT TO PRIVATE AND OTHER PUBLIC SECTORS (KSH BN)

	2011 Jun		2012 Jun		Annual Change		Share of private sector credit expansion (%)
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)	
1. Credit to other public sector	**21.7**	**2.0**	**41.2**	**3.3**	**19.4**	**89.3**	
Local government	1.0	0.1	1.3	0.1	0.4	35.4	
Parastatals	20.8	1.9	39.8	3.2	19.1	91.9	
2. Credit to private sector	**1044.7**	**98.0**	**1216.8**	**96.7**	**172.2**	**16.5**	**100.0**
Agriculture	49.3	4.6	54.3	4.3	5.0	10.1	2.9
Manufacturing	129.0	12.1	159.2	12.7	30.2	23.4	17.5
Trade	170.3	16.0	206.7	16.4	36.4	21.4	21.1
Building and construction	5.8	0.5	5.7	0.5	-0.1	-1.5	0.0
Transport & communications	12.9	1.2	13.0	1.0	0.1	1.1	0.1
Finance & insurance	151.7	14.2	188.1	14.9	36.4	24.0	21.1
Real estate	39.5	3.7	59.3	4.7	19.7	49.9	11.5
Mining and quarrying	75.5	7.1	83.3	6.6	7.8	10.3	4.5
Private households	24.3	2.3	26.7	2.1	2.4	10.0	1.4
Consumer durables	118.0	11.1	150.7	12.0	32.7	27.8	19.0
Business services	25.5	2.4	25.9	2.1	0.4	1.8	0.3
Other activities	152.6	14.3	166.8	13.3	14.3	9.4	8.3
3. TOTAL (1+2) *	**1066.4**	**100.0**	**1258.0**	**100.0**	**191.6**	**18.0**	

* Absolute and percentage changes may not necessarily add-up due to rounding

Source: Central Bank of Kenya

Reserve Money

Reserve money, which comprises currency in circulation and commercial banks deposits at the Central Bank of Kenya (CBK), increased by Ksh 38.8 billion (17.6 percent) to Ksh 259.3 billion in June 2012 from Ksh 220.4 billion in June 2011. As shown in Table 5.5, the increase in reserve money reflected Ksh 8.3 billion (7.0 percent) growth in currency outside banks and Ksh 30.5 billion (30.0 percent) in bank reserves. At Ksh 259.3 billion in June 2012, reserve money was Ksh 7.5 billion above target.

The sources of reserve money in the twelve months to June 2012 were increases in the net foreign assets of CBK. The NFA rose by Ksh 57.6 billion or 20.4 percent to Ksh 340.4 billion in the year to June 2012 reflecting build-up of official foreign exchange reserves.

The NDA of the Central Bank of Kenya declined by Ksh 18.8 billion (30.2 percent) to Ksh -81.1 billion in the year to June 2012, from Ksh -62.3 billion in the previous year. The decrease in NDA reflected improved open markets operations by the Central Bank to sterilize excess liquidity in the money market through Repo sales and term auction deposits. Meanwhile, net government borrowing increased by Ksh 12.3 billion to close at Ksh 5.2 billion in June 2012 compared to net deposits of Ksh 7.1 billion in June 2011. Other domestic assets of the Central Bank increased by Ksh 23.3 billion to Ksh -56.7 billion from Ksh -80.0 billion in June 2011 (Table 4.6).

TABLE 4.5: RESERVE MONEY AND ITS SOURCES (KSH BN)

	2010 June	2011 June	2012 June	Absolute Change 2010/11	Absolute Change 2011/12	%age Change (%) 2010/11	%age Change (%) 2011/12	2012 June Target	Deviation
1. Net Foreign Assets	242.9	282.8	340.4	39.9	57.6	16.4	20.4	322.4	18.0
2. Net Domestic Assets	-32.6	-62.3	-81.1	-29.7	-18.8	91.0	30.2	-70.6	-10.5
2.1 Government Borrowing (net)	7.5	-7.1	5.2	-14.6	12.3	-195.3	-173.6	-12.6	17.9
2.2 Advances & Discounts	0.0	19.9	-35.4	19.9	-55.3	0.0	-278.1	-5.1	-30.3
2.3 Other Domestic Assets (net)	-42.9	-80.0	-56.7	-37.1	23.3	86.6	-29.1	-52.9	-3.9
3. Reserve Money	210.3	220.4	259.3	10.2	38.8	4.8	17.6	251.8	7.5
3.1 Currency outside banks	101.3	119.0	127.3	17.7	8.3	17.4	7.0	133.2	-5.9
3.2 Bank reserves	109.0	101.5	132.0	-7.5	30.5	-6.9	30.0	118.6	13.4

Source: Central Bank of Kenya

Outlook

Over the next twelve months to June 2013, the Central Bank will target an expansion in broad money supply, M3 of 16.5 percent and reserve money growth of 12.0 percent .(Table 4.7). The liquidity supply in the monetary programme will support economic expansion of 5.2 percent in December 2012 and 5.5 percent by June 2013. Inflation as measured by the GDP deflator is projected to fall from 13.4 percent in June 2012 to 11.3 percent in June 2013 owing to reduced food and oil prices. In tandem, credit provision to private sector is projected to grow by 16.8 percent in June 2013. The Bank will continue to use open market operations to implement monetary policy in the period to June 2013.

TABLE 4.6: MONETARY PROGRAMME FOR 2012/13

	Jun-12	Jun-13
	Est	Proj.
Ksh Billion		
Reserve Money	251.8	281.9
Net Foreign assets	322.4	346.6
Money Supply (M3)	1,638.6	1,908.9
Annual Growth Rates		
Money Suppy (M3)	18.7	16.5
Reserve Money	14.2	12.0
Real GDP	4.8	5.5
Credit to Private Sector	16.8	16.8
GDP deflator	13.4	11.3
Months of import cover	4.3	4.3

Source: Central Bank of Kenya

5. INTEREST RATES

Central Bank Rate (CBR)

In September 2011 the Monetary Policy Committee increased the Central Bank Rate (CBR) by 75 basis points to 7.00 percent to rein in inflationary pressures. The CBR was increased further by 400 basis points in October 2011 to 11.00 percent in order to contain inflation and inflationary pressures and stabilize the exchange rate.

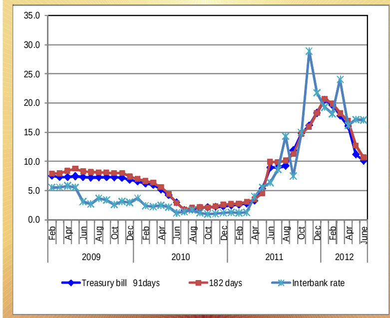
The MPC enhanced the tight monetary policy stance in November and December 2011 by further raising the CBR by 550 basis points and 150 basis points to 16.5 percent and 18.00 percent, respectively. In addition the cash reserve requirements (CRR) was raised by 50 basis points from 4.75 percent to 5.25 percent effective December 15, 2011 to reinforce the monetary policy stance. In its meetings from January through June 2012, the MPC sustained the CBR at the December level of 18.00 percent to signal continuation of the tight monetary policy stance in an effort to tame inflation expectations as well as stabilize the exchange rate.

Short-Term Rates

The CBR signalled the direction of change in short-term interest rates. The short-term rates trended upwards in the first half of the fiscal year 2011/12 in response to the increases in the CBR (Table 5.1 and Chart 5A). The average interbank rate increased from 8.61 percent in July 2011 to 28.90 percent in November 2011 and thereafter declined to 17.09 percent through June 2012. The easing of the average interbank rate during the second half reflected improved market liquidity supported by net redemptions of Government securities.

The 91-day Treasury bill rate and the 182-day Treasury bill rate trended upwards during the first seven months of fiscal year 2011/12 before declining in the second half. The 91-day Treasury bill rate increased from 8.99 percent in July 2011 to 20.56 percent in January 2012 and declined thereafter to average 10.09 percent in June 2012. Similarly, the 182-day Treasury bill rate increased from 9.85 percent in July 2011 to 20.69 percent in January 2012 and declined thereafter to an average of 10.67 percent in June 2012.

CHART 5A: SHORT TERM INTEREST RATES



Source: Central Bank of Kenya

Lending Rates

The average commercial banks' lending rates rose from 14.14 percent in July 2011 to 20.41 percent in June 2012. The increase in the overall lending rate was reflected in all loan categories (overdraft, 1-5 years and over 5 years loans) for both the corporate and business loans. The average lending rate in the 1 to 5 years loans category in the private loans increased by 682 basis points from 14.54 percent in July 2011 to 21.34 percent in June 2012.

TABLE 5.1: INTEREST RATES (%)

	2011							2012					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91-day	8.95	8.99	9.23	11.93	14.80	16.14	18.30	20.56	19.70	17.80	16.01	11.18	10.09
Treasury bill 182-day	9.93	9.85	10.15	11.28	14.68	15.90	18.30	20.69	19.88	18.24	16.92	12.71	10.67
Average Lending Rate	13.91	14.14	14.32	14.79	15.21	18.51	20.04	19.54	20.28	20.34	20.22	20.12	20.41
Overdraft	13.59	13.89	14.28	14.64	14.87	18.67	20.20	20.38	20.53	20.53	20.27	20.41	20.30
Interbank rate	6.36	8.61	14.29	7.46	14.95	28.90	21.75	19.27	18.15	24.02	16.15	17.16	17.09
Average Deposit rate	3.68	3.85	4.07	4.21	4.83	5.75	6.99	7.66	8.01	8.01	9.04	8.42	7.88
3 - months deposits	4.38	4.72	5.48	5.74	7.01	8.88	10.87	11.51	12.36	12.09	13.70	12.83	12.12
Savings	1.37	1.37	1.37	1.35	1.33	1.41	1.59	1.62	1.69	1.72	1.58	1.59	1.46
Spread	10.23	10.29	10.25	10.58	10.39	12.73	13.06	11.88	12.27	12.33	11.19	11.69	12.52

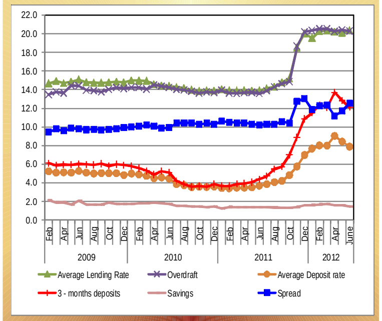
Source: Central Bank of Kenya

Deposit Rates

The average commercial banks' deposit rates rose from 3.85 percent in July 2011 to 7.88 percent in June 2012. The increase in the deposit rates were reflected in all categories/ maturities of deposits. The increase in the deposits rate was more pronounced for 0 to 3 months deposits categories, which increased by 740 basis points to 12.12 percent. The deposit rate on demand deposits rose from 1.09 percent in July 2011 to 1.63 percent in June 2012, while the savings deposits rate increased from 1.37 percent to 1.46 percent. The increase in the deposit rate was enhanced by strong competition for deposits among commercial banks.

The increase in the overall lending rate in the year to June 2012 was much higher than the rise in overall deposits rate. Consequently, the interest rate spread widened from 10.29 percent in July 2011 to 12.52 in June 2012. Chart 5A and 5B, and Table 5.1 show the movement in interest rates during the period.

CHART 5B: COMMERCIAL BANKS' AVERAGE INTEREST RATES



Source: Central Bank of Kenya

Interest Rates Outlook

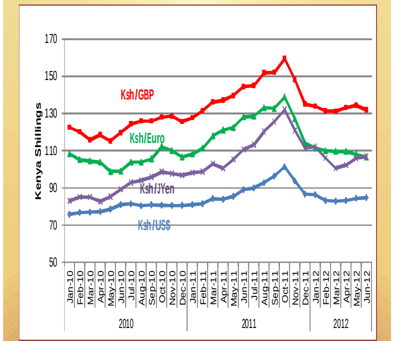
In the medium term, interest rates are expected to remain relatively stable, consistent with expected stability in most of the macroeconomic fundamentals. The Central Bank of Kenya will support interest rates stability by continued implementation of prudent monetary policy. However, in order to stimulate savings and investments, deposit rates must increase and lending rates must decline in line with return on investments and improvement in efficiency of the money market. Lower interest rate spreads will signal increasing efficiency in the financial market.

6. EXCHANGE RATES

The Kenya Shilling strengthened against major world trading currencies in the fiscal year 2011/12 (Table 6.1 and Chart 6A). Between June 2011 and June 2012, the Kenya Shilling appreciated by 4.8 percent to exchange at an average of Ksh 84.8 per US$ in June 2012 compared to Ksh 89.0 per US$ in June 2011.

The Kenya Shilling strengthened against the Sterling pound, the Euro and the Japanese Yen to exchange at Ksh 132 per Sterling pound, Ksh 106.5 per Euro and Ksh 106.9 per 100 Japanese Yen compared to Ksh 144.4 per Sterling Pound, Ksh 128.1 per Euro and Ksh 110.6 per 100 Japanese Yen. The appreciation of the Shilling mainly reflects the tight monetary policy stance adopted by the Monetary Policy Committee. In addition, the disbursements from the IMF through the Enhanced Credit Facility programme towards the end of 2011 and the disbursement of US$ 600 million syndicated loan to the government provided a further cushion to the Kenya shilling.

CHART 6A: KENYA SHILLING EXCHANGE RATES



Source: Central Bank of Kenya

TABLE 6.1: KENYA SHILLING EXCHANGE RATES

	2008			2009			2010			2011			2012		
	Jan	Jun	Dec	Jan	June	Dec	Jan	June	Dec	Jan	June	Dec	Jan	June	% change June 11-June 12
KSH/USD	68.1	63.8	78.0	78.9	77.9	75.4	75.8	81.0	80.6	81.0	89.0	86.7	86.3	84.8	-4.78
KSH/GBP	134.0	125.3	116.5	114.3	127.2	122.5	122.5	119.6	125.7	127.7	144.4	135.1	133.9	132.0	-8.62
KSH/EUR	100.2	99.2	105.6	105.0	109.0	110.3	108.3	99.0	106.5	108.2	128.1	114.1	111.4	106.5	-16.87
KSH/100 JPY	63.2	59.6	85.4	87.4	80.6	84.1	83.1	89.2	96.8	98.1	110.6	111.3	112.2	106.9	-3.36
KSH/ZAR	9.8	8.0	7.8	8.0	9.6	10.1	10.2	10.6	11.8	11.7	13.1	10.6	10.8	10.1	-22.77
USH/KSH*	25.2	25.1	25.1	25.1	27.5	25.2	25.5	27.9	28.6	28.8	27.6	28.2	27.9	29.3	6.14
TZS/KSH*	17.1	18.6	16.6	17.0	16.9	17.6	17.7	18.0	18.2	18.4	17.8	18.7	18.4	18.7	5.02
RWF/KSH*										7.3	6.7	7.0	7.0	7.1	6.24
BRF/KSH*										15.1	13.8	15.1	15.2	16.5	19.52

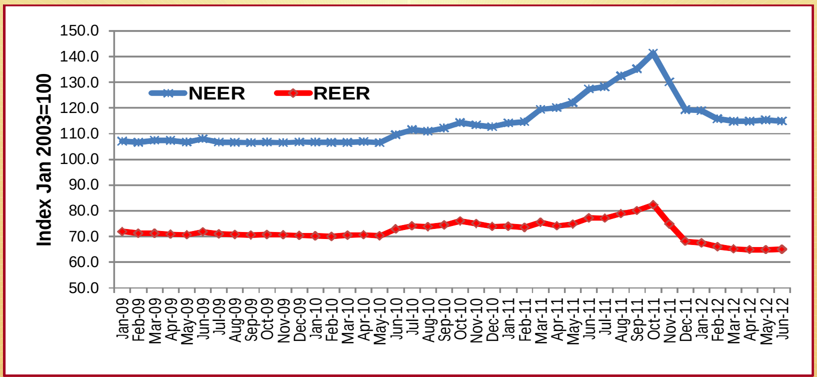
Source: Central Bank of Kenya

The Kenya Shilling strengthened against the South African Rand and all the EAC currencies. The Kenya Shilling strengthened substantially against the South African Rand, appreciating by 22.8 percent to exchange at Ksh 10.1 per ZAR in June 2012 compared to Ksh 13.1 per ZAR in June 2011. Over the same period, the Kenya Shilling strengthened against the EAC countries to exchange at USH 29.3 per Ksh, TSH 18.7 per Ksh, RWF 7.1 per Ksh and BRF 16.5 per Ksh in June 2012 compared to USH 27.6 per Ksh, TSH 17.8 per Ksh, RWF 6.7 per Ksh and BRF 13.8 per Ksh in June 2011.

International Trade Competitiveness

The performance of the Kenya Shilling against bilateral currencies was reflected in an appreciation of the basket of Kenya's major trading partner country currencies. Between June 2011 and June 2012, the trade-weighted nominal effective exchange rate (NEER) index and the real effective exchange rate (REER) index appreciated by 9.8 percent and 15.8 percent, respectively. The steep appreciation of the REER reflected higher inflation in Kenya relative to inflation of the trading partner countries.

CHART 6B: KENYA SHILLING REER AND NEER



NEER: Nominal Effective Exchange Rate Index (2003=100)
REER: Real Effective Exchange Rate Index (2003=100)

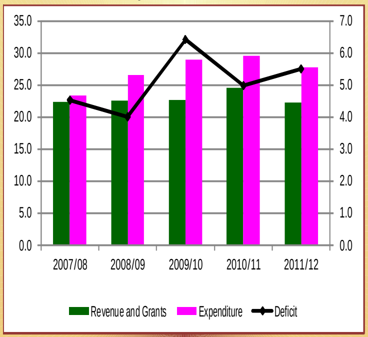
Source: Central Bank of Kenya

Outlook for the Kenya Shilling

The Shilling recovered following a rapid depreciation in the third quarter of 2011. The severe drought in the Horn of Africa and the combination of high international food and oil prices contributed to a marked widening of the current account deficit exacting considerable pressure on the Kenya Shilling. However, monetary policy actions and favourable weather led to the stabilisation of the exchange rate in the second half of 2011/2012. The Kenya Shilling is expected to be relatively stable in the next fiscal year largely on account of sound economic fundamentals.

7. GOVERNMENT BUDGETARY OPERATIONS

CHART 7A: GOVERNMENT BUDGET PERFORMANCE



Sources: Central Bank of Kenya and Treasury

Government budgetary operations in the fiscal year 2011/12 resulted in a budget deficit of Ksh 181.5 billion or 5.5 percent of GDP on commitment basis, compared with Ksh 137.6 billion or 5.0 percent of GDP in a similar period in the fiscal year 2010/11. The deficit, however, remained within the revised target of Ksh 236.2 billion or 7.2 percent of GDP for the 2011/12 fiscal year (Table 7.1 and Chart 7A). Government receipts and expenditure increased less rapidly than projected following underperformance in the economy. During the year under review, 57.6 percent of budget financing came from external sources, compared with 35.2 percent, 6.8 percent and 24.4 percent in the fiscal years 2008/09, 2009/10 and 2010/11, respectively.

TABLE 7.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS

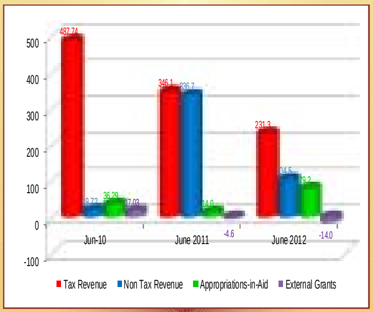
	FY 2008/2009	FY 2009/2010	FY 2010/2011	FY 2011/2012		
	Actual	Actual	Actual	Prov.	Rev. Target	Over(+) / Below (-)
1. REVENUE & GRANTS	**506.0**	**560.8**	**679.5**	**734.4**	**846.7**	**-112.3**
Revenue	487.9	543.8	660.8	719.1	804.5	-85.4
Tax Revenue	417.4	487.7	584.6	659.1	676.3	-17.3
Non Tax Revenue	13.0	19.7	24.7	31.7	48.6	-16.9
Appropriations-in-Aid	31.1	36.3	51.5	28.4	79.6	-51.2
External Grants	18.1	17.0	18.8	15.3	42.2	-27.0
2. EXPENDITURE AND NET LENDING	**595.7**	**718.6**	**817.1**	**915.9**	**1082.9**	**-167.0**
Recurrent Expenditure	435.5	519.8	581.4	639.1	697.5	-58.5
Development Expenditure	160.2	198.8	235.6	276.8	385.4	-108.6
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-89.8**	**-157.8**	**-137.6**	**-181.5**	**-236.2**	**54.7**
Deficit on a commitment basis as a % of GDP	-4.0	-6.4	-5.0	-5.5	-7.2	
4. ADJUSTMENT TO CASH BASIS	-27.3	-9.0	19.7	0.0	0.0	0.0
5. DEFICIT ON A CASH BASIS	**-117.0**	**-166.8**	**-117.8**	**-181.5**	**-236.2**	**54.7**
Deficit on a cash basis as a % of GDP	-5.2	-6.8	-4.3	-5.5	-7.2	
6. DISCREPANCY: Expenditure (+) / Revenue (-	**0.0**	**-3.2**	**1.6**	**-8.8**	**-2.0**	
7. FINANCING	**117.0**	**163.7**	**119.5**	**172.6**	**234.2**	**-61.6**
Domestic (Net)	75.9	152.5	90.4	73.2	62.0	11.3
External (Net)	41.1	11.1	29.1	99.4	172.3	-72.9
Capital Receipts (net of restructuring costs)	0.0	0.0	0.0	0.0	0.0	**0.0**
Others	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Treasury and Central Bank of Kenya

Government Revenue

Government revenue (including grants) amounted to Ksh 734.4 billion in the fiscal year 2011/12 compared with Ksh 679.5 billion in a similar period in the fiscal year 2010/11 (Chart 7B). This represented an overall increase of Ksh 54.9 billion (or 1.7 percent of GDP), which was largely attributed to tax and non-tax revenue during the period. Tax revenue increased by Ksh 74.5 billion and non-tax revenue by Ksh 7 billion, while appropriations in aid and external grants declined by Ksh 23.1

CHART 7B: COMPOSITION OF REVENUE

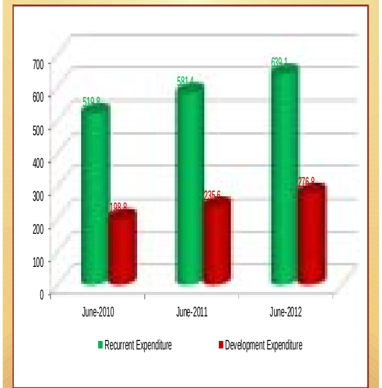


Sources: Central Bank of Kenya and Treasury

billion and Ksh 3.5 billion, respectively. In terms of share in GDP total revenue and grants decreased from 24.6 percent in fiscal year 2010/11 to 22.3 percent in fiscal year 2011/12. But overall targets were missed by 13.3 percent in fiscal year 2011/12, with the shortfall attributed to decline in virtually all the sources, following underperformance in the economy and discretion to zero rate some taxes to support some sectors and to augment demand for goods and services by the poor.

Tax revenue collections in the fiscal year 2011/12 was Ksh 659.1 billion, or 12.7 percent above Ksh 584.6 billion collected in a similar period of fiscal year 2010/11, but lower than the programmed target of Ksh 676.3 billion. Underperformance in overall tax collected was attributed to a slowdown in economic activity and special tax policies during the year which included the removal of excise duty on kerosene, reduction of excise duty on diesel, duty remission on imported wheat and maize, among others. These policies were meant to address the cost of living during the period.

CHART 7C: GOVERNMENT EXPENDITURE



Sources: Central Bank of Kenya and Treasury

Expenditure and Net Lending

As shown in Table 7.1, Government expenditure and net lending increased by 12.1 percent, from Ksh 817.1 billion in the fiscal year 2010/11 to Ksh 915.9 billion in the fiscal year 2011/12. Recurrent and development expenditures increased by Ksh 57.6 billion and Ksh 41.2 billion, respectively, to stand at Ksh 639.1 billion and Ksh 276.8 billion, at the end of fiscal year 2011/12 (Chart 7C).

Despite the increases during the year, recurrent and development expenditures remained below respective programmed targets of Ksh 697.5 billion and Ksh 385.4 billion. Development expenditure was Ksh 41.2 billon or 17.5 percent below target, following slower absorption rates, especially with respect to the externally financed projects. The percentage of development expenditure in total expenditure, however, increased from 28.8 percent in the fiscal year 2010/11 to 30.2 percent in the fiscal year 2011/12, while that of recurrent expenditure to total expenditure declined from 71.2 percent to 69.8 percent, during the same period. These trends are consistent with the Government fiscal policy objective of allocating more resources towards infrastructural developments in order to create a conducive environment for doing business, hence promoting investments to achieve and sustain high economic growth in line with the Vision 2030.

Financing

Budgetary operations of the Government resulted in a financing requirement of Ksh 173.0 billion in the fiscal year 2011/12 compared with Ksh 136.8 billion in the same period in the previous year. The expansion reflected largely in the requirement for budget deficit financing.

The Government sourced the funds through domestic borrowing amounting to Ksh 73.6 billion and net external debt borrowing of Ksh 99.4 billion (Table 7.2).

TABLE 7.2: GOVERNMENT OVERALL BORROWING REQUIREMENTS AND ITS SOURCES, JULY-JUNE (KSH BN)

I. FINANCING REQUIREMENTS	2008/09	2009/10	2010/11	2011/12
1. Budget deficit	83.5	163.7	117.8	172.6
2. External debt reduction	-	-	-	-
3. Domestic debt reduction	6.3	-	10.8	-
3.1 Central Bank (incl. items in transit)	6.3	-	10.8	-
3.2 Commercial banks (net of deposits)	-	-	-	-
3.3 Non-bank sources	-	-	-	-
4. Increase in GoK deposits at CBK	-	-	5.2	0.4
5. Adjustment to cash basis			3.0	-
TOTAL	89.8	163.7	136.8	173.0
II. FINANCING SOURCES	2008/09	2009/10	2010/11	2011/12
1. Budget surplus	-	-	-	-
2. External debt increase	11.6	11.9	29.1	99.4
3. Increase in domestic debt	72.4	131.1	107.7	73.6
3.1 Central Bank	-	9.8	-	7.7
3.2 Commercial banks	43.6	91.6	24.4	25.4
3.3 Non-bank sources	28.8	29.7	83.3	40.6
4. Reduction in GoK deposits at CBK	3.3	20.7	-	-
5. Privatisation proceeds (Net of Restructuring Co	2.5	-	-	-
TOTAL	89.8	163.7	136.8	173.0

Source: Treasury and Central Bank of Kenya

8. PUBLIC DEBT

Kenya's public and publicly guaranteed debt increased by Ksh 141.9 billion (9.5 percent) during the fiscal year 2011/12 to stand at Ksh 1.6 trillion at the end of June 2012, from Ksh 1.5 trillion at the end of June 2011. Outstanding debt at the end of June 2012 comprised Ksh 858.8 billion (52.6 percent) domestic debt and Ksh 774.6 billion (47.4 percent) external debt (Table 8.1). Domestic debt and external debt increased by Ksh 94.6 billion and Ksh 47.3 billion, respectively, during the year under review. As a percentage of GDP, overall public debt stock declined from 54.0 percent to 49.6 percent during the period.

TABLE 8.1: PUBLIC DEBT (KSH BN)

	June 2008		June 2009		June 2010		June 2011		June 2012	
	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT										
Securitised debt	**427.2**	**99.2**	**511.6**	**98.7**	**640.6**	**97.1**	**753.0**	**98.5**	**848.8**	**98.8**
Treasury Bills	111.3	25.8	150.1	**29.0**	191.3	**29.0**	157.4	**20.6**	161.8	**18.8**
Of which Repo Treasury bills	34.4	8.0	33.3	**6.4**	32.2	**4.9**	30.8	**4.0**	29.8	**3.5**
Treasury Bonds	315.2	73.2	360.7	**69.6**	448.6	**68.0**	595.7	**77.9**	687.0	**80.0**
Government Stocks	0.8	0.2	0.8	**0.1**	0.8	**0.1**	0.0	**0.0**	0.0	**0.0**
Non Securitised debt	**3.4**	**0.8**	**6.9**	**1.3**	**19.0**	**2.9**	**11.2**	**1.5**	**10.0**	**1.2**
Overdraft/Advances	0.4	0.1	5.1	**1.0**	17.6	**2.7**	9.8	**1.3**	9.5	**1.1**
others	3.0	0.7	1.8	**0.3**	1.3	**0.2**	1.4	**0.2**	0.5	**0.1**
TOTAL DOMESTIC DEBT	**430.6**	**100.0**	**518.5**	**100.0**	**660.3**	**100.0**	**764.2**	**100.0**	**858.8**	**100.0**
(as a % of GDP	21.2		23.1		25.9		**27.7**		26.1	
(as a % of Total Debt	50.1		49.2		53.9		51.2		52.6	
EXTERNAL DEBT**										
Bilateral	153.2	34.8	185.9	34.6	196.3	34.7	257.0	35.3	246.2	31.8
Multilateral	268.2	61.0	327.6	61.0	348.6	61.7	445.3	61.2	463.0	59.8
Comm. Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	50.5	6.5
Export Credit	18.5	4.2	23.8	4.4	20.5	3.6	25.0	3.4	14.8	1.9
TOTAL EXTERNAL DEBT	**440.0**	**100.0**	**537.4**	**100.0**	**565.5**	**100.0**	**727.3**	**100.0**	**774.6**	**100.0**
(as a % of GDP	21.6		24.0		22.2		26.3		23.5	
(as a % of Total Debt	50.5		50.8		46.1		48.8		47.4	
TOTAL PUBLIC DEBT	**870.6**		**1053.8**		**1,225.7**		**1,491.5**		**1,633.4**	
(as a % of GDP)	42.8		47.0		48.1		54.0		49.6	

* External debt stock Revised
** Provisional

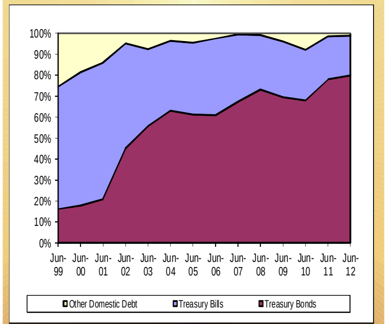
Sources: Central Bank of Kenya and Treasury

Public Domestic Debt

Total domestic debt increased by 94.7 billion during the fiscal year 2011/12 from Ksh 764.1 billion in June 2011 to Ksh 858.8 billion in June 2012; most of it was securitized debt. Government debt held in securities (including repos), at the end of June 2012 amounted to Ksh 848.8 billion compared with Ksh 752.9 billion at the end of June 2011. Of this, 80.9 percent was in Treasury bonds and 19.1 percent in Treasury bills (excluding repos). During the year to June 2012, total Treasury bonds increased by Ksh 91.2 billion, compared with holdings of the previous year, reflecting the government debt management strategy of restructuring domestic debt to benchmark-long dated instruments in order to minimize the risks associated with short term domestic borrowing. Government overdraft at Central Bank, which is the main component of other domestic debt, declined from Ksh 9.8 billion in June 2011 to Ksh 9.5 billion in June 2012.

As shown in Chart 8A, the percentage of Treasury bonds in total domestic debt increased from 77.9 percent in June 2011 to 80 percent in June 2012, while that of Treasury bills declined from 20.6 percent of total domestic debt to 18.8 percent during the period. Treasury bills (including Repos) increased from Ksh 157.4 billion to Ksh 161.8 billion during the period.

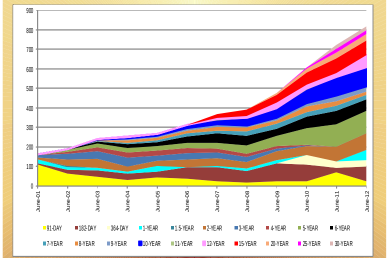
CHART 8A:COMPOSITION OF GOVERNMENT DOMESTIC DEBT



Sources: Central Bank of Kenya and Treasury

The average maturity of domestic debt (by the period to maturity) stood at 5 years and 4 months in June 2012 compared to 5 years and 10 months in June 2011. The longer average maturity is consistent with the government debt management strategy of restructuring domestic debt to benchmark long dated instruments in order to minimize the risks associated with short term domestic borrowing. As shown in Chart 8B, the 5-year Treasury bond, accounted for the largest proportion of outstanding Government securities during the period. However, its share declined from 15.8 percent in June 2011 to 13.4 percent in June 2012. The percentage of Treasury bonds with maturities of between 10-years and 30-years increased to 36.2 percent during the year ending June 2012 up from 35.9 percent in June 2011 following successful issuance of longer dated Treasury bonds.

CHART 8B: OUTSTANDING TREASURY BILLS & BONDS BY TENOR



Sources: Central Bank of Kenya

The trend holdings of Treasury bills and bonds by creditor categories are shown in Tables 8.2 and 8.3. Treasury bills holdings by commercial banks declined from 55.8 percent in June 2011 to 46.7 percent in June 2012. Commercial bank holdings of Treasury bonds increased marginally from 48.4 percent to 48.6 percent during the period. The continued re-opening of bond issues to add to their liquidity and support for bond trading was a resounding success during the year. The infrastructure bond issued during the year has exhibited popularity in the bond market due its attractive features like tax exemptions.

TABLE 8.2: OUTSTANDING STOCK OF TREASURY BILLS BY HOLDER (KSH BN)

Holders	Jun-10		Jun-11		Jun-12	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	167.2	87.4	119.4	75.9	105.5	65.2
Central Bank*	33.2	17.4	31.7	20.1	30.0	18.5
Comm. Banks	133.8	69.9	87.7	55.8	75.5	46.7
NBFIs	0.2	0.1	0.0	0.0	0.0	0.0
Insurance Companies	8.4	4.4	4.7	3.0	7.2	4.5
Parastatals	1.9	1.0	3.2	2.1	1.2	0.7
of which NSSF	0.0	0.0	0.0	0.0	0.0	0.0
Building Societies	0.0	0.0	0.0	0.0	0.0	0.0
Others	13.8	7.2	30.9	19.6	47.9	29.6
Total	191.3	100.0	157.3	100.0	161.8	100.0

* Includes Repo Treasury bills

Source: Central Bank of Kenya

TABLE 8.3: OUTSTANDING STOCK OF TREASURY BONDS BY HOLDER (KSH BN)

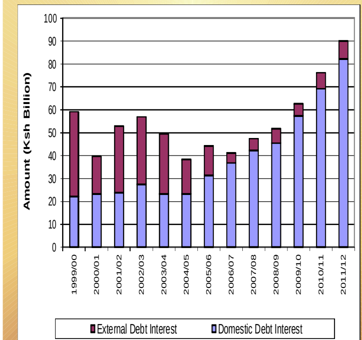
Holders	Jun-10		Jun-11		Jun-12	
	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	211.7	47.2	290.9	48.8	338.9	49.3
Central Bank	0.0	0.0	0.0	0.0	3.3	0.5
Comm. Banks	208.9	46.6	288.4	48.4	334.1	48.6
NBFIs	2.8	0.6	2.5	0.4	1.5	0.2
Insurance Companies	53.8	12.0	74.7	12.5	74.7	10.9
Parastatals	38.0	8.5	23.7	4.0	21.6	3.1
of which NSSF	20.1	4.5	22.5	3.8	24.5	3.6
Building Societies	0.4	0.1	0.3	0.0	0.6	0.1
Others	124.7	27.8	206.1	34.6	251.1	36.6
Total	448.6	100.0	595.7	100.0	687.0	100.0

Source: Central Bank of Kenya

Debt Service

As shown in Chart 8C, cumulative Government expenditure on interest and other charges on domestic debt increased from Ksh 76 billion in the fiscal year 2010/11 to Ksh 90 billion in the fiscal year 2011/12. At the same time, interest accumulated on external debt increased by Ksh 0.7 billion from Ksh 7.0 billion to Ksh 7.7 billion, during the same period.

CHART 8C: INTEREST PAYMENTS ON PUBLIC DEBT



Public and Publicly Guaranteed External Debt

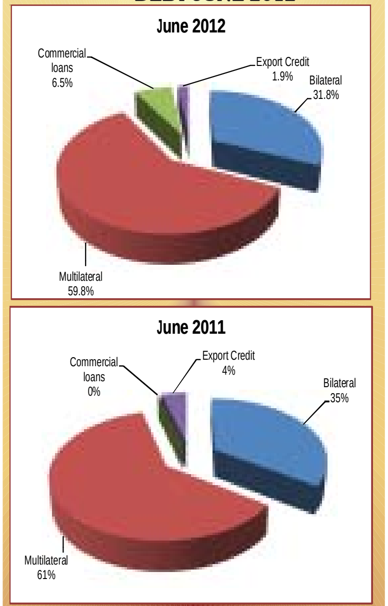
Kenya's external debt increased by 6.50 percent, from Ksh 727.3 billion (US$ 8.09 billion) in June 2011 to Ksh 774.6 billion (US$ 8.72 billion) in June 2012.

TABLE 8.4: DISTRIBUTION OF EXTERNAL PUBLIC DEBT

	Jun-10	%	Jun-11	%	Jun-12	%
Bilateral	196.3	34.7	257.0	35.3	246.2	31.8
Multilateral	348.6	61.7	445.3	61.2	463.0	59.8
Commercial loans	0.0	0.0	0.0	0.0	50.5	6.5
Export Credit	20.5	3.6	25.0	3.4	14.8	1.9
Total	565.5	100.0	727.3	100.0	774.6	100.0

Sources: Central Bank of Kenya and Treasury

CHART 8D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2012



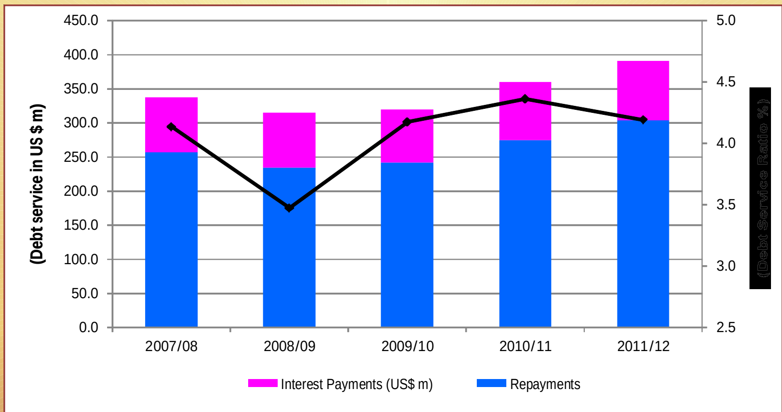
Sources: Central Bank of Kenya and Treasury

The percentage of external debt owed to multilateral corporations (including loans from the IMF) and bilateral creditors declined from 61.2 percent and 35.3 percent in June 2011 to, respectively, 59.8 percent and 31.8 percent in June 2012 (Table 8.4 and Charts 8D and 8E). The percentage of external debt contracted through export credits decreased from 3.4 percent in June 2011 to 1.9 percent in June 2012 following repayments. The government contracted a Ksh 50 billion loan on commercial basis, equivalent to US$ 600 million which was disbursed in May 2012 and largely accounted for the increase in total external debt.

External Debt Service

The external debt service in the period comprised Ksh 34.7 billion in principal repayments and Ksh 7.7 billion in interest payments. The debt service ratio, which is the ratio of external debt service payments to export earnings of goods and services, increased from 5.10 percent in the fiscal year 2010/11 to 5.25 percent in the fiscal year 2011/12. As shown in Chart 8E, the debt service ratio has increased since 2009/10 financial year.

CHART8E: EXTERNAL DEBT SERVICE AND DEBT SERVICE RATIO

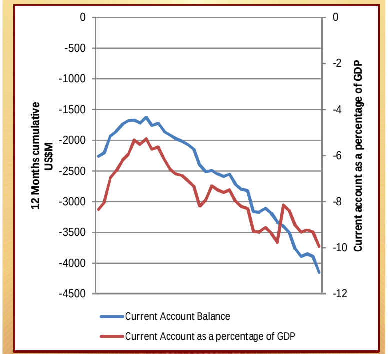


Sources: Central Bank of Kenya and

9. BALANCE OF PAYMENTS

The overall balance of payments improved by 222 percent or US$ 580 million in the year to June 2012. The improvement was reflected in the surplus of the capital and financial accounts which offset the widening current account deficit. The surplus in the capital and financial account was derived from net short term flows (including errors and omissions) with the widening of the current account deficit (Chart 9A and Table 9.1) reflected in a relatively large increase in the value of imports compared to earnings from exports of goods and services.

CHART 9A: TRENDS IN THE CURRENT ACCOUNT BALANCE



Sources: Central Bank of Kenya

TABLE 9.1: BALANCE OF PAYMENTS (US $ M)

ITEM	Year to June 2011	Year to June 2012*	Absolute Change	Percentage Change
1. OVERALL BALANCE	261	841	580	222
2. CURRENT ACCOUNT	-2,800	-3,895	-1,095	39
2.1 Goods	-8,105	-9,812	-1,706	21
Exports (fob)	5,567	5,933	366	7
Coffee	213	263	50	24
Tea	1,108	1,138	30	3
Horticulture	732	648	-84	-11
Oil products	120	85	-35	-29
Manufactured Goods	670	744	75	11
Raw Materials	264	428	163	62
Chemicals and Related Products (n.e.s)	500	584	84	17
Miscelleneous Man. Articles	491	546	55	11
Re-exports	313	365	52	17
Other	1,156	1,132	-24	-2
Imports (cif)	13,672	15,745	2,072	15
Oil	3,299	4,192	893	27
Chemicals	1,847	1,979	132	7
Manufactured Goods	2,021	2,315	294	15
Machinery & Transport Equipment	3,942	4,049	106	3
Other	2,401	2,897	496	21
2.2 Services	5,306	5,917	611	12
Non-factor services (net)	2,559	3,169	610	24
Inflows	3,869	4,638	769	20
Transportation (net)	623	815	192	31
Inflows	1,632	1,978	346	21
Income (net)	-20	-109	-89	445
of which official interest	-61	-102	-41	67
Current Transfers	2,767	2,857	90	3
Private (net)	2,568	2,777	209	8
Credit	2,608	2,791	183	7
Public (net)	200	80	-119	-60
3. CAPITAL & FINANCIAL ACCOUNT	3,061	4,736	1,675	55
as a pecentage share of GDP	9	11	2	26
3.1 Capital Account (net)	249	185	-64	-26
3.2 Financial Account	2,812	4,551	1,739	62
Official, medium & long-term	335	1,128	793	237
Inflows	582	1,414	832	143
Outflows	-248	-287	-39	16
Private, medium & long-term (net)	647	39	-608	-94
Commercial Banks (net)	466	94	-372	-80
Other private medium & long-term (net)	181	-55	-236	-131
Short-term (net) incl. errors & omissions	1,831	3,385	1,554	85
memo:				
Gross Reserves	5,249	7,030	1,781	34
Official	4,142	5,283	1,140	28
*imports cover***	*3.3*	*3.7*	0	11
*imports cover****	*3.8*	*4.3*	0	12
Commercial Banks	1,106	1,747	641	58

* Provisional
** Based on current year's imports of goods and non-factor services
*** Based on 36 months average of imports of goods and non-factor services

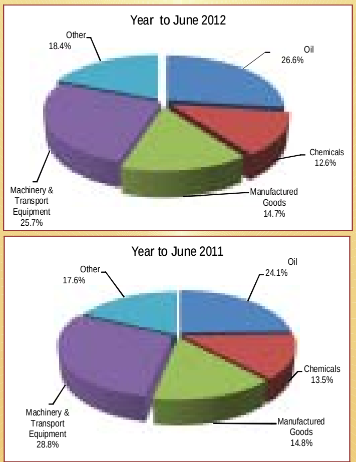
Source: Central Bank of Kenya

Trade in Goods and Services

Merchandise Account

Kenya's trade deficit deteriorated from US$ 8,105 million during the fiscal year 2010/11 to US$ 9,812 million in fiscal year 2011/12 owing to increased imports and slower growth in export of goods. The proportion of imports financed by exports declined from 41 percent in fiscal year 2010/2011 to 38 percent in fiscal year 2011/2012. Value of imports of goods increased by 15 percent or US$ 2,072 million, exceeding export growth of 7 percent or US$ 366 million. The increase in merchandise imports reflected increases in imports of oil, chemicals, manufactured goods, machinery and transport equipment (Table 9.1).

CHART 9B: COMPOSITION OF KENYA'S IMPORTS

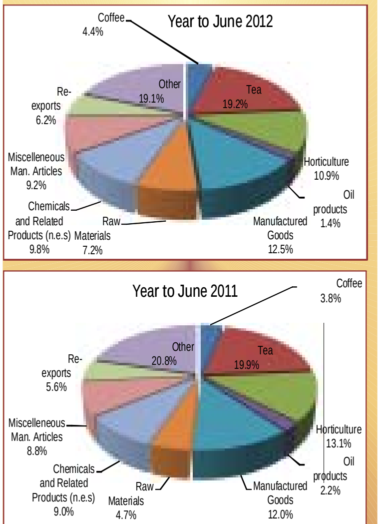


Sources: Central Bank of Kenya

Imports

The value of Kenya's commodity imports rose by 15 percent to US$ 15,745 million during the fiscal year 2011/12 from US$ 13,672 million in the fiscal year 2010/11. All components of imports recorded positive increase in value but contributions to total inputs were unevenly distributed. The share of oil imports increased from 24 percent in the fiscal year 2010/2011 to 27 percent of total imports in the fiscal year 2011/2012 due to higher international oil prices. Imports of machinery and transport equipment accounted for 26 percent of the total import bill in fiscal year 2011/12 down from 29 percent in fiscal year 2010/11. Imports of manufactured items, mainly intermediate goods, accounted for 15 percent of the total import bill in fiscal year 2011/12 (Chart 9B).

CHART 9C: COMPOSITION OF KENYA'S EXPORTS



Sources: Central Bank of Kenya

Exports

The value of goods exported increased by 7 percent from US$ 5,567 million in the fiscal year 2010/11 to US$ 5,933 million during the fiscal year 2011/12. The improvement in export performance arose from exports of coffee, tea, manufactured goods, raw materials, chemicals and related products, whose value increased by 24 percent, 3 percent, 11 percent, 62 percent and 17 percent, respectively in fiscal year 2011/12. Horticulture accounted for 11 percent of Kenya's total commodity exports in the fiscal year 2011/12, declining from 13 percent in fiscal year 2010/11. Receipts from horticultural exports declined from US$ 732 million to US$ 648 million in fiscal year 2011/12 due to a reduction in export prices and quantities (Chart 9C).

Services

The services account comprises of non-factor services, income and current transfers. The surplus in the services account improved by 12 percent, from US$ 5,306 million in the fiscal year 2010/11 to US$ 5,917 million in fiscal year 2011/12. Earnings from non-factor services, which mainly include travel, transport and financial services increased by 20 percent from US$ 3,869 million in 2010/11 to US$ 4,638 million in the fiscal year 2011/12. Receipts from transportation services dominated, amounting to US$ 1,978 million in 2011/12 compared to US$ 1, 632 million in 2010/11. The current transfers account grew by 3 percent from US$ 2,767 in 2010/11 million to US$ 2,857 million in 2011/12 mainly on account of increased private transfer credit which increased by US$ 183 million to US$ 2,791 million. The expansion of private transfer credit was derived from remittances which increased by 44 percent from US$ 748 million in the year to June 2011, to US$ 1,080 million, in the year to June 2012. Remittance transfers have maintained a steady increase since early 2010 (Table 9.2).

TABLE 9.2: REMITTANCES TO KENYA ('000 US $)

Month/Year	2004	2005	2006	2007	2008	2009	2010	2011	2012
January	25,154	28,564	31,506	40,930	53,925	39,535	45,117	64,139	89,755
February	27,676	26,056	30,283	39,533	50,382	53,353	46,423	60,759	103,970
March	29,944	31,219	36,354	48,562	59,344	55,361	52,309	71,557	106,198
April	27,773	29,216	35,369	38,251	67,872	48,117	52,679	70,071	95,625
May	26,931	32,358	42,427	41,163	48,538	49,180	51,172	68,124	100,995
June	30,047	34,360	35,667	48,643	49,490	46,347	52,541	71,888	99,488
July	33,187	29,133	41,065	53,350	44,137	50,372	50,652	72,797	
August	28,894	31,759	30,587	58,803	43,388	55,947	51,993	79,563	
September	28,894	31,616	28,841	60,575	48,953	53,347	58,557	84,854	
October	25,223	33,037	29,633	46,848	61,113	53,037	58,503	81,311	
November	25,473	34,282	31,403	55,564	43,970	48,231	56,380	80,802	
December	29,130	40,557	34,459	41,421	40,129	56,329	65,617	85,244	
Annual Total	338,326	382,153	407,593	573,643	611,242	609,156	641,943	891,109	596,032

Source: Central Bank of Kenya

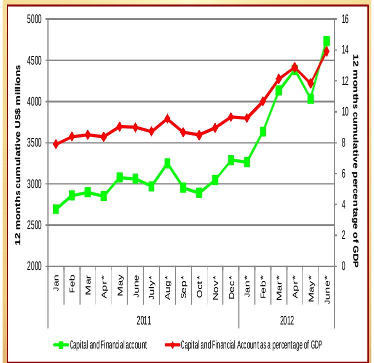
The income account deficit however widened by US$ 89 million from US$ 20 million in fiscal year 2010/12 to US$ 109 million in fiscal year 2011/12 on account of a decline in receipts from Investment income and increased deficit on employees' compensation.

Capital and Financial Flows

The Capital and Financial account of the balance of payments improved by 55 percent, from a surplus of US$ 3,061 million in the fiscal year 2010/11 to US$ 4,736 million surplus in fiscal year 2011/12. The improvement reflected increased inflows in the financial account. As a share of GDP, the Capital and Financial account balance improved from 9 percent in the year to June 2011 to 11 percent in the year to June 2012 (Chart 9D).

The capital account, which comprise project grants to Government declined by 26 percent, from US$ 249 million in the fiscal year 2010/11 to US$ 185 million in the fiscal year 2011/12. The financial account surplus increased by 62 percent from US$ 2,812 million in the fiscal year 2010/11 to US$ 4,551 million in the fiscal year 2011/12. The improvement in the financial account was largely obtained from official medium and long term inflows and net short term flows including errors and omissions. Net short term flows including errors and omissions increased by 85 percent or US$ 1,554 million from US$ 1,831 million in the fiscal year 2010/11 to US$ 3,385 million in the fiscal year 2011/12. Net Official medium and long term flows increased by US$ 793 million to US$ 1,128 in the fiscal year 2011/12 from US$ 335 million in the fiscal year 2010/11, while net private medium and long-term flows which combine net flows from commercial banks and other private medium and long-term flows, posted a decrease of US$ 608 million in net flows.

CHART 9D: TREND IN THE CAPITAL FINANCIAL ACCOUNT



Source: Central Bank of Kenya

Other Private, Medium and Long-term flows which exclude net flows from Commercial Banks, declined by US$ 236 million from US$ 181 million to US$ 55 million mainly reflecting a decline in the inflows of US$ 106 million and increased outflows of US$ 128 million. The commercial banks reduced net foreign assets by US$ 94 million in the fiscal year 2011/12 compared to US$ 466 million in the fiscal year 2010/11. The drawdown is attributed to portfolio reallocation in favour of Kenya Shilling denominated assets during the period.

Direction of Trade

As shown in Table 9.3, the main destination countries for Kenya's merchandise exports in the fiscal year 2011/12 were Uganda (13.7 percent), Tanzania (8.8 percent), United Kingdom (8.2

percent), the Netherlands (6.1 percent), and the United States of America (5 percent). Overall, African countries absorbed 48.7 percent of Kenya's merchandise exports.

TABLE 9.3: KENYA'S EXPORTS: MAIN DESTINATION COUNTRIES (US$ M)

Destination Country	Fiscal Years			Proportion (%)		
	2009/10	2010/11	2011/12	2009/10	2010/11	2011/12
Uganda	601	808	814	12.3	14.7	13.7
Tanzania	402	442	521	8.2	8.1	8.8
Egypt	212	226	269	4.3	4.1	4.5
Sudan	196	257	167	4.0	4.7	2.8
Somalia	167	152	233	3.4	2.8	3.9
DRC	150	178	209	3.1	3.2	3.5
Rwanda	134	142	166	2.7	2.6	2.8
Others	385	396	509	7.9	7.2	8.6
Total Africa	2,247	2,600	2,888	46.0	47.4	48.6
United Kingdom	539	507	487	11.0	9.3	8.2
Netherlands	349	362	361	7.1	6.6	6.1
USA	214	309	298	4.4	5.6	5.0
Pakistan	218	231	249	4.5	4.2	4.2
United Arab Emirates	208	225	248	4.3	4.1	4.2
Germany	95	90	104	2.0	1.6	1.7
India	87	101	105	1.8	1.8	1.8
Afghanistan	157	146	135	3.2	2.7	2.3
Others	771	913	1,069	15.8	16.7	18.0
Total Exports	4,885	5,484	5,943	100.0	100.0	100.0

Source: Central Bank of Kenya

On the other hand, Kenya sourced most imports in 2011/12 from the United Arab Emirates (13.6 percent), China (11.5 percent), India (11.4 percent), Saudi Arabia (5.6 percent) and South Africa (4.9 percent).

TABLE 9.4: KENYA'S IMPORTS: MAIN SOURCE COUNTRIES (US$ M)

Source Country	Fiscal Years			Fiscal Years		
	2009/10	2010/11	2011/12	2009/10	2010/11	2011/12
South Africa	833	797	768	7.5	5.9	4.9
Egypt	172	233	273	1.6	1.7	1.7
Others	394	549	687	3.6	4.1	4.4
Total Africa	**1,400**	**1,579**	**1,728**	**12.6**	**11.7**	**11.1**
India	1,221	1,581	1,802	11.0	11.7	11.6
United Arab Emirate	1,566	1,780	2,142	14.1	13.2	13.7
China	1,140	1,651	1,811	10.3	12.2	11.6
Japan	686	697	697	6.2	5.2	4.5
USA	572	483	671	5.2	3.6	4.3
United Kingdom	497	622	508	4.5	4.6	3.3
Singapore	302	551	110	2.7	4.1	0.7
Germany	308	353	431	2.8	2.6	2.8
Saudi Arabia	434	350	888	3.9	2.6	5.7
Indonesia	295	389	669	2.7	2.9	4.3
Netherlands	212	244	216	1.9	1.8	1.4
France	195	241	260	1.8	1.8	1.7
Bahrain	82	81	227	0.7	0.6	1.5
Italy	165	137	196	1.5	1.0	1.3
Others	2,027	2,757	3,240	18.3	20.4	20.8
Total Imports	**11,101**	**13,497**	**15,597**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Kenya

Kenya's Trade Structure

The proportion of Kenya's total trade with Europe declined from 23.1 percent in 2010 to 21.4 percent in 2011. Much of the trade between Kenya and European countries was with the European Union, at Ksh 308.8 billion in 2011 compared with Ksh 264.6 billion in 2010 mainly on account of increased imports.

The proportion of trade with African countries declined to 21.9 percent in 2011 from 22.4 percent in 2010. Trade with the East African Community, however rose in 2011 to Ksh 164.1 billion up from Ksh 121.7 billion in 2010 mainly on account of increased exports. Trade with COMESA grew from Ksh 176.8 billion in 2010 to Ksh 236.8 billion in 2011 owing to an increase in exports.

The proportion of Kenya's total trade with Asia notably the Middle East increased from 47.9 percent in 2010 to 50.2 percent in 2011, while the proportion of trade with America remained relatively stable at 5.8 percent in 2011 compared to 5.9 percent in 2010.

TABLE 9.5: KENYA'S TRADE STRUCTURE

	Total Trade in Billions of Kenya Shillings			Proportion (%)								
	2009	2010	2011*	2003	2004	2005	2006	2007	2008	2009	2010	2011
Europe	272.2	313.3	390.3	28.9	27.5	24.5	26.8	25.1	23.8	24.0	23.1	21.4
Western Europe	242.3	287.1	148.1	27.3	26.2	23.6	25.2	23.6	21.7	21.4	21.2	8.1
European Union	229.0	264.6	308.8	25.6	24.8	22.1	23.3	22.0	19.9	20.2	19.5	16.9
Others	13.4	17.5	44.3	1.7	1.4	1.4	1.8	1.5	1.7	1.2	1.3	2.4
Eastern Europe	29.9	26.2	37.2	1.5	1.3	1.0	1.6	1.5	2.1	2.6	1.9	2.0
America	83.8	80.0	106.9	4.7	5.3	9.3	7.0	8.6	5.9	7.4	5.9	5.8
U.S.A	67.5	61.8	70.3	3.7	3.3	7.8	5.8	7.2	4.3	6.0	4.6	3.8
Others	16.3	10.0	28.0	1.0	2.0	1.5	1.1	1.4	1.1	1.4	0.7	1.5
Africa	267.4	303.7	399.5	26.2	26.6	26.1	22.3	22.3	22.3	23.6	22.4	21.9
E.A.Community	103.0	121.7	164.1	12.1	11.6	11.1	7.7	8.8	8.7	9.1	9.0	9.0
Tanzania	37.9	43.8	57.4	3.4	3.4	3.3	3.0	3.3	3.3	3.3	3.2	3.1
Uganda	50.7	61.3	86.3	6.8	6.6	6.3	3.7	4.5	4.3	4.5	4.5	4.7
Comesa[a]	72.7	176.8	236.8	7.1	7.3	7.1	7.3	7.6	7.1	6.4	13.0	13.0
Other Countries	91.7	83.1	105.2	7.0	7.8	7.9	7.3	5.9	6.5	8.1	6.1	5.8
Asia	501.4	649.5	916.5	37.5	37.8	36.6	42.0	43.2	47.2	44.2	47.9	50.2
Middle East	168.2	199.3	335.9	17.6	18.6	16.6	16.8	16.3	17.9	14.8	14.7	18.4
Far East	333.2	450.3	580.6	19.9	19.2	20.0	25.2	26.9	29.2	29.4	33.2	31.8
Australia & Oceanic	5.3	4.7	4.0	0.5	0.4	0.4	0.5	0.4	0.2	0.5	0.3	0.2
All other Countries N.E.S	3.0	5.7	9.5	2.1	2.4	3.2	1.5	0.4	0.3	0.3	0.4	0.5
Grand Total	**1133.0**	**1357.0**	**1826.7**		**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

*Provisional

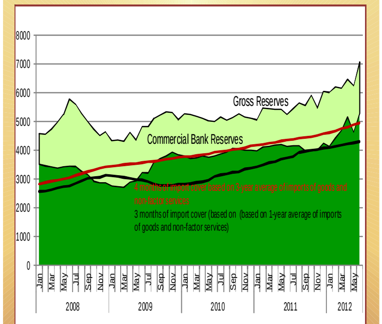
[a] Excluding member countries Uganda, Rwanda & Burundi

Source: Economic Survey, 2008

Foreign Exchange Reserves

Gross foreign reserves of the banking system increased from US$ 5,249 million at the end of June 2011 to US$ 7,030 million at the end of June 2012 (Chart 9E).

CHART 9E: FOREIGN EXCHANGE RESERVES



Source: Central Bank of Kenya

In value terms, the official foreign exchange reserves held by Central Bank of Kenya increased from US$ 4,142 million or 3.8 months of import cover at the end of June 2011 to US$ 5,283 million or 4.27 months of import cover at the end of June 2012. The improvement in gross official foreign exchange reserves reflected domestic interbank purchases by the Central Bank to enhance import cover, program disbursement under the IMF's Three-Year Extended Credit Facility and the disbursement of the syndicated loan to the government amounting to US$ 600 million in June 2012.

Foreign exchange reserves of commercial banks increased by US$ 641 million from US$ 1,106 million at the end of June 2011 to US$ 1,747 million at the end of June 2012. Most of the commercial banks foreign reserves were held as balances with banks abroad amounting to US$ 1,385 million in June 2012 compared to US$ 793 million in June 2011.

10. BANKING SECTOR DEVELOPMENTS

Overview

During the period ended June 30, 2012, the Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 2 credit reference bureaus, 5 representative offices and 115 foreign exchange bureaus.

The Banking Sector recorded improved performance as indicated by the growth in the key categories of number of bank customer deposit accounts and bank loan accounts.

Structure of the Balance Sheet

The banking sector aggregate balance sheet grew by 15.8 percent from Ksh 1.9 trillion in June 2011 to Ksh 2.2 trillion in June 2012. The major components of the balance sheet on the asset side were loans and advances, government securities and placements, which accounted for 56.6 percent, 19.5 percent and 7.3 percent of total assets respectively, while customer deposits were the main component on the liabilities side.

TABLE 10.1: BALANCE SHEET (KSH MILLION)

	12-Jun	11-Jun	% Change
Cash	39,669	36,319	9%
Balances at CBK	122,183	80,298	52%
Placements	160,073	115,954	38%
Govt. Securities	428,733	421,570	2%
Other Investments	46,727	46,550	0%
Loans & Advances (Net)	1,242,367	1,038,853	20%
Other Assets	155,253	134,222	16%
Total Assets	**2,195,005**	**1,873,766**	17%
Deposits	1,667,760	1,412,841	18%
Other Liabilities	212,130	196,014	8%
Capital & Reserves	315,115	264,911	19%
Total Liabilities and Shareholders' Funds	**2,195,005**	**1,873,766**	17%

Source: Central Bank of Kenya

Loans and Advances

The banking sector gross loans and advances increased from Ksh 1.08 trillion in June 2011 to Ksh 1.29 trillion in June 2012 translating to a growth of 19.0 percent. The growth was registered in all the 11 sectors as indicated in Table 10.2.

TABLE 10.2: SECTORAL DISTRIBUTION OF LOANS (KSH BN)

Sectors	12-Jun	11-Jun	% Change
Personal/Household	326.8	296	10.40%
Trade	257.1	198.5	29.50%
Manufacturing	174.8	151.2	15.60%
Real Estate	168.6	130.8	28.90%
Transport and Communication	102.8	88.3	16.40%
Agriculture	64.7	57.6	12.30%
Financial Services	51.7	48.7	6.10%
Building and Construction	51.9	33	57.30%
Energy and Water	42.3	38.5	9.90%
Tourism, Restaurant and Hotels	32.6	24.4	33.60%
Mining and Quarrying	16.1	16.1	0.00%
Gross/Total	**1,289.30**	**1,083.10**	**19.00%**

Source: Central Bank of Kenya

Deposit Liabilities

Customer deposits were the main source of funding for the banking sector assets, accounting for 75.5 percent of total liabilities and shareholders' funds. The deposit base increased by 21.4 percent from Ksh 1.4 trillion in June 2011 to Ksh 1.7 trillion in June 2012 mainly attributed to branch expansion, remittances inflows and receipts from exports.

Capital and Reserves

The banking sector registered strong capital levels in June 2012 with total capital, which comprises core and supplementary capital, growing by 22.6 percent from Ksh 240.1 billion in June 2011 to Ksh 294.3 billion in June 2012. Shareholders' funds increased by 19.0 percent from Ksh 264.9 billion in June 2011 to Ksh 315.1 billion in June 2012. Similarly, the ratio of total and core capital to total risk-weighted assets increased from 19.0 percent and 16.9 percent to 20.3 percent and 17.7 percent, respectively. The improvement in capital base of the commercial banks is attributed to the CBK's policy to raise the capital base from Ksh 250 million in 2008 to Ksh 1 billion by December 2012.

Non–Performing Loans

The stock of gross non-performing loans (NPLs) decreased by 1.4 percent from Ksh. 58.3 billion in June 2011 to Ksh. 57.5 billion in June 2012. Similarly, the ratio of gross NPLs to gross loans improved from 5.4 percent in June 2011 to 4.5 percent in June 2012.

The reduction in NPLs is attributed to continued deployment of enhanced appraisal standards by banks. During the period under review, 5 out of 11 sectors registered increase in NPLs as shown in Table 10.3.

TABLE 10.3: SECTORAL DISTRIBUTION OF NPLs LOANS (KSH BN)

Sectors	Jun-12	Jun-11	% Change
Personal/Household	19.7	18.8	4.80%
Trade	12.3	11.7	5.10%
Manufacturing	5	7	-28.60%
Real Estate	6.5	6.7	-3.00%
Transport and Communication	3.7	3.7	0.00%
Agriculture	4.1	4.9	-16.30%
Financial Services	1.4	1.6	-12.50%
Building and Construction	2.3	1.7	35.30%
Energy and Water	0.3	0.2	50.00%
Tourism, Restaurant and Hotels	2.1	1.8	16.70%
Mining and Quarrying	0.1	0.2	-50.00%
Gross/Total	**57.5**	**58.3**	-1.40%

Source: Central Bank of Kenya

Profitability

During the period ending June 30, 2012, the sector registered Ksh. 53.2 billion pre-tax profits, an increase of 30.4 percent from Ksh 40.8 billion as at June 2011 as shown in Table 10.4. Similarly, total income stood at Ksh. 176.4 billion being an increase of 60.0 percent from Ksh. 110.3 billion registered at the end of June 2011. Total expenses increased by 77.7 percent from Ksh. 69.4 billion in the June 2011 to Ksh. 123.3 billion in June 2012.

Interest income from loans and advances, fees and commissions and government securities comprised the major sources of income accounting for 62 percent, 25 percent and 13 percent of total income, respectively. On the other hand, interest on deposits, staff costs and other expenses were the key components of expenses, accounting for 42 percent, 24 percent and 20 percent, respectively.

TABLE 10.4: BANKING INDUSTRY PROFITS (KSH BILLION)

Item	Jun-12	Jun-11	% change
Total income	146.1	110.3	32.50%
Expenses before provisions	102.3	65.6	55.60%
Profit before provisions	57.9	43.8	32.20%
Provisions for bad debts	4.7	3.9	20.50%
Profit before tax	53.2	40.8	30.40%

Source: Central Bank of Kenya

Credit Reference Bureaus

The sharing of credit information was launched in July 2010 and is picking up gradually. As at June 30, 2012, there were 2 licensed credit reference bureaus operating in Kenya. During the period under review banking institutions requested 1,774,185 credit reports compared to 728,553 reports as at June 2011. The uptake of credit reports by credit providers is expected to increase as use of credit reports increasingly becomes entrenched in the credit appraisal processes.

The introduction of the credit information sharing mechanism has further strengthened credit appraisal standards. Banks have now incorporated credit reference reports in the credit risk appraisal. Credit referencing will go a long way in inculcating credit utilization discipline by borrowers.

Agency Banking

As at June 30, 2012, 10 commercial banks had contracted 12,067 agents facilitating over 20.4 million transactions valued at Ksh. 104.4 billion. This represented an increase over the 6 banks that had contracted 6,513 agents facilitating over 5 million transactions valued at Ksh. 16.7 billion by June 2011.

Deposit Taking Microfinance Institutions

The gross loans and advances for the 6 Deposit Taking Microfinance (DTMs) operating at end of June 2012 increased by 17.8 percent to Ksh.17.9 billion from Ksh. 15.2 billion as at June 2011. Similarly, the deposits base increased by 28.1 percent to stand at Ksh. 12.3 billion from Ksh. 9.6 billion in June 2011. The number of deposit accounts stood at 1.6 million while the number of loan accounts were 0.5 million.

Representative Offices

In November 2011 and June 2012, respectively the Central Bank granted authority to First Rand Bank of South Africa and Bank of China Limited to open Representative Offices in Kenya. There are now 5 foreign banks that operate Representative Offices in Kenya.

Under the Banking Act, a Representative Office of a foreign bank in Kenya is not permitted to engage in banking business as defined in the Act but can only engage in marketing and liaison roles in connection with the activities of its parent bank and affiliates.

Banking Sector 2012 Outlook

The banking sector is expected to sustain its growth momentum on the backdrop of declining inflation, stabilization of the Kenya shilling exchange rate and downward revision of lending interest rates. The Central Bank is also conducting a comprehensive review of the banking sector legal and regulatory framework. The revised prudential and risk management guidelines to be issued in the second half of 2012 are intended to address emerging risks and ensure the continued stability and integrity of the sector as the number of Kenyans included in the banking sector continues to grow rapidly.

The enhanced regulatory framework will strengthen corporate governance and risk management frameworks to deal with cross border risks as Kenyan banks expand regionally. The new framework will also enable banks to boost their liquidity management, loans management and enhance their resilience to withstand macro-economic shocks. The capital management framework will be strengthened to ensure banks hold adequate capital in relation to their risk profile and have adequate buffers to ride out periodic macro-economic shocks.

MODES OF PAYMENTS

There are two main modes of payments, namely non-cash and cash instruments.

1 NON-CASH INSTRUMENTS

1.1 KENYA ELECTRONIC PAYMENT AND SETTLEMENT SYSTEM (KEPSS)

Kenya Electronic Payments and Settlement System (KEPSS) moved a volume of 1,406,886 transactions worth Ksh20,886 billion in the year to June 30, 2012, compared to 1,048,206 transactions worth Ksh18,793 billion in the same period last year. The growth represents a 34.2 percent increase in volume and 11.1percent increase in value compared to the year to June 30, 2011. The average amount moved per transaction decreased from Ksh17.81 million to Ksh14.98 million, reflecting a decrease of 15.9percent and signifying increased use of the system by the public for low value payments. The number of transactions moved per day, however, increased by 34.4 percent to 5,593 transactions from 4,163 transactions in the year to June 30, 2012. This increase is attributed to increased awareness by the public of KEPSS as a safe and efficient mode of payment for both high value and time critical payments, the continuing effects of both value capping and G-Pay system, which were implemented with effect from October 1, 2009. These factors have increased the daily flows through the KEPSS System. The proportion of direct payments through KEPSS increased from 87.1 percent to 98.5 percent, while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS decreased from 12.9 percent 1.5 to percent in the same period (Tables 12.1 and 12.2).

TABLE 12.1: TRENDS IN TOTAL ANNUAL FLOWS

Year to June 30	Total value moved per year (Ksh m)	No. of Transactions	Average value per transaction (Ksh m)	Days worked	Per day Value (Ksh m)	Per day Transactions
2006	7,641,197	120,249	61.38	227	32,919	532
2007	7,929,003	155,131	51.38	249	32,038	627
2008	14,506,951	232,516	62.30	247	59,419	949
2009	15,441,446	277,445	55.67	248	62,139	1,121
2010	16,806,252	673,368	28.78	254	66,259	2,663
2011	18,792,538	1,048,206	17.81	252	74,758	4,163
2012	20,886,830	1,406,886	14.98	252	82,884	5,583

Source: Central Bank of Kenya, Banking/National Payments Division

TABLE 12.2: DIRECT PAYMENT VS. NET SETTLEMENT INSTRUCTIONS (NSI)

Year to June 30	Total value moved (Ksh)	Settlement proportions Direct (Ksh m)	%	Indirect {NSI (Ksh m)}	%
2006	7,461,197	6,878,229	92.20	582,968	7.80
2007	7,929,003	7,234,837	91.20	694,166	8.80
2008	14,506,951	13,606,759	93.79	900,193	6.21
2009	15,441,446	14,549,876	94.23	891,570	5.77
2010	16,806,252	14,549,876	86.57	2,256,376	13.43
2011	18,792,538	16,360,759	87.06	2,431,779	12.94
2012	20,866,830	20,549,173	98.48	317,657	1.52

Source: Central Bank of Kenya, Banking/National Payments Division

MT 102 (a single customer transfer message that pays multiple beneficiaries) and MT 103 (a single customer transfer message that pays one beneficiary) are messages processed by commercial banks through KEPSS on behalf of their customers.

Multiple third party Message Type MT 102 increased by 21.20 percent from 125,262 messages in the year to June 30, 2011 to 151,814 messages in the year to June 30, 2012. In the same period, single third party Message Type MT 103 increased by 42.79percent from 977,569 messages to 1,395,902messages. Overall, total third party messages processed through KEPSS increased by 40.34 percent from 1,102,831 messages to 1,547,716 messages in the year to June 30, 2012 (Table 12.3). The increase in these messages reflects growing awareness of KEPSS among the public as a safe and efficient payment system for large value and time critical payment systems.

TABLE 12.3: THIRD PARTY TRANSACTIONS PROCESSED THROUGH KEPSS BY MESSAGE TYPE

Year to June 30	MT102	MT103	TOTAL
2006	6,192	24,978	31,170
2007	8,147	46,587	54,734
2008	9,132	75,674	84,806
2009	9,410	115,443	124,853
2010	73,704	561,768	635,472
2011	125,262	977,569	1,102,831
2012	151,814	1,395,902	1,547,716

Source: Central Bank of Kenya, Banking/National Payments Division

1.2 THE AUTOMATED CLEARING HOUSE OPERATIONS

Automated Clearing House (ACH) largely operated smoothly during the year to June 30, 2012. The ACH throughput for the period under review was 27.63 million transactions with a value of Ksh 2,497 billion for both Debit and Credit instruments compared to 28.66 million transactions valued at Ksh 2,284 billion in the same period last year as indicated in Table 12.4. This represents an increase of 9.3 percent in value and a 3.6 percent decrease in volume throughput, respectively. This outcome can be attributed to the delay by the public to acquire the new cheques in line with the cheque truncation requirements, however, the increase in value transacted denotes the trust the public has in the new clearing system.

Cheques dominated the ACH payment instruments accounting for 65.95 percent of total volume of transactions through the Clearing House. In the year to June 2012, the volume of cheques processed through the Automated Clearing House was 18.2 million cheques valued at Ksh 2,134 billion compared to 16.71 million cheques valued at Ksh 1,939 billion in similar period in 2011.

Electronic Funds Transfer (EFT) transactions based payments increased by 5.22 percent during this period from Ksh345 billion to Ksh363 billion (Table 12.4).

TABLE 12.4: CLEARING HOUSE KSH TRANSACTION TO JUNE 30, 2012

Financial Year	Items	Values (Ksh bn)	Volumes ('000')
2005	Debit	1,943	11,287
	Credit	355	3,633
	Total	**2,298**	**14,920**
2006	Debit	2,642	14,513
	Credit	479	5,032
	Total	**3,121**	**19,545**
2007	Debit	3,063	16,859
	Credit	592	5,601
	Total	**3,655**	**22,460**
2008	Debit	3,616	18,670
	Credit	676	5,496
	Total	**4,293**	**24,166**
2009	Debit	3,901	18,549
	Credit	766	7,859
	Total	**4,667**	**26,408**
2010	Debit	1,954	15,732
	Credit	367	9,304
	Total	**2,321**	**25,036**
2011	Debit	1,939	16,713
	Credit	345	11,942
	Total	**2,284**	**28,655**
2012	Debit	2,134	18,222
	Credit	363	9,409
	Total	**2,497**	**27,631**

Source: Central Bank of Kenya, Banking/National Payments Division

The ACH continued to witness increased transactions activity in Domestic Foreign Currency Cheque Clearing (DFCCC) in the year to June 30, 2012 compared to the same period last year. The US dollar denominated Cheques processed through the clearing house increased by 16.83 percent from a volume of 337.2 to 393.9 thousand Cheques, while the GBP and EURO denominated Cheques declined by 14.30 and 10.55 percent from 2.30 and 12.3 thousand Cheques to 1.97 and 11.0 thousand Cheques, respectively, in the same period. In terms of value moved, the US dollar recorded an increase of 19.06 percent, while the EURO and GBP recorded a decrease of 43.61 and 25.96 percent, respectively (Table 12.5). The US dollar remained the preferred currency in the domestic foreign currency cheque clearing followed by the Euro and the Pound, respectively.

TABLE 12.5: DOMESTIC FOREIGN CURRENCY CHEQUE CLEARING TRANSACTIONS TO JUNE 30, 2012

Currency	USD		GBP		EURO	
	Value (m)	Volume ('000')	Value (m)	Volume ('000')	Value (m)	Volume ('000')
2005	1,202.67	159.4	19.83	2.0	78.37	5.1
2006	1,812.80	240.8	23.07	2.6	114.30	7.2
2007	2,124.75	272.4	23.86	2.6	108.13	7.5
2008	2,457.48	278.0	35.82	2.7	99.06	7.9
2009	2,637.32	282.0	52.98	2.9	138.31	9.8
2010	1,500.33	302.4	17.57	2.6	75.75	10.0
2011	1,239.25	337.2	11.41	2.3	77.01	12.3
2012	1,475.46	393.9	6.43	2.0	57.02	11.0
Growth (%)	19.06%		-43.61%		-25.96%	

Source: Central Bank of Kenya, Banking Services Division

1.3 AUTOMATED TELLER MACHINES (ATMS) AND PLASTIC CARD USAGE

The number of Automated Teller Machines (ATMs) in the payment card industry increased by 5.0 percent from 2,183 ATMs in June 2011 to 2,291 ATMs in June 2012. This growth may be attributed to commercial banks' business expansion strategies.

The value of transactions effected through cards in the year to June 2012 increased by 7.95 percent and 37.3 percent from Ksh623.74 billion to Ksh673.34 billion and Ksh555.17 billion to Ksh762.23 billion for acquirers and issuers, respectively. Correspondingly, withdrawals increased by 34.59 percent and 90.13 percent from 110.56 million withdrawals to 148.80 million withdrawals and 115.70 million withdrawals to 219.98 million withdrawals for acquirers and issuers, respectively. The growing usage of cards signifies a growing shift from cash based payments to non-cash payments by the public (Table 12.6 A).

TABLE 12.6A: AUTOMATED TELLER MACHINE'S USAGE

	2005	2006	2007	2008	2009	2010	2011	2012
Number of ATM machines	555	737	1,078	1,510	1,827	1,943	2,183	2,291
Number of transactions (m)								
Acquirers	-	-	58.63	77.92	86.72	93.43	110.56	148.80
Issuers	-	-	42.08	54.70	77.42	83.80	115.70	219.98
Other	-	-	-	3.44	3.56	-	-	0.01
Value of transactions (bn)								
Acquirers	-	-	312.87	396.93	431.79	507.99	623.74	673.34
Issuers	-	-	136.44	258.33	417.04	439.22	555.17	762.23
Other	-	-	-	18.51	18.93	-	-	62.52

Source: NPS Cards Statistics

The total number of cards in use rose by 15.12 percent from 8.6 million cards in June 2011 to 9.9 million cards in June 2012, with debit cards recording a growth of 15.71 percent from 7.0 million cards in June 2011 to 8.1 million cards in June 2012 (Table 12.6B).

TABLE 12.6B: NUMBER OF CARDS IN CIRCULATION

	2005	2006	2007	2008	2009	2010	2011	2012
ATM cards	426,110	829,962	943,359	900,148	985,141	1,252,893	1,439,729	1,640,004
Debit cards	496,647	750,085	971,449	1,528,866	3,700,646	4,156,187	7,002,091	8,121,460
Credit cards	69,478	73,238	107,106	107,653	106,842	111,383	117,835	131,397
Charge cards	3,142	3,769	5,775	5,160	1,682	791	1,418	2,877
Total	995,377	1,657,054	2,027,689	2,541,827	4,794,311	5,521,254	8,561,073	9,895,738

Source: NPS Cards Statistics

1.4 MOBILE PHONE USAGE FOR FUNDS TRANSFER

Mobile phone money transfer service usage continued to increase among the Kenyan public as indicated by the growth in the number of transactions which increased by 39.51 percent from 364.06 million transactions in the year to June 30, 2011 to 507.90 million transactions in the year to June 30, 2012. The Central Bank of Kenya continues to monitor the developments in this sector in line with the Government's policy of enhancing financial inclusion and deepening especially for rural/urban poor and the un-banked.

The customer base Mobile phone money transfer service increased by 10.06 percent from 17.99 million customers to 19.8 million customers, while the number of agents increased by 31.61 percent from 46,588 to 61,313 in the same period with M-Pesa accounting for 76.42 percent, Zap 19.0 percent and Yu 2.8 percent. The value transferred through mobile money transfer services increased by 50.29 percent from Ksh919.22 billion for the year to June 30, 2011 to Ksh 1,375.83 billion for the year to June 30, 2012 (Table 12.7).

TABLE 12.7: MOBILE PHONE MONEY TRANSFER

Year to	Jun 30, 2007	Jun 30, 2008	June 30, 2009	Jun 30, 2010	Jun 30, 2011	Jun 30, 1905
Amount transferred (Ksh billion)	1.49	61.07	318.44	597.31	919.22	1,375.83
Number of agents	527	3,011	10,735	31,902	46,588	61,313
Number of transactions (million)	0.48	21.77	125.12	251.25	364.06	507.90
Number of 'registered' customers/accounts (million)	0.18	3.04	7.39	10.44	17.99	19.80

Source: Service providers

2. CASH INSTRUMENT

Currency in circulation increased from Ksh147.76 billion as at the end of June 2011 to Ksh159.49 billion as at end of June 2012 reflecting an increase of Ksh11.73 billion or 7.94 percent from the previous year's issued currency as indicated in Table 12.8. In weighted terms, bank notes account for 96.93 percent, while coins account for 3.07 percent of currency in circulation.

TABLE 12.8: CURRENCY IN CIRCULATION (NOTES & COINS)

	Jun-07		Jun-08		Jun-09		Jun-10		Jun-11		Jun-12	
Item	Ksh bn.	%	Ksh bn.	%	Ksh bn.	%	Kshs bn.	%	Kshs bn.	%	Ksh bn.	%
Currency in circulation	89.94	100.00	99.89	100.00	108.25	100.00	125.17	100.00	147.76	100.00	159.49	100.00
Bank Notes	86.45	96.12	96.14	96.25	104.22	96.27	120.72	96.44	143.07	96.83	154.60	96.93
Coins	3.49	3.88	3.75	3.75	4.04	3.73	4.45	3.56	4.69	3.17	4.89	3.07

Source: Central Bank of Kenya, Currency Division

TABLE 12.9: CURRENCY IN CIRCULATION (PIECES)

	Bank notes						Coins				
	2008/2009	2009/2010	2010/2011	2011/2012	% change		2008/2009	2009/2010	2010/2011	2011/2012	% change
	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)			Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	
1000/=	78.69	90.22	108.99	119.66	9.79	40/=	1.92	2.25	2.51	5.71	11.51
500/=	20.86	25.33	29.87	29.77	-0.34	20/=	69.84	75.95	81.20	82.81	6.91
200/=	31.74	38.21	43.67	41.38	-5.24	10/=	111.34	125.80	128.75	128.85	2.35
100/=	61.80	70.71	75.39	81.47	8.07	5/=	151.19	170.60	183.25	183.45	7.42
50/=	44.39	55.28	62.24	65.60	5.40	1/=	511.45	539.00	569.13	605.86	5.59
20/=	10.10	10.05	10.04	10.01	-0.27	/50=	258.90	272.00	274.69	274.80	0.99
10/=	12.06	12.00	11.99	11.96	-0.27	/10=*	358.64	360.00	358.61	358.53	-0.39
5/=*	5.80	5.80	5.77	5.75	-0.31	/05=*	305.12	300.00	305.10	305.06	1.70
	265.44	307.60	347.96	365.62	16.83		1768.39	1845.60	1903.23	1945.07	3.12

*5 shillings notes, 10 cents and 5 cents coin were demonetized with effect from December 31, 2011

Source: Central Bank of Kenya, Currency Division

Notes in circulation grew by 16.51 percent from 348 million pieces in the year to June 30, 2011 to 366 million pieces in the year to June 30, 2012. The usage of Ksh 1,000, Ksh 100 and Ksh 50 notes that increased by 9.80 percent, 8.10 percent and 5.4 percent in the year to June 30, 2012, respectively, while the circulation of the Ksh 500 and Ksh 200 notes declined by

0.3 per cent and 5.24 per cent. Coins in circulation grew by 136.02 percent in the same period from 1,903 million pieces to 1,945 million pieces, with the Ksh 40 coin, Ksh 20 coin, Ksh 10 coin, and Ksh 5 coin increasing by 127.3 percent, 1.99 percent, 0.08 percent, and 0.11 percent, respectively. Public preference for bank notes explains the high proportion of currency in circulation being in Bank notes than coins.

2.1 CASH INFLOWS AND OUTFLOWS

Deposits by banks (i.e. Cash inflows) increased by 119.82 percent from Ksh 175.1 billion as at June 30, 2011 to Ksh 384.9 billion as at June 2012. Similarly withdrawals (i.e. cash outflows) increased by 102.98 percent from Ksh 194.9 billion to Ksh 395.6 billion in the same period. This reflects a net currency outflow in the year to June 30, 2012 of Ksh 10.9 billion (Table 12.10).

TABLE 12.10: CURRENCY INFLOWS AND OUTFLOWS (KSHS M)

Inflow by banks	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Bank Notes	268,543	283,083	271,257	175,149	384,996
Coins	562	376	248	29	21
Total	**269,105**	**283,459**	**271,505**	**175,178**	**385,017**
Outflows by banks					
Bank Notes	278,236	291,161	287,754	194,935	395,599
Coins	831	657	658	147	204
Total	**279,066**	**291,818**	**288,412**	**195,082**	**395,803**
Net Outflows	**(9,961)**	**(8,359)**	**(16,907)**	**(19,904)**	**(10,786)**

Source: Central Bank of Kenya, Currency Division

2.2 DEVELOPMENT IN COUNTERFEITING PRACTICES

Counterfeit activity declined significantly with the number of counterfeit notes lower by 44.8 percent from 639 counterfeit notes in the year to June 30, 2011 to 353 counterfeit notes in the year to June 30, 2012 (Table 12.11). The resultant impact in value terms was a decrease of 43.8 percent in the total value of counterfeit notes from Ksh 0.35 million in the previous year to Ksh 0.21 million in the year to June 30, 2012.

In terms of denomination, there were 165 pieces of Ksh 1,000 making up 46.7 percent, 31 pieces of Ksh 500 or 8.8 percent, 123 pieces of Ksh 200 or 34.8 percent, and 28 pieces of Ksh 100 or 7.9 percent of the counterfeit notes, respectively.

The reduction in number of counterfeits is attributed to increased public education, which is carried out by the Central Bank of Kenya and enforcement of sorting guidelines issued to commercial banks. These initiatives have resulted in more vigilance in the industry and the public in general.

TABLE 12.11: COUNTERFEIT NOTES BY DENOMINATION

	Pieces					Proportion
	2007/2008	2008/2009	2009/2010	2010/2011	2010/2012	2010/2011
1000/=	653	1,376	485	259	165	46.74
500/=	205	442	113	75	35	8.78
200/=	172	411	297	204	123	34.84
100/=	94	60	143	72	8	7.93
50/=	4	7	4	29	4	1.13
20/=	0	0	0	0	2	0.57
10/=	0	0	0	0	0	0.00
5/=	0	0	0	0	0	0.00
Total	**1,128**	**2,296**	**1,042**	**639**	**353**	**100.00**

	Amounts (KSH)					Proportion
	2006/2007	2007/2008	2009/2010	2009/2011	2009/2012	2010/2011
1000/=	653,000	1,376,000	485,000	259,000	165,000	79.26
500/=	102,500	221,000	56,500	37,500	15,500	7.45
200/=	34,400	82,200	59,400	40,800	24,600	11.82
100/=	9,400	6,000	14,300	7,200	2,800	1.34
50/=	200	350	200	1,450	200	0.10
20/=	0	0	0	0	80	0.04
10/=	0	0	0	0	0	0.00
5/=	0	0	0	0	0	0.00
Total	**799,500**	**1,685,550**	**615,400**	**345,950**	**208,180**	**100.00**

Source: Central Bank of Kenya, Currency Department

3 CURRENT AND FUTURE DEVELOPMENTS

3.1 LEGAL FRAMEWORK

The National Payment Systems (NPS) Bill, 2010 was enacted into Law (i.e. the National Payment System Act 2011) in December 2011. The act makes provision for the regulation and supervision of payment systems and payment service providers, and for connected purposes. This Act therefore enhances the Bank's oversight powers for non-bank based payment and clearing settlement systems.

In the period under review, the Bank commenced operationalization of the NPS Act 2011 by initiating the process of issuing the regulations and guidelines for the retail payments sub-sector (Mobile Money and Electronic Money) of the National Payments System. These regulations are aimed at ensuring that E-Money Issuers and Payment Service Providers conduct their businesses prudently and in accordance with the provisions of the NPS Act and the Central Bank of Kenya Act.

3.2 CONNECTIVITY TO KEPSS

The integration between Kenya Revenue Authority's Common Cash Receipting System (CCRS), the recently implemented T24 System and KEPSS was finalized and the functional operation between CCRS and T24 is currently being tested. This integration facilitates receipt and management of tax revenues efficiently by KRA for the benefit of the tax-paying public.

3.3 EAST AFRICAN CROSS BORDER PAYMENT SYSTEM

The East Africa Payment System (Cross Border Payment System) was rolled out to the live environment of the EAC member states respective Real Time Gross Settlement Systems and is currently undergoing the pilot run in the live environment. EAPS will provide a platform for efficient and safe settlement of intra-regional financial transactions across the EAC member countries once it becomes fully operational.

3.4 CHEQUE TRUNCATION PROJECT

The Cheque Truncation System was implemented in August 2011. The rollout transformed the country to one clearing zone and reduced the clearing cycle to T + 2 thereby helping minimize fraud, reduce cheque handling costs for commercial banks while facilitating early access to funds by the public access funds. The Kenya Bankers Association in liaison with the Central Bank is exploring modalities for further reducing the clearing cycle to T + 1 and to waive the charges for hitherto upcountry cheques.

13. CURRENCY DEVELOPMENTS

The following is a summary of developments in Currency Management Department in the financial year 2011/12:

Currency in Circulation

Overall Currency in Circulation increased by approximately Ksh 12 billion in the year as detailed below:

TABLE 13.1: CURRENCY IN CURCULATION

CENTRE	CIRCULATION JUNE 30TH 2011 (KES.)	CIRCULATION JUNE 30TH 2012 (KES.)
Nairobi	180,983,527,921.20	197,761,461,471.20
Mombasa	38,006,595,526.25	39,424,138,826.25
Kisumu	-4,277,980,560.00	-2,972,157,860.00
Eldoret	-63,771,263,524.70	-65,826,490,524.70
Nyeri	-110,303,000.00	539,321,000.00
Nakuru	-3,606,290,000.00	-11,945,997,000.00
Meru	531,983,000.00	2,506,161,000.00
Total	**147,756,269,362.75**	**159,486,436,912.75**

Source: Central Bank of Kenya, Currency Operations and Branch Administration Department

Currency Centres

The three currency centres in Nyeri, Nakuru and Meru account for a total of 14 percent of all Currency activities in the Country. The centres serve a total of 185 commercial bank branches.

Combating Counterfeits

In an effort to ensure that counterfeiting is minimized, the Bank stepped up its public awareness campaigns on Security features of Banknotes. The Department participated in Nairobi international trade fair, the Eldoret National Show, Meru Agricultural Show and the Nakuru Agricultural Show. In all these forums, public education on currency security features was extensively carried out. The Department also collaborated with other large cash handling institutions through the Kenya School of Monetary Studies in ensuring that their employees are educated on security features of Banknotes.

14. REGIONAL INTEGRATION DEVELOPMENTS

1.0 INTRODUCTION

The Central Bank participates in a number of regional integration initiatives and programmes, particularly those relating to monetary and financial integration. These iniatives include the implementation of monetary and financial cooperation programmes of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB). This chapter reviews the progress in the implementation of macroeconomic convergence and other financial and monetary developments in the EAC, COMESA and AACB in 2011/12.

2.0 THE EAC MONETARY COOPERATION PROGRAMME

2.1 Background

Pursuant to economic integration efforts, Articles 5, 82 to 85 of the EAC Treaty, provides that Partner States undertake to co-operate in monetary and fiscal matters in accordance with the approved macro-economic policies, harmonization programmes and convergence framework.

Partner States Central Banks through the Monetary Affairs Committee of Governors (MAC) are mandated to steer aspects of the EAC treaty relating to monetary and financial cooperation. MAC is tasked to laying the foundation for a common monetary union encompassing one currency and one central bank among other monetary related issues in East Africa. The specific objectives of MAC include the following: Monetary Policy Harmonization; Macroeconomic Convergence; Capital Account Liberalization; Harmonization of Legal and Regulatory Framework of Banking Supervision; Development of the Payment System; Information Technology Infrastructure Development; and Financial Markets Integration, among others.

On the progress towards the establishment of the East African Monetary Union (EAMU), the EAC Central Banks apportioned their work programme into three distinct blocks. These are: First, the analytical and design block which entails immediate activities to improve understanding of the entire process, especially the pre-conditions for EAMU establishment and the institutional set up. Second, the harmonizing of operating frameworks block which entails the activities that will ensure that the EAC Partner States' operating frameworks are harmonized, thereby setting the stage for enhanced convergence in not only policies, but also the required structures. Third and finally, the policy regimes block which deals with the actual development and implementation of the common monetary and exchange rate regime for EAMU, integrating the Payment Systems for the region and approximation of laws, among other medium term activities. The High Level Task Force (HLTF) is tasked with this block. The first and the second blocks provide technical inputs to inform the High Level Task Force (HLTF) in identifying the beacons of the integration process.

Hence, MAC continued to provide technical input on monetary issues to the HLTF. The taskforce commenced negotiation on the EAMU protocol. MAC progressed work on identified technical issues especially those pertaining to conduct of monetary policy and monetary operations required to inform the HLTF. More broadly, the technical input from the EAC central banks to the HLTF focused to achieve the following objectives:

- Attain a common exchange rate policy
- Attain currency convertibility
- Attain a common monetary policy
- Attain macroeconomic convergence
- Attain harmonized monetary and financial statistics
- Harmonize frameworks for monetary and exchange rate policy operations
- Harmonize supervisory and legal and regulatory frameworks
- Promote financial stability
- Attain uniform infrastructure for payments and securities transactions

The EAC central banks have made significant progress towards achieving these objectives with the analytical work on course. With Technical support from International Growth Center the EAC Central Banks have completed the study on exchange rate arrangements. Two other studies: the study on monetary policy harmonisation in the EAC region and study on macroeconomic convergence criteria via technical support from the IMF are in the final stage of completion and validation. The study on the Exchange Rates Arrangement in the EAC has been validated at technical level and presented to the Sectoral Council on Finance and Economic Affairs held in May, 2012 and will be forwarded to the HLTF for use as inputs. Some of the quick wins by MAC include efforts to improve currency convertibility where Partner States Central Banks have opened currency reciprocal accounts for all EAC Central Banks currencies with an MOU for currency repatriation being signed by partner states central banks. Governors have also signed the agreement for establishing, implementing and participating in the East African Payment System (EAPS). EAPS implementation of an integrated East African Payments System is on-going.

2.1 EAC Macroeconomic Convergence Criteria and Progress in 2011

Since May 2007, the Governors of EAC Partner States adopted a new set of convergence criteria with the following timelines.

- **Stage 1 (Year 2007-2010)**
- **Stage II (2011-2014)**
- **Stage III (2015)**

The criteria were classified into primary and secondary criteria. The primary criteria are the primary preconditions for convergence, which need to be met while secondary criteria reinforce the primary criteria. The primary criteria include benchmarks on fiscal deficits, inflation and external reserves. The secondary criteria include areas of policy and real convergence.

Stage II (2011-2014)

The primary criteria are:

(a) Overall budget deficit to GDP ratio (excluding grants) not exceeding 5 percent; and overall budget deficit to GDP Ratio (including grants) not exceeding 2 percent;
(b) Annual average inflation rate of not more than 5 percent;
(c) External reserves of more than 6 months of imports of goods and non-factor services.

The Secondary Criteria are:

(a) Maintenance of market based interest rates;
(b) Maintenance of high and sustainable rate of real GDP growth of not less than 7.0 percent;
(c) Sustained pursuit of debt sustainability;
(d) Domestic savings to GDP Ratio of at least 20 percent;
(e) Maintenance of sustainable level of current account deficit (excluding grants) as percent of GDP;
(f) Achievement of sustainable growth rate of real GDP of not less than 7.0 percent.

EAC economies have recorded strong growth being one of the regions least affected by recent financial turmoil and global financial crisis. All the Partner States recorded improved economic performance in 2011 expanding by 5.9 percent compared to 5.8 percent in 2010. The economies in the region are projected to continue posting strong growth in 2012 and 2013. The IMF projects that the real GDP growth for Kenya, Tanzania and Uganda will be 5.2 percent, 6.4 percent and 4.2 percent in 2012, and 5.7 percent, 6.7 percent and 5.4 percent in 2013 respectively.

The Kenyan economy remained resilient in 2011 with real GDP expanding by 4.4 percent. This expansion however was lower than the 5.8 percent growth experienced 2011. The slow growth rate in 2011 compared to that of 2010 was as a result of high oil and food prices in addition to unfavourable weather conditions in some parts of the country. This was made worse by instability in the Foreign Exchange market during the second half of 2011. The main drivers behind growth in 2011 include activities related to wholesale and retail trade, transport and communication with a contribution of 17.4 and 12.7 percent to the GDP growth.

In 2011, the region experienced very high inflation originating primarily from high food and fuel prices but also from demand pressures. The region recorded pressures on the currencies to weaken and exchange rate volatility. The pressures for the currencies to weaken resulted from the widening of the current account deficit originating from rapid expansion of the oil import bill and imports for infrastructure development. In addition, the exchange rate volatility factored effects of the Euro sovereign debt crisis and currency speculation activities. Given these challenges, the EAC Governors coordinated policy responses in the region through tightening monetary policy, stemming volatility in the foreign exchange markets, and curbing currency speculative activities beginning October 2011. Rebuilding policy buffers and containing inflation remains a priority in the EAC.

The performance of Kenya and other countries of EAC in respect to each convergence criteria are provided in Table 14.1

TABLE 14.1: MACROECONOMIC PERFORMANCE AND CONVERGENCE UNDER THE EAC CRITERIA

Criteria	Target level Stage 2 and Date	2003	2007	2008	2009	2010	2011	Jun-12
Budget Deficit (Excl. Grants) / GDP*	Not exceeding 5% between 2011-2014	-4.7	1.89	5.23	5.75	7.90	5.66	6.49
Budget Deficit (Incl. Grants) / GDP*	Not exceeding 2% between 2011-2014	-1.5	1.02	3.93	4.94	7.21	4.98	6.02
Inflation rate– annual average	not > 5% per year between 2011-2014	2.8	4.46	9.86	15.11	5.43	6.88	15.97
Gross Foreign Exchange Reserves in Months of Imports of goods & non-factor services**	External Reserves of more than 6 months of imports of goods and non-factor services between 2011-2014	6.3	3.60	4.50	3.60	3.90	3.80	4.30
GDP Growth Rate At Factor Cost-constant prices***	Not less than 7% p.a. between 2011-2014	6.4	6.99	1.53	2.74	5.76	4.38	
Current Account Deficit (Excl. Grants) / GDP	Sustainable levels between 2011-2014	-12.7	2.51	4.09	8.33	6.58	8.22	11.43
Gross National Savings/GDP***	at least 20% between 2011-2014	17.8	13.90	15.90	12.90	11.30	13.20	

* Actual as a percentage of GDP on commitment basis from various Quarterly Economic and Budgetary Reviews

** Based on average of 36 monhts import

*** Various Economic Surveys

THE COMESA MONETARY COOPERATION PROGRAMME

Background

The mandate to establish a Monetary Union in COMESA region is derives from Article 4 (4) of the COMESA Treaty signed at Kampala, Uganda on November 5, 1993, which states that the Member States shall "in the field of monetary affairs and finance, co-operate in monetary and financial matters and gradually establish convertibility of their currencies and a payments union as a basis for the eventual establishment of a monetary union". To be consistent with the Africa Monetary Cooperation Programme led by the Association of African Central Banks and to fast tract achievement of a monetary union, the Seventh Meeting of the Ministers of Finance held in Lusaka, Zambia on November, 2004 adopted revised macroeconomic convergence criteria aimed at establishing a monetary union in COMESA by 2018. The revised convergence criteria, are categorized into primary (preconditions for convergence) and secondary (reinforcement conditions) criteria, and will be implemented in three phases; (i) Stage 1 (2005-2010), Stage 2 (2011-15) and; Stage 3 (2016-18). The following are convergence criteria in the second stage.

Primary Criteria:

(a) Overall budget deficit/GDP ratio (excluding grants) of not more than 4 percent;
(b) Annual average inflation rate not exceeding 3 percent;
(c) Eliminate central bank financing of the budget.
(d) External reserves of equal to or more than 5 months of imports of goods and non-factor services;

Secondary Criteria

(a) Achievement and maintenance of stable real exchange rates;
(b) Achievement and maintenance of market based positive real interest rates;
(c) Achievement of a sustainable real GDP of not less than 7 percent;

(d) Pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to sustainable level;
(e) Total domestic revenue to GDP ratio at of least 20 percent.
(f) Maintenance of current account deficit (excluding grants) as a percentage of GDP to sustainable level;
(g) Achievement and maintenance of domestic investment rate of at least 20 percent;
h) Gradual liberalisation of Capital Account.

The key highlights of this cooperation during the year to June 2012 include hosting of the Seventeenth Meeting of the COMESA Committee of Governors of Central Banks from 3rd to 4th November, 2011 in Ezulwini, Kingdom of Swaziland to review progress on; attainment of COMESA macroeconomic convergence, operations of the COMESA Monetary Institute; and the status of implementation of the Regional Payments and Settlement System. The COMESA Monetary Institute (CMI) which is located at the Kenya School of Monetary Studies (KSMS), Nairobi, Kenya became operational on 7 March 2011. The Host Agreement was finalized and will be endorsed by the Government of Kenya and COMESA Secretariat early in the year to June 2013. The process of recruiting the Executive Director for CMI is to be completed in the course of 2012.

Implementation of the Regional Payment and Settlement System (REPSS) which was launched at the COMESA Summit in 2009 remained on course. REPSS allows member countries to transfer funds more easily and promptly within the region. It had been estimated that member States could save an amount of US$ 45.8 million when channelling intra-COMESA trade through REPSS increasing up to US$ 229.0 million when the region starts trading on an open account. Nine central banks have already signed the REPSS Agreements and prefunded their accounts at the Bank of Mauritius.

2.2 Kenya's Progress in the Implementation of COMESA Monetary Harmonization Programme

Kenya made progress in meeting secondary convergence criteria for Stage 2 (Year 2011-15) of the COMESA Monetary Harmonization Programme.

With regard to primary criteria, Kenya did not meet any of the criteria. The overall budget deficit increased from 5.66 percent in the year to June 2011, to 6.49 percent in the Year to June 2012, surpassing the COMESA target of 4 percent. The overall average inflation rate rose in the year to 2012 to 15.97 percent from 6.88 percent in the Year to 2011, exceeding the COMESA target of 3 percent. Kenya's official external reserves at 4.3 months of import cover in 2012, was under the 5 months of import cover COMESA Monetary Harmonization Target.

Kenya however met several of the secondary criteria targets. Total domestic revenues to GDP were 26.7 percent in the year to 2012, well above the 20 percent or more COMESA target. The ratio of debt relative to GDP declined from 54.2 percent in 2011 to 49.61 percent in 2012. In 2011, the rate of Domestic Investment was at 20.9 percent, meeting the COMESA target of at least 20 percent.

TABLE 14.2: KENYA'S PROGRESS IN IMPLEMENTATION OF COMESA MONETARY CO-OPERATION PROGRAMME DURING STAGE 2 (YEAR 2011-2015)

Primary Criteria	Target for Stage 2 (2011-2015)		Year					
		2003	2007	2008	2009	2010	2011	Jun-12
1. Overall budget deficit/GDP ratio (excluding grants)*	Not exceeding 4 percent	-4.7	1.89	5.23	5.75	7.90	5.66	6.49
2. Inflation rate– annual average	Not exceeding 3 per cent	2.8	4.46	9.86	15.11	5.43	6.88	15.97
3. Central Bank financing of the budget deficit **	Eliminate		0.00	0.00	0.00	0.00	0.00	0.00
4. External reserves in months of imports of goods and non-factor services***	Equal to or more than 5 months of imports of goods and non-factor services	4.2	3.60	4.50	3.60	3.90	3.80	4.30
Secondary Criteria	Target Stage 2 (2011-2015)	2003	2007	2008	2009	2010	2011	Jun-12
1. Achievement of a sustainable real GDP ****	Not less than 7 percent	3	6.99	1.53	2.74	5.76	4.38	
2. Domestic fiscal receipts/GDP ratio*****	= or > 20 percent	19.4	20.86	22.02	22.04	24.31	23.93	26.69
3. Current account deficit (excluding grants) as percent of GDP	Sustainable level	0.6	2.51	4.09	8.33	6.58	8.22	11.43
4. Achievement and maintenance of domestic investment rate (%)	at least 20 percent	16.4	19.10	19.20	23.40	19.80	20.90	
5. Maintenance of positive real interest rates	Positive real interest rates							
5. Maintenance of real exchange rate stability - REER Index	Achieve and maintain stable exchange rates (REER. Jan 2003 = 100)	115.3	75.71	70.46	70.97	72.93	77.21	65.02

* Actual as a percent of GDP on commitment basis from various Quarterly Economic and Budgetary Reviews
** Based on Government Audited revenues for the Fiscal year and Central Bank overdraft as at end-Dec
*** Based on average of 36 months of import
**** Various Economic Surveys
***** Based on revenues (excluding grants) as a percent of GDP at current market prices for each fiscal year

3.0 THE AFRICAN MONETARY COOPERATION PROGRAMME (AMCP)

3.1 Background

The AMCP was adopted during the 26th ordinary Assembly of the Association of African Central Banks (AACB) Governors held in Algiers on September 4, 2002. The programme involves the adoption of collective policy measures aimed at implementing a harmonized monetary system and common management institution in Africa. It envisages the harmonization of the monetary cooperation programme of the various sub regional groupings as building blocks with the ultimate aim of evolving to a single monetary zone by the year 2021 with a common currency and a common central bank at the continental level. It has both primary and secondary convergence criteria under the AMCP which should be attained by at least 51 percent of the AACB Membership before the launching of the African Monetary Union by 2021.

3.2 Progress in Implementation of the AMCP

The year 2011 was the third year of the stage III of the AMCP implementation. For most countries, a number of targets under the primary criteria were not met as standards became tighter with the transition to stage III of the AMCP implementation. Most of the secondary criteria of the AMCP were observed. Table 14.2 shows Kenya's performance in the implementation of the AMCP.

Stage III Criteria (Year 2009 - 2012)

Observance of the following macroeconomic indicators by year 2012.

- Budget deficit/GDP ratio not exceeding 3 percent by 2012.
- Elimination of Central Bank credit to government.
- Inflation rate of less than 5 percent.
- External reserves/imports cover of equal or greater than 6 months.

TABLE 14.3: MACROECONOMIC PERFORMANCE AGAINST CONVERGENCE CRITERIA UNDER THE AMCP FOR 2012 – AACB EASTERN AFRICA REGION

AMCP Targets for Stage III (2009 – 2012)						
Primary Criteria						
	Targets for Stage III (2009 – 2012)	2008	2009	2010	11-Jun	12-Jun
Overall Budget deficit/GDP excluding grants*	not exceeding 3% by 2012	-5.2	-5.7	-7.9	-5.7	-6.5
Inflation rate Annual Average	less than 5 percent per annum	16.23	9.39	3.97	6.88	15.97
Elimination of Central Bank Credit to Government		0	0	0	0.3	0.01
External reserves months of Imports cover**	equal or greater than 6 months	4.5	3.6	3.9	3.8	4.3
Secondary Criteria						
	Targets for Stage III (2009 – 2012)	2008	2009	2010	11-Jun	12-Jun
Domestic fiscal Receipts/GDP ratio	equal to or more than 20%	22.02	22.04	24.31	23.93	26.69
Salary mass/total domestic fiscal receipt ratio	Less than 35 percent	33.8	31.7	29	30	29.7
The sourcing of minimum of 20% Government investment capital from fiscal receipts	equal to or more than 20%	24.6	25.7	25.6	25	
Current Account/GDP ratio	Sustainable level	-7.3	-5.33	-7.93	-8.22	-11.43
Real effective exchange rate	Maintenance of real exchange rate stability	66.75	71.8	72.93	77.21	65.02

* Actual as a percentage of GDP on commitment basis from various Quarterly Economic and
** Based on Government Audited revenues for the fiscal year and Central Bank overdraft as at end-Dec
*** Based on average of 36 months of import
**** Based on Revenues as a percent of GDP at current

Kenya's overall budget deficit to GDP ratio (on a commitment basis and excluding grants) increased to 6.5 percent in the year to June 2012 from 5.7 percent in the year to June 2011. The budget deficit was within the programmed target of 8.4 percent, but above the AMCP target of 3 percent. Kenya's annual average inflation rose by 16.0 percent in June 2012 compared with an annual average of 6.9 percent in June 2011. The increase was mainly caused by sharp increase in world food and fuel prices. The world crude oil prices rose from US $109.0 per barrel in

October 2011 to US $127.0 per barrel in March 2012. The depreciation of the Kenya Shilling against major world currencies in the second half of 2011 further accelerated the prices of imported goods. The overdraft facility was negligible, thus meeting the criteria on the elimination of Central Bank credit to Government. Kenya recorded an increase in the official foreign reserve from US$ 4,142 million or 3.8 months of import cover in June 2011 to US$ 5,283 million or 4.3 months of import cover in June 2012. However, the increase official reserve was not enough to cover the AMPC criterion of at least 6 months of import cover due to a huge import bill.

Under the secondary criterion, the domestic fiscal receipts to GDP ratio, the salary mass to total domestic receipt ratio and the government capital investment to fiscal receipt were above the AMCP target of above 20 percent, minimum of 35 percent and above 20 percent respectively. Domestic fiscal receipts to GDP ratio increased from 23.9 percent in June 2011 to 26.7 percent in June 2012. Over the same period, the salary mass to total domestic receipt ratio declined by 0.3 percent to 29 percent in June 2012, while the government capital investment to fiscal receipt declined marginally to 25 percent in 2011. Kenya's trade weighted real effective exchange rate (REER) appreciated by 15.8 percent from 77.2 in June 2011 to 65.0 percent in June 2012. The steep appreciation of the REER reflected the higher inflation rate in Kenya relative to inflation of the trading partner countries. Kenya's current account to GDP ratio worsened from 7.9 percent in the Year to June 2011 to 9.8 percent in the year to June 2012.

15. ECONOMIC OUTLOOK

The Kenyan economy is expected to grow by 5.2 percent in 2012. Economic performance will be supported by lower inflationary pressures derived from improved supply side conditions particularly for food on account of improved weather conditions. Prudent monetary policy will dampen inflationary expectations thereby easing underlying inflation while the continued stabilization of the Kenya shilling is expected to mitigate against unfavourable price developments in the international commodity markets. Improved macroeconomic conditions as well as continued pursuit of prudent monetary policy are expected to reflect in stable domestic interest rates. The Central Bank will also continue with reforms in the banking sector aimed at strengthening and enhancing efficiency in the financial markets. On the fiscal side, ongoing public expenditure on infrastructure development should help to lock in gains achieved in the past year and, in the medium term, enhance the country's production capacity and competitiveness by improving on efficiencies especially in terms of lower energy and data costs, and improved accessibility via road, air and sea ports.

On the downside, contined volatility in international oil prices, spill over effects of global economic slowdown, and balance of payments pressure associated with a high current account deficit and uncertainity associated with general elections scheduled on March 4, 2013 remain potent threats to Macoreconomic stability.

CENTRAL BANK OF KENYA
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

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CENTRAL BANK OF KENYA
BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2012

DIRECTORS

Prof. Njuguna Ndung'u	-	Governor	
Dr. Haron. Sirma	-	Deputy Governor	(Appointed 24 October 2011 and retired from the Board on 2 May 2012)
Dr. Hezron Nyangito	-	Deputy Governor	(Retired 24 October 2011)
Mr. Joseph K. Kinyua	-	Permanent Secretary, Treasury - Member	
Dr. William O.Ogara	-	Member	
Dr. Mbui Wagacha	-	Member	
Ms. Vivienne Y. Apopo	-	Member	
Ms. Florence K. Muindi	-	Member	

SENIOR MANAGEMENT

Prof. Njuguna Ndung'u	-	Governor	
Dr. Haron M Sirma	-	Deputy Governor	(Appointed 24 October 2011)
Dr. Hezron Nyangito	-	Deputy Governor	(Retired 24 October 2011)
Mr. Kennedy K. Abuga	-	Director – Governors' Office and Board Secretary	
Mr. Aggrey J.K. Bett	-	Director – Finance & IMS Department	
Mr. Fredrick Pere	-	Director – Banking Supervision Department	
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies	
Mr. William Nyagaka	-	Director – Internal Audit Department	
Mr. Charles Koori	-	Director – Research Department	
Mr. Cassian J. Nyanjwa	-	Director – Department of Estates, Supplies and Transport	
Mr. James T. Lopoyetum	-	Director – Currency Operations and Branch Administration Department	
Mr. Gerald Nyaoma	-	Director – Financial Markets Department	
Mr. Peter K. Rotich	-	Director – Human Resources and Administration Department	
Mr. Mark Lesiit	-	Director – Banking & Risk Management Department	(Appointed 3 April 2012)
Mr. Jackson M. Kitili	-	Director – Banking & Risk Management Department	(Transferred 3 April 2012)

REGISTERED OFFICE

Central Bank of Kenya Building
Haile Selassie Avenue
P.O. Box 60000
00200 Nairobi, Kenya

BRANCHES AND CURRENCY CENTERS

Mombasa
Central Bank of Kenya Building
Nkrumah Road
P.O.Box 86372
80100 Mombasa, Kenya

Kisumu
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Jomo Kenyatta Highway
P.O. Box 4
40100 Kisumu, Kenya

Nyeri
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Kenyatta Street
P.O. Box 840
10100 Nyeri

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30100 Eldoret, Kenya

Kenya School of Monetary Studies
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P.O. Box 65041
00200 Nairobi, Kenya

Nakuru
George Morara Street
P.O. Box 14094
20100 Nakuru,Kenya

Meru
Co-operative Bank Building
Njuri Ncheke Street
P.O. Box 2171
60200 Meru, Kenya

CENTRAL BANK OF KENYA
BANK INFORMATION - CONTINUED
FOR THE YEAR ENDED 30 JUNE 2012

AUDITORS

KPMG Kenya
Lonrho House, 16th Floor
Standard Street
P.O .Box 40612
00100 Nairobi, Kenya

MAIN LAWYERS

Oraro and Co. Advocates
ACK Garden House
1st Ngong Avenue
P.O .Box 51236
00200 Nairobi, Kenya

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2012

The directors submit their report together with the audited financial statements for the year ended 30 June 2012, which shows the state of affairs of the Bank.

1. Incorporation

The Bank is incorporated under the Central Bank of Kenya Act Cap 491(the Act).

2. Principal activities

The Bank is established and administered under the Act with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

3. Results

3.1 Financial results

The financial results for the year are set out on page **82**. During the year under review, total operating income registered amounted to KShs23, 154m (2011-KShs 10,551m) including a revaluation surplus of KShs 7,530m (2011-KShs 1,3698m) from revaluation of non-current assets. Total expenditure on the other hand amounted to KShs 8,554m (2011-KShs 8,560m) comprising operating expenses amounting to KShs 7,674m and monetary policy expenses of KShs 880m (2011-KShs 8,531m and KShs 29m respectively). As a result, the Bank recorded a net loss of Kshs 13,638m including unrealized foreign currency revaluation loss amounting to KShs 28,238m. The comparative position for previous year (2011) is a net surplus of KShs 40,925 million (inclusive of foreign currency translation gain of KShs 38,934m).The foreign currency revaluation losses were accumulated as the Kenya Shilling gained value against major convertible currencies, particularly towards the end of the year in comparison with values prevailing on June 30, 2011. Without the translation losses and the gain on revaluation of non-current assets, the operating net surplus at KShs 7,070m in the year 2012 is much higher than the previous year's (KShs 622m) owing to higher than normal income in 2012 from higher lending to Government and commercial banks that amounted to KShs 5,596m against KShs 1,043m in 2011 due to shortfalls in Government revenue and tight liquidity in the market earlier on in the year. This lending all took place at unprecedented higher Central Bank Rate (CBR) that was at 18% for a considerable period. Higher than expected income derived from foreign currency sales in the wake of depreciating local currency in the last quarter of 2011 also contributed to the higher income in 2012. However, this positive income performance was moderated by monetary policy expenses that went up from KSHs 29m in 2011 to KShs880m by the year end in June 2012 as a result of the monetary policy steps taken to stabilize the local currency in the later part of 2011.Overall, the financial performance of the Bank has over the last two years been about 60% lower than normal owing to the effects of the sluggish World economy which has adversely affected the Bank's foreign currency investment income.

CENTRAL BANK OF KENYA
DIRECTORS' REPORT (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2012

3.2 Financial position

The assets of the Bank increased by KShs 63,454m or 14% from KShs.446,616m reported as at June 30, 2011 to KShs 510,070m as at June 30, 2012 mainly due to build-up of foreign currency reserves as a result of both inflows from IMF's Extended Credit Facility (ECF tranches) and net purchases of foreign currency. There was also an increase of about KShs 9.9b from bills and bonds discounted by the Bank from the market and an increase of KShs 8.9b in property and equipment arising from revaluation of non-current assets and additions to work in progress. This was moderated by the foreign currency revaluation losses occasioned by the strengthening of the Kenya Shilling unit that shrunk the shilling value of foreign assets during the period and balances of overnight lending to commercial banks that had decreased by KShs 19.8b at year end.

Liabilities on the other hand increased due to a rise in deposits of commercial banks by 18% and Repo instruments for monetary policy interventions that went up from nil in 2011 to KShs 35,672m by year end in 2012. IMF account balances and currency in circulation also went up by 19% and 8% owing to inflows to the Bank from IMF's Extended Credit Facility and normal growth of demand for cash in the economy. The deficit of KShs 13,638m registered during the period under review arising from foreign currency revaluation loss amounting to KShs 28,238m posted to General Reserves reduced these increases in liabilities.

4. Dividend

The Board of Directors recommends a dividend of KShs 2.5 billion to be paid to the Treasury (2011: Nil).

5. Directors

The directors who served during the year and up to the date of this report are listed on page **72**.

6. Auditors

The auditors, KPMG Kenya, were appointed during the financial year 2009/2010 in line with the Public Procurement and Disposal Act, 2005 for a period of three years and are serving their final year in the audit of the year under review.

BY ORDER OF THE BOARD

K. K. Abuga
BOARD SECRETARY

Date: 28 September 2012

CENTRAL BANK OF KENYA
STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the financial statements of Central Bank of Kenya set out on pages **82 to 137** which comprise the statement of financial position as at 30 June 2012, and the statement of comprehensive income, statement of changes in equity and statement of cashflows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Central Bank Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of the Bank's operating results.

The Directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

The Directors have made an assessment of the Bank's ability to continue as a going concern and have no reason to believe the Bank will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 28 September 2012 and were signed on its behalf by:

Governor

Director

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE

The Central Bank of Kenya is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from CBK Act Cap 491 of the laws of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

Board of Directors

Section 11 of the CBK Act Cap 491 provides that the Board of Directors shall be composed of a Chairperson, a Governor, The Permanent Secretary to the Treasury, who is a non-voting member and five Non-Executive Directors. Previously, all the Board members were appointed by the President. With effect from 2nd May, 2012 however, the Act was amended and now requires that the President appoints the Governor after the conduct of a competitive process and following the approval of Parliament. The proposed procedure for appointing the Chairperson, although not yet enacted, is intended to be similar to the appointment procedure applicable to the Governor. Other than the Permanent Secretary to the Treasury who is ex-officio, all the non-executive Directors of the Board are appointed by the President of the Republic of Kenya. All the Board members are appointed for terms of four years each and are eligible for reappointment provided that no Board Member hold office for more than two terms.

Currently there are five Non-Executive Directors namely Dr. Mbui Wagacha, Mr. John Gerin Msafari, Ms. Vivienne Yeda Apopo and Ms. Florence Kagendi Muindi who are all serving their first term and Dr. William Otiende Ogara who is serving his second term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

Board meetings

The Board meets once every six weeks and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to maintain full and effective control over strategic, financial and operational issues. The Board is not involved in the conduct of day-to-day business as this is the responsibility given to the Governor by the CBK Act Cap 491. It, however, retains responsibility for determining the policy of the Bank.

Audit Committee

The members of the Audit Committee are Dr. William Otiende Ogara (Chairman), Dr. Mbui Wagacha, Mr. John Gerin Msafari and Ms. Vivienne Yeda Apopo. The members are all Non-Executive Directors having experience in Accounting, Auditing, Economics, Banking, Financial and Business Management and Legal matters. The committee currently meets on monthly basis and as necessary. Its responsibilities are to:

- Keep under review the efficiency and effectiveness of internal controls in the Bank;
- Keep under review financial information and improve the quality of financial reporting with particular attention to compliance with legal and reporting requirements;
- Receive and consider the Bank's Annual Budget and recommend it to the Board for approval;
- Review the effectiveness of the Internal Audit Function and reports received there from;
- Review the External Auditors' Audit scope timetables and approach; their performance and their findings;
- Participate in the appointment of the external auditors and their fees;
- Review the Bank's annual financial statements prior to their submission to the Board;
- Review the Bank's Risk Management Policies and Procedures.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (continued)

Monetary Policy Committee (MPC)

Section 4D of the CBK (Amendment) Act 2008 establishes the Monetary Policy Committee. The committee is responsible for formulating monetary policy and is required to meet at least once in two months. Members of the committee are appointed by the Minister for Finance for an initial period of three years each and may be reappointed for another final term of three years.

The Committee is currently made up of the following:

- The Governor who is also the Chairman-internal member
- The Deputy Governor who is the Deputy Chairman-internal member
- Permanent Secretary to the Treasury or his representative who shall be non-voting member
- Professor T. C. Ryan-external member appointed by Minister for Finance
- Mrs. Sheila S.M.R. M'Mbijjewe-external member appointed by Minister for Finance
- Prof. Francis M. Mwega-external member appointed by Minister for Finance
- Mrs. Farida Abdul-external member appointed by Minister for Finance
- Mr. Charles Koori- internal member appointed by Governor
- Mr. John K. Birech-internal member appointed by Governor

Human Resources Committee

Members of this Committee include Ms. Florence K. Muindi as the Chairperson, Dr. William Otiende Ogara, Mr. John Gerin Msafari and Ms. Vivienne Yeda Apopo. Governor and the Deputy Governor attend the meetings as and when necessary. The committee meets regularly and as and when need arises to review human resource policies and make suitable recommendations to the Board.

Financial Stability and Investment Committee

Members of this Committee are Ms. Vivienne Yeda Apopo as the Chairperson, Dr. William Otiende Ogara, Dr. Mbui Wagacha and Deputy Governor. The committee meets regularly and as and when need arises to review financial stability issues and foreign reserves management and investments policies and make suitable recommendations to the Board.

Management Structure

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on page **72.** The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

There are several other Management Committees, which advise the Governor on specific issues in order to enable him to discharge his responsibilities as the Chief Executive Officer of the Bank.

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial 2011/2012 is disclosed in Note 32(iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every *meeting* attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for the staff loans.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (continued)

Code of Ethics

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests, which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct apply to the entire Bank's staff under the staff rules and regulations.

Internal Controls

The management of the Bank has put in place a series of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2005. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of Bank policies and procedures. There is a budget and a procurement plan that is prepared and approved by the Board before commencement of the financial year. The Board receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.

Internal Audit and Risk Management

The internal audit function is performed by Internal Audit Department. Risk Management Unit is a separate function under Banking Department and is responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit Department and Risk Management are availed to the Audit Committee of the Board.

Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explains current monetary policy and also provides the expected monetary policy stance. In addition, the Bank issues policy briefs to the Treasury on both the monetary and fiscal policies. On an annual basis, the Financial Statements are published in the Kenya Gazette and are also placed in the website of the Bank.

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF CENTRAL BANK OF KENYA

We have audited the financial statements of Central Bank of Kenya set out on pages **82 to 137** which comprise the statement of financial position at 30 June 2012, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

As stated on page **77**, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 30 June 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of Kenya Act.

KPMG Kenya

Date: 28 September 2012

CENTRAL BANK OF KENYA
STATEMENT COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2012

	Note	2012 KShs'million	2011 KShs'million
Interest income	4	8,308	4,303
Interest expense	5	(888)	(30)
Net interest income		**7,420**	**4,273**
Fee and commission income	6	3,000	3,003
Foreign exchange (loss)/gain	7	(25,111)	40,017
Other operating income	8	1,189	793
Operating income		**(13,502)**	**48,086**
Operating expenses	9	(7,666)	(8,530)
(Loss)/profit for the year		**(21,168)**	**39,556**
Other comprehensive income			
Fair value on valuation of leasehold land	28	1,489	-
Revaluation surplus	29	6,041	1,369
Total comprehensive income		**(13,638)**	**40,925**

The notes set out on pages 89 to 137 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2012

			Restated	Restated
		2012	2011	2010
ASSETS	**Note**	**KShs' million**	**KShs' million**	**KShs' million**
Balances due from banking institutions and gold holdings	10	437,961	368,835	284,682
Funds held with International Monetary Fund (IMF)	11	2,200	2,731	26,272
Items in the course of collection	12	333	409	316
Advances to banks	13	9,973	49	31
Loans and advances	14	10,817	30,642	20,674
Other assets	15	2,224	5,385	4,802
Retirement benefit asset	16	2,193	1,897	1,894
Property and equipment	17	12,083	3,117	1,296
Prepaid operating lease rentals	18	-	-	-
Intangible assets	19	1,412	1,171	853
Due from Government of Kenya	20	30,874	32,380	33,102
TOTAL ASSETS		**510,070**	**446,616**	**373,922**
LIABILITIES				
Currency in circulation	21	159,216	147,718	125,024
Deposits	22	160,642	135,792	143,228
Amounts due to International Monetary Fund (IMF)	11	97,182	81,829	63,276
Investments by Banks	23	35,673	-	-
Other liabilities	24	1,755	9,447	9,474
Dividends payable	25	-	2,641	2,641
Accruals	26	149	98	113
TOTAL LIABILITIES		**454,617**	**377,525**	**343,756**
EQUITY AND RESERVES				
Share capital	27	5,000	5,000	5,000
General reserve fund	28	40,543	62,722	23,166
Revaluation reserve	29	7,410	1,369	-
Proposed dividend	30	2,500	-	2,000
TOTAL EQUITY AND RESERVES		**55,453**	**69,091**	**30,166**
TOTAL LIABILITIES AND EQUITY		**510,070**	**446,616**	**373,922**

The financial statements were approved by the Board of Directors for issue on -- September 2011 and signed on its behalf by:

Governor | **Director**

The notes set out on pages 89 to 137 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30 2012

	Note	Share capital KShs million	General Reserve Fund KShs million	Revaluation reserve KShs million	Proposed dividend KShs million	Total KShs million
2011:						
At 1 July 2010		**5,000**	**23,166**	**-**	**2,000**	**30,166**
Comprehensive income for the year						
Profit for the year	28	-	39,556	-	-	39,556
Other comprehensive income for the year						
Revaluation surplus	29	-	-	1,369	-	1,369
Total comprehensive income for the year		**-**	**39,556**	**1,369**	**-**	**40,925**
Transactions with owners recorded directly in equity						
2010 dividends paid		-	-	-	(2,000)	(2,000)
Proposed dividends		-	-	-	-	-
Total contributions by and distribution to the owners		**-**	**-**	**-**	**(2,000)**	**(2,000)**
At 30 June 2011		**5,000**	**62,722**	**1,369**	**-**	**69,091**
2012:						
At 1 July 2011		**5,000**	**62,722**	**1,369**	**-**	**69,091**
Comprehensive income for the year						
Loss for the year	28	-	(21,168)	-	-	(21,168)
Other comprehensive income for the year						
Fair value on valuation of leasehold land	28	-	1,489	-	-	1,489
Revaluation surplus	29	-	-	6,041	-	6,041
Total comprehensive income for the year		**-**	**(19,679)**	**6,041**	**-**	**(13,638)**
Transactions with owners recorded directly in equity						
Proposed dividends		-	(2,500)	-	2,500	-
As at 30 June 2012		**5,000**	**40,543**	**7,410**	**2,500**	**55,453**

The notes set out on pages 89 to 137 form an integral part of these financial statements.

CENTRAL BANK OF KENYA
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30 2012

	Note	2012 KShs'million	2011 KShs'million
Operating activities			
Net cash generated by operating activities	31(a)	**85,010**	**24,966**
Investing activities			
Receipts of government loan		1,506	722
Purchase of property and equipment		(1,624)	(1,523)
Purchase of intangible assets		(319)	(334)
Proceeds from disposal of property and equipment		5	1
Proceeds from International Monetary Fund - SDR accounts		15,353	23,541
Net cash generated from in investing activities		**14,921**	**22,407**
Financing activities			
Dividends paid		(2,641)	(2,000)
Net cash outflow from financing activities		**(2,641)**	**(2,000)**
Net increase in cash and cash equivalents		97,290	45,373
Cash and cash equivalents at beginning of year		362,750	277,314
Exchange rate effects		(25,111)	40,017
Cash and cash equivalents at end of year	31(b)	**434,929**	**362,704**

The notes set out on pages 89 to 137 form an integral part of these financial statements

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

1. REPORTING ENTITY

The Central Bank of Kenya (the "Bank") is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from CBK Act Cap 491 of the Laws of Kenya (the "Act") and is domiciled in Kenya. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

2. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

(a) Basis of preparation

(i) Statement of compliance

The financial statements are prepared in accordance with and comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(ii) Basis of measurement

The financial statements are prepared under the historical cost convention except for certain investments such as retirement benefit assets and property and equipment which are measured at fair value.

(iii) Form of presentation

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the "lender of last resort" to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases, confidence can best be sustained if the Bank's support is disclosed only when the conditions giving rise to potential instability in the economy have improved. Although the financial effects of such operations are included in the financial statements of the Bank, these statements may not explicitly identify such support.

(iv) Significant accounting judgement and estimates

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the directors' best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In particular information about significant areas of estimations and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 3 – *Critical accounting estimates and judgements*.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Basis of preparation (continued)

(v) Functional and presentation currency

These financial statements are presented in Kenya shillings (KShs), which is the Bank's functional currency.

Except for where indicated, financial information presented in Kenya shillings has been rounded to the nearest million.

(vi) Change in accounting policy

During the year, the bank amended its accounting policy on leasehold land and property to comply with International Accounting Standards number 17 (Leases) with respect to valuation of leasehold land and properties. The accounting policy was changed to carry leasehold land and properties at valuation rather than cost. The effect of changes in accounting policy is outlined in note 38 of the financial statements.

(b) Revenue recognition

Income is recognised in the period in which it is earned. Income is not accrued if its recoverability is considered doubtful.

(i) Interest income and expenses

Interest income and expense are recognised in the profit or loss for all interest bearing instruments on an accrual basis using the effective interest method based on the actual purchase price. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments.

(ii) Fees and commission income

Fees and commission income, which arise mainly from sale of government securities on behalf of the government by the Bank, are recognised when the corresponding services are provided.

(c) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at rates ruling at the transaction dates. Monetary assets and liabilities at the reporting date which are expressed in foreign currencies are translated into Kenya Shillings at rates ruling at that date. The resulting differences from conversion and translation are recognised in profit or loss in the year in which they arise.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Currency printing and minting expenses

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the profit or loss from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Cost of coins minted is expensed in full on delivery in the year of purchase/ acquisition. The life span of each bank note denomination is as described in note (3 (c)) below.

(e) Employee benefits

(i) Retirement benefits

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund scheme administered by Trustees and funded by the Bank and employees of the Bank. Central Bank of Kenya Staff Pension Scheme, Deposit Protection Fund Board, and other related parties, reimburses the Bank the costs of contributions relating to staff seconded to them by the Bank. Kenya School of Monetary Studies (KSMS) partly reimburses the Bank by meeting most of its recurrent expenditure.

The defined benefit obligation is calculated annually by an independent actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of government bonds that have terms to maturity approximating to the terms of the related pension liability.

The Bank's net obligation in respect of the plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value and the fair value of any plan assets is deducted. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised as income or expense when the net cumulative unrecognised actuarial gains and losses at the end of the previous report year exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets as at that date. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plan.

Past service cost is recognised as an expense on a straight line basis over the average period until the benefits become vested. If the benefits vest immediately, the past service cost is recognised immediately. Any net defined benefit surplus is limited to the benefit that is available to the Bank.

Where the calculation results in a benefit to the Bank, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reduction in future contributions to the plan.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Employee benefits (continued)

(i) Retirement benefits - continued

The Bank also makes contributions to a statutory pension scheme, the National Social Security Fund (NSSF). Contributions to the scheme are determined by local statute and are shared between the employer and employee.

(ii) Other employee benefits

The estimated monetary liability for employees' accrued leave entitlement at the reporting date is recognised as accrued expense.

(f) Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Costs include expenditure that is directly attributable to the acquisition of the asset. Items of property and equipment are depreciated on a straight-line basis in the income statement over the estimated useful lives of the assets at the following rates:

Building improvements	Twenty years
Motor vehicles & Computer equipment	Four years
Currency Processing Equipment	Ten years
Other Office Equipment	Five years
Furniture, Fixtures & Fittings	Ten years

The estimated useful lives of items of property and equipment were revised from Ten years and Two years for Buildings and Property & Equipment respectively with effect from July 1, 2011 to the useful lives stated above.

Property that is being constructed or developed for future use to support operations is classified as Work–in–Progress (WIP) and stated at cost until construction or development is complete, at which time the asset it is reclassified as property and equipment in use.

Subsequent expenditures are capitalized only when it is probable that the future economic benefits will flow to the Bank. Expenditure incurred to replace a component of item of property and equipment is accounted for separately and capitalized while the major replaced component is derecognised.

All other expenditure items which do not meet the recognition criteria are recognised in profit or loss as expenses as they are incurred.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any loss or gain on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in other operating income in profit or loss in the year the asset is derecognised

The assets' residual values, useful lives and methods of depreciation are reviewed and adjusted if appropriate at each financial year end.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Intangible assets

Intangible assets include the value of computer software. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are measured at cost less accumulated amortisation and any impairment loss.

Intangible assets that are being developed for future use to support operations are classified as Work –in – Progress (WIP) and stated at cost until development is complete, at which time they are reclassified as Intangible assets.

The useful lives of intangible assets are assessed to be finite and are amortised over the useful economic life. The amortisation expense on intangible assets with finite lives is recognised in the Statement of Comprehensive Income.

Amortisation is calculated using the straight line method to write down the cost of intangible assets to the residual values over the estimated useful life as follows:

Computer software - Five years

Amortisation methods, useful lives and residual values are reviewed at each financial year end and adjusted when deemed appropriate.

(h) Impairment of non-financial assets

The carrying amounts of the Bank’s non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset’s recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated to assets in the unit (group of units) on a pro-rata basis.

(i) Financial instruments

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, which is the date that the Bank becomes a party to the contractual provisions of the instrument.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(ii) Recognition and initial measurement

The classification of financial instruments on initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

(iii) Classification and measurement

The Bank determines the classification of its investments at initial recognition. The main categories include:

Loans, advances and receivables
Loans, advances and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to counterparty with no intention of trading the receivable. The Bank has classified the following financial assets as loans and receivables originated by the entity: loans and advances, amounts due from the Government, other assets, International Monetary Fund (IMF) related assets and cash and cash equivalents. After initial measurement, loans and receivables are measured at amortised cost using effective interest method less any allowance for impairment.

As the lender of last resort, the Bank may grant loans or advances for fixed periods not exceeding six months to commercial banks that pledge Government securities specified by the Bank. In its capacity as the fiscal agent and banker to the Government of Kenya (GoK), the Bank may make direct advances to the Government for the purpose of offsetting fluctuations between receipts from the budgeted revenue and the payments of the Government. The total amount of advances to the Government outstanding shall not exceed five percent of the gross recurrent revenue of the Government as shown in the Appropriation Accounts for the latest year for which those financial statements have been audited by the Auditor-General.

The Bank also operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The Bank determines the terms and conditions for granting of the above loans with reference to the prevailing market interest rates and may determine different rates for different classes of transactions and maturities.

Loans granted at a lower than market interest rates are measured at present value of anticipated future cashflows discounted using market interest rates. The difference between the fair value of the loans and the carrying amount is treated as a long term employee benefit and is accounted for as a prepayment. The long term benefit is recognised as interest income while prepayment is expensed to staff costs as the services are rendered to the bank over the period of the loan.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(iii) Classification and measurement - continued

Held to maturity
Investments classified as held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are measured at amortised cost using the effective interest method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in 'Interest income' in the profit or loss. The losses arising from impairment of such investments are recognised in the profit or loss line 'Impairment losses on financial investments'. Were the Bank to sell other than an insignificant amount of such assets, the entire category would be reclassified as available for sale. The Bank currently classifies term deposits, Government securities, repurchase and reverse purchase instruments as held to maturity.

Other liabilities
Other liabilities are measured at amortised cost, which approximates fair value due to the short term nature thereof.

Cash and cash equivalents
Cash and cash equivalents comprises of cash balances, bank deposits, current accounts, gold holding, government securities with maturity of up to 3 months from the date of issue. Cash and cash equivalents are carried at amortised cost in the statement of financial position..

Financial liabilities
Financial liabilities are measured at amortised cost except for financial liabilities designated at fair value through profit and loss. Financial liabilities are initially recognised at fair value less, in the case of liabilities measured at amortised cost (including due to banks, due to International Monetary Fund other deposits and other funds borrowed), transaction costs incurred and any difference between the proceeds net of transaction costs and the redemption amount is recognised in the profit or loss as interest expense over the period to maturity using the effective interest method. Financial liabilities which are repayable on demand are recognised at nominal value. Deposits represent reserve deposits of depository institutions' participants and current accounts of the Bank. The Bank has classified the following financial instruments as financial liabilities: currency in circulation, deposits, IMF related liabilities and other liabilities.

Financial assets at fair value through profit or loss: Held for Trading
A financial asset is classified in this category if it is acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are classified as held at fair value through profit or loss. The Bank has classified the Reserve Asset Management Programme (RAMP) financial instruments as held for trading.

(iv) Derecognition

Financial assets are de-recognized when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all of the risks and rewards of ownership.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(iv) Derecognition - continued

A financial liability is de-recognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the profit or loss.

The gains and losses on investments held to maturity and loans and receivables are recognized in the profit or loss when the investments are derecognized.

(v) Gains and losses on subsequent measurement

Gains and losses on amortisation of premiums or discounts of financial instruments measured at amortised cost are recognised in profit or loss of the period in which they arise. Gains and losses due to impairment are recognised as stated in the paragraph dealing with impairment.

(vi) Offsetting

Financial assets and financial liabilities are offset and the net amount reported on the reporting date where there is a legally enforceable right to set off the recognised amount and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

(vii) Impairment of financial assets

At each reporting date, the Bank assesses whether there is objective evidence that a financial asset not measured at fair value through profit or loss is impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows on the assets that can be estimated reliably.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar risk characteristics.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(vii) Impairment of financial assets - continued

In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in the statement of comprehensive income and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit and loss. Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of other comprehensive income to the statement of comprehensive income. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in other comprehensive income. Changes in impairment allowances attributable to time value are reflected as a component of interest income.

(j) Amounts repayable under Repurchase Agreements (REPOs)

REPO is an arrangement involving the sale for cash, of security at a specified price with a commitment to repurchase the same or similar securities at a fixed price either at a specific future date or at maturity.

For monetary purposes (liquidity management), the Bank from time to time mops up money from the financial market (REPO) or injects money into the market (Reverse REPO). The Bank engages in the above with commercial banks only.

When the Bank mops money from commercial banks, it creates a liability in its financial statements and secures this borrowing (liability) by assigning part of the securitized debt owing from Government to the Bank to the commercial banks it has mopped from. The Bank freezes the money mopped and pays interest at market rates on the money. The money mopped stays until maturity (4 to 7 days).

Similarly the Bank also lends money to commercial banks (reverse repo). In this process, the Bank creates an asset in its financial statements and takes a security from the borrowing bank usually in form of Treasury Bills or Bonds. The Bank earns interest on this lending. The injected money stays with the borrowing bank until maturity (4 to 7 days).

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Amounts repayable under Repurchase Agreements (REPOs) (continued)

(i) The Bank treats reverse REPOs as collateralized loans for accounting purposes. In this case, a reverse REPO is recognised as a secured advance and is shown separately as Advance to Banks while repurchase agreements are shown as a liability in the books of Bank.

(ii) REPOs continue to be recognised in the statement of financial position and are measured in accordance with policies for non-trading investment.

(iii) The difference between sales and repurchase price is treated as interest expenditure and is recognised in the profit or loss.

The Bank also accepts, for monetary policy purposes, term deposits from commercial banks on a voluntary basis at market terms for periods of 14, 21 and 28 days. This is a relatively new monetary instrument that the Bank uses in addition to REPO and is similar to REPO only that it is not secured.

(k) Currency in circulation

Currency issued by the Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recognised at face value in these financial statements. Currency in circulation represents the face value of notes and coins in circulation. Bank notes and coins held by the Bank as cash in main vault, intermediary vault, and cashiers at the end of financial year are excluded from the liability of notes and coins in circulation because they do not represent currency in circulation.

(l) Deposits

Deposits are non-derivative financial liabilities with fixed or determinable receipts that are not quoted in an active market. They arise when the Bank receives money or services directly from counterparty with no intention of trading the payable. Deposits held are measured at amortised cost with interest income accruing on an effective interest rate basis.

Cash Ratio Deposits are taken from commercial banks for liquidity management (monetary policy purposes) of the Bank in accordance with the Banking Act and are interest free. Cash Ratio Reserves is a monetary policy instrument used to manage liquidity. The deposits earn no interest to commercial banks and the Bank does not trade on these deposits in any way. The deposits are currently computed at 5.25% of each commercial bank’s deposits it has taken from the public. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

(m) Provisions

A provision is recognised when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to that liability.

(n) Leasing

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Leasing (continued)

(i) Bank as a lessee

Finance leases, which transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in 'Property and equipment' with the corresponding liability to the lessor included in 'Other liabilities.' Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in 'Interest and similar expense.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Bank will obtain ownership by the end of the lease term. Operating lease payments are not recognised in the statement of financial position. Any rentals payable are accounted for on a straight-line basis over the lease term and included in 'Other operating expenses'.

(ii) Bank as a lessor

Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. The Bank leases out some of its properties as operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

(o) Dividends

The Central Bank of Kenya Act (Cap 491) allows the Bank to retain at least 10% of realized income after taking into account expenses. In addition to this, the Board of Directors in the year 2007 set a policy that all dividends shall be net of unrealized income and other revaluations gains in addition to the retention allowed by the Act.

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity until they are declared.

(p) Commitments on behalf of Treasury

The Bank issues Treasury bills and bonds and commitments on behalf of Treasury arising from the issue of Treasury bills and Treasury bonds are not included in these financial statements as the Bank is involved in such transactions only as an agent.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) Comparative

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

(r) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 30 June 2012, and have not been applied in preparing these financial statements as follows:

Standard/Interpretation		Effective date
IAS 12 amendment	*Deferred tax: Recovery of Underlying Assets*	Annual periods beginning on or after 1 January 2012
IAS 1 amendment	*Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*	Annual periods beginning on or after 1 July 2012
IFRS 10	*Consolidated Financial Statements*	Annual periods beginning on or after 1 January 2013
IFRS 11	*Joint Arrangements*	Annual periods beginning on or after 1 January 2013
IFRS 12	*Disclosure of Interests in Other Entities*	Annual periods beginning on or after 1 January 2013
IFRS 13	*Fair Value Measurement*	Annual periods beginning on or after 1 January 2013
IAS 19 amended 2011	*Employee Benefits*	Annual periods beginning on or after 1 January 2013
IAS 27	*Separate Financial Statements (2011)*	Annual periods beginning on or after 1 January 2013
IAS 28	*Investments in Associates and Joint Ventures (2011)*	Annual periods beginning on or after 1 January 2013
IFRIC 20	*Stripping Costs in the Production Phase of a Surface Mine*	Annual periods beginning on or after 1 January 2013
IFRS 1 amendment	*Government Loan*	Annual periods beginning on or after 1 January 2013
IFRS 7 amendment	*Disclosures: Offsetting Financial Assets and Financial Liabilities*	Annual periods beginning on or after 1 January 2013
IAS 32 amendment	*Offsetting Financial Assets and Financial Liabilities*	Annual periods beginning on or after 1 January 2014
IFRS 9	*Financial Instruments*	Annual periods beginning on or after 1 January 2015

The Bank will adopt the above standards, interpretations and amendments on their effective dates.

The Bank does not intend to early adopt any of the above amendments, standards and interpretations.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including experience of future events that are believed to be reasonable under the circumstances. The most significant use of judgement and estimates are as follows:

(a) Impairment losses on loans, advances and receivables

The Bank reviews its loans, advances and receivables at each reporting date to assess whether an allowance for impairment should be recognised in the profit or loss. In particular, judgement by the directors is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on the assumptions about a number of factors and actual results may differ, resulting in future changes in the allowance.

In addition to specific allowances against individual significant loans and advances, the Bank makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration such factors as any deterioration in industry, technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

(b) Property, equipment and intangible assets

Critical estimates are made by the Management in determining depreciation and amortisation rates for property, equipment and intangible assets. The rates used are set out in the accounting policy 2(f) and 2(g) above. Land and Buildings were revalued in the current year. The basis of valuation and assumptions used are disclosed in Note 17 and 18.

(c) Useful life of currency

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the income statement from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Previously the costs were expensed upon delivery and payment of currency stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition.

Useful lives of the various banknotes denominations are currently estimated as follows:

KShs 1,000	2 years
KShs 500	2 years
KShs 200	2 years

The useful life for all other denominations is estimated at 1 year.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

(d) Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

All financial instruments are initially recognised at fair value, which is normally the transaction price. In certain circumstances, the initial fair value may be based on a valuation technique which may lead to the recognition of profits or losses at the time of initial recognition. However, these profits or losses can only be recognised when the valuation technique used is based solely on observable market inputs.

Subsequent to initial recognition, some of the bank's financial instruments are carried at fair value, with changes in fair value either reported within profit or loss or within other comprehensive income until the instrument is sold or becomes impaired.

The fair values of quoted financial instruments in active markets are based on current prices. If the market for a financial instrument is not active including for unlisted securities, the bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Where representative prices are unreliable because of illiquid markets, the determination of fair value may require estimation of certain parameters, which are calibrated against industry standards and observable market data, or the use of valuation models that are based on observable market data.

The fair value for the majority of the Bank's financial instruments is based on observable market prices or derived from observable market parameters.

(e) Pensions

The cost of the defined benefit pension plan is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. See Note 16 for assumptions used.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

		2012	2011
4	**INTEREST INCOME**	**KShs million**	**KShs million**
	Cash and cash equivalents (Note 4a)	32	42
	Held to maturity investments (Note 4b)	1,194	1,513
	Loans and advances (Note 4c)	6,778	2,393
	Held for trading investments (Note 4d)	304	355
		8,308	**4,303**

(a) Interest income from cash and cash equivalents

Income from IMF	**32**	**42**

U8(b) Interest income from held to maturity investments

Interest on Sterling Pound term deposits	441	547
Interest on US Dollar term deposits	185	339
Interest on Euro term deposits	568	627
	1,194	**1,513**

The weighted average interest rates for term deposits were:

US Dollar	0.17%	0.21%
UK Sterling Pounds	0.40%	0.70%
Euro	0.18%	1.18%

(c) Interest income from loans and advances

Interest on loan due from Government Debt	929	958
Interest on Government overdraft	3,664	890
Interest on staff loans	103	271
Interest on reverse REPOs	1,403	36
Interest on local commercial banks overnight loans	521	115
Interest on foreign commercial banks overnight loans	8	2
Other interest income	150	121
	6,778	**2,393**

(d) Interest income from held for trading investments

Interest income – World Bank RAMP	**304**	**355**

The Bank has engaged the services of Reserve Asset Management Programme (RAMP) which is the investment arm of the World Bank to assist in building capacity in foreign reserves management. The Bank has availed US$300 million (2011 - US$300 million) for the Programme.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

4 INTEREST INCOME (Continued)

(e) Additional disclosure on income by source

	2012 KShs million	2011 KShs million
Foreign investments earnings	1,539	1,913
Local investments earnings	6,666	2,298
Other interest earnings	103	92
	8,308	**4,303**

5 INTEREST EXPENSE

	2012	2011
Interest on monetary policy issues/ REPOs	880	29
Interest paid to IMF	8	1
	888	**30**

6 FEE AND COMMISSION INCOME

	2012	2011
Commission on sale of Government securities	3,000	3,000
Poverty Reduction and Growth Facility (PRGF) (IMF-GoK) Commission	-	3
	3,000	**3,003**

The Bank earns from the Government a commission of 1.5% of amounts raised for its agency role in the issuance of Treasury bills and bonds. The commission income is limited to KShs 3 billion as per an agreement between the Bank and Treasury effective 1 July 2007. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.

7 FOREIGN EXCHANGE (LOSS) / GAIN

	2012 KShs million	2011 KShs million
Foreign exchange dealing profit (Note 7a)	3,116	991
Foreign Bonds Pending Receivables	11	92
Foreign exchange translation (loss)/gain (Note 7b)	(28,238)	38,934
	(25,111)	**40,017**

(a) Foreign exchange dealing profit

	2012	2011
Gains on sale of foreign exchange to Government	3,116	989
Foreign exchange dealing profit on commercial banks	-	2
	3,116	**991**

(b) Foreign exchange translation (loss)/gain

	2012	2011
Revaluation (loss)/gain on current accounts	(24,164)	533
Revaluation (loss)/gain on foreign deposits	(9,997)	45,482
Revaluation gain/(loss) on IMF accounts	9,080	(9,924)
Revaluation of RAMP securities	(3,158)	2,824
Others-Revaluation gains on Gold Holdings	1	19
	(28,238)	**38,934**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

7 FOREIGN EXCHANGE (LOSS)/GAIN (Continued)

Exchange rates	2012	2011
US Dollar	84.10	89.70
GBP	131.18	144.3
Euro	105.78	130.0

Foreign currency investment mix	2012	2011
US Dollar	63%+ /-5%	45%+ /-5%
GBP Sterling Pound	14%+/-5%	30%+/-5%
Euro	23%+/-5%	25%+/-5%
	100%	100%

8 OTHER OPERATING INCOME

	2012 KShs million	2011 KShs million
Actuarial gain on retirement benefit obligations	296	3
Miscellaneous income	206	153
Licence fees from Commercial Banks and bureaus	181	182
Penalties Commercial banks and Forex Bureaus	34	48
Rent received	1	1
KSMS other operating income-hospitality services and tuition fee	444	405
Profit on disposal of property and equipment	27	1
	1,189	793

9 OPERATING EXPENSES

	2012 KShs million	2011 KShs million
Staff costs (Note 9(a))	4,134	3,992
Currency expenses (Note 9(b))	1,216	1,766
Property maintenance expenses (Note 9(c))	765	654
Depreciation on property and equipment (Note 17)	191	1,070
Amortisation on intangible assets (Note 19)	78	13
Other expenses (Note 9(d))	1,275	1,029
Impairment loss on financial asset	4,686	-
Auditors' remuneration	6	5
Banking expenses	1	1
	12,352	8,530

(a) Staff costs

	2012	2011
Personnel emoluments	3,669	3,417
Medical benefit	229	210
Other Staff costs	198	358
Directors' expenses	38	7
	4,134	3,992

CENTRAL BANK OF KENYA
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9 OPERATING EXPENSES (Continued)

	2012 KShs million	2011 KShs million
(b) Currency expenses		
Notes production	1,200	1,162
Coins production	7	584
Notes issue	7	10
Coin Issue	2	5
Agency Centres	-	5
	1,216	**1,766**
(c) Property maintenance expenses		
Maintenance of property	359	288
Security of premises	258	234
Property renovation	30	28
Electricity	76	60
Other	42	44
	765	**654**
(d) Other expenses		
Transport and travelling	161	179
Office expenses	199	165
Postal service expense	131	121
Legal and professional fees	102	100
Other administrative expenses	682	464
	1,275	**1,029**

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2012 KShs million	2011 KShs million
Cash and cash equivalents (Note 10(a))	60,008	14,058
Held for trading investments (Note 10(b))	42,612	37,734
Held to maturity investments (Note 10(c))	335,267	316,967
Gold holdings	74	76
	437,961	**368,835**

(a) Cash and cash equivalents

	2012	2011
Special project accounts	12,878	5,846
Current account	39,031	2,640
Domestic forex currency cheque clearing	8,099	5,572
	60,008	**14,058**

CENTRAL BANK OF KENYA
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10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS (Continued)

	2012 KShs million	2011 KShs million
(b) Held for trading		
US Dollar deposits	8	36
Fixed income securities	42,525	37,612
Accrued interest	79	86
	42,612	**37,734**
(c) Held to maturity investments		
Term deposits (Note 10 (c)(i))	335,219	316,719
Accrued interest on term deposits	48	248
	335,267	**316,967**
(i) Term deposits		
Dollar deposits	187,543	118,853
Sterling Pound deposits	68,873	94,548
Euro deposits	78,803	103,318
	335,219	**316,719**

11. FUNDS HELD AT/AMOUNTS DUE TO INTERNATIONAL MONETARY FUND (IMF)

Kenya has been a member of the International Monetary Fund (IMF) since 1966. The Bank is the designated depository for the IMF's holdings of Kenya's currency. IMF currency holdings are held in the No. 1 and No. 2 Accounts, which are deposit accounts of the IMF with the Bank.

	2012		2011	
	SDR Million	KShs Million	SDR' Million	KShs Million
Assets- Funds held at IMF				
IMF balances (SDR asset account)	**17**	**2,200**	**19**	**2,731**
Liabilities- Amounts due to IMF				
International Monetary Fund Account No. 1	21	2,711	20	2,886
International Monetary Fund Account No. 2	-	1	-	1
International Monetary Fund – PRGF Account	521	66,183	328	47,042
IMF-SDR Allocation account	260	32,972	223	31,900
International Monetary Fund loans to Government of Kenya	-	-	-	-
	802	**101,868**	**571**	**81,829**
Security at 30 June	**249**	**32,550**	**241**	**32,550**

Borrowings from and repayments to the IMF are denominated in Special Drawing Rights (SDRs). The SDR balances in IMF accounts are translated into KShs at the prevailing exchange rates and any unrealized gains or losses are accounted for in accordance with accounting policy on foreign currencies.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
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11. FUNDS HELD AT/AMOUNTS DUE TO INTERNATIONAL MONETARY FUND (IMF) (Continued)

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository. The security issued is in part payment of Kenya's quota of IMF shares.

Kenya's quota in IMF and SDRs allocations amounting to SDR 271.4 million and SDR 259.6 million respectively. The quota of SDR 271.4 million has not been accounted for in the financial statements of the Bank.

12 ITEMS IN THE COURSE OF COLLECTION

	2012 KShs million	2011 KShs million
Items in the course of collection	**333**	**409**

The balance represents the value of clearing instruments, which are held by the Bank while awaiting clearing by respective commercial banks.

13 ADVANCES TO BANKS

	2012 KShs million	2011 KShs million
Treasury Bonds Discounted	3,298	32
Treasury Bills Discounted	6,578	16
Accrued interest	97	1
	9,973	**49**

For monetary policy operations, the Bank lends money to commercial banks through reverse Repo for short durations of up to 7 days only. These advances are secured against government securities of any maturity. To promote liquidity, the Bank also buys securities on discount basis from commercial banks. The securities so discounted and held are of varying maturities.

14 LOANS AND ADVANCES

	2012 KShs million	2011 KShs million
Overnight Lending to commercial banks	-	19,873
Irrecoverable amount from banks under liquidation	3,706	3,706
Government overdraft account (see below and Note 32)	7,257	7,571
Loan from IMF to the Government of Kenya (Note 32)	-	(3)
Advances to employees	3,577	3,220
	14,540	34,367
Allowance for loan impairment (banks & staff)	(3,723)	(3,725)
Net advances as at 30 June	**10,817**	**30,642**

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14 LOANS AND ADVANCES (Continued)

	2012 KShs million	2011 KShs million
Movement in the loan impairment allowance is as follows:		
At start of the year	(3,725)	(3,784)
Additional impairment allowance made during the year	-	(1)
Recoveries during the year	2	60
At end of the year	**(3,723)**	**(3,725)**

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at the Bank at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit stands at KShs 25,373,202,658.35 based on the Government financial statements for 2009/2010, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 22,926,066,860.60 based on the Government financial statements for 2008/2009. The Government overdraft attracts an interest at the CBR rate determined by the Bank which varies from time to time according to the monetary policy stance in place.

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the "lender of last resort" to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. Commercial banks did not utilise this facility in the year under review (2011: KShs 19.8million). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

15. OTHER ASSETS

	2012 KShs million	2011 KShs million
Prepayments and sundry debtors	250	2,374
Deferred currency expenses	1,659	2,796
Other	5,001	215
	6,910	5,385
Provision for impairment losses	(4,686)	-
	2,224	**5,385**

The policy of the Bank is to expense banknotes costs over a predetermined useful life of the notes upon issue of the banknotes into circulation.

16 RETIREMENT BENEFIT ASSET

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund. The defined benefit plan is funded by the Bank and the employees of the Bank. The retirement benefit asset is recognised in the financial statements of the Bank up to a limit as described in the accounting policy.

The amounts recognised in the statement of financial position are determined on the basis of an actuarial review carried out as at 30 June.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
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16 RETIREMENT BENEFIT ASSET (Continued)

	2012 KShs million	2011 KShs million
Present value of funded obligations	12,673	12,137
Fair value of plan assets	(17,103)	(15,872)
Present value of net asset	(4,430)	(3,735)
Unrecognised actuarial gain	2,237	1,838
Balance at 30 June	**(2,193)**	**(1,897)**

The amounts recognised in profit or loss are as follows:

	2012	2011
Current service costs	565	601
Interest costs	1,071	1,022
Expected return on plan assets	(1,492)	(1,334)
Net actuarial gains recognised	24	-
Past service cost	625	-
Adjustment for previous year values	(724)	58
Total expenses included in operating expenses	**69**	**347**

Movements in the net asset recognised at the reporting date are as follows:

	2012	2011
Net liability at start of period	(1,897)	(1,894)
Net expense recognised in the profit or loss	69	347
Employer contributions	(365)	(350)
Net liability at end of period	(2,193)	(1,897)
Actual return on plan assets	**608**	**1,173**

The principal actuarial assumptions at the reporting date were:

	2012	2011
Discount rate (p.a.)	12.5%	9%
Salary increase (p.a.)	10.5%	7%
Expected return on plan assets (p.a.)	12.5%	9%
Future pension increases	3%	0%

Historical information	**2012 KShs million**	**2011 KShs million**	**2010 KShs million**	**2009 KShs million**	**2008 KShs million**
Fair value of plan assets	17,102	15,872	14,868	11,678	12,136
Present value of funded obligations	(12,673)	(12,137)	(11,550)	(9,582)	(10,496)
Retirement benefit asset	**4,429**	**3,735**	**3,318**	**2,096**	**1,640**

CENTRAL BANK OF KENYA
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17 PROPERTY AND EQUIPMENT

30-Jun-12	Freehold land and buildings	Leasehold land and buildings	Work in progress	Motor vehicles	Furniture and equipment	
Cost	KShs million	KShs million	KShs million	KShs million	KShs million	KShs million
At beginning of year (Restated)	1,010	-	325	263	5,444	7,042
Transfers from prepaid operating lease rentals	-	300	-	-	-	300
Additions	25	-	971	95	533	1,624
On revaluation	5,057	1,455	-	-	-	6,512
Disposals	-	-	-	-55	-2	-57
At end of the year	6,092	1,755	1,296	303	5,975	15,421
Accumulated depreciation and						
At start of the year	986	-	-	214	2,993	4,193
Transfers from prepaid operating lease rentals	-	32	-	-	-	32
Charge for the year	19	6	-	24	142	191
On revaluation	-986	-32	-	-	-	-1,018
On disposal	-	-	-	-58	-2	-60
At end of the year	19	6	-	180	3,133	3,338
Net carrying value						
At 30 June 2012	**6,073**	**1,749**	**1,296**	**123**	**2,842**	**12,083**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

17 PROPERTY AND EQUIPMENT (Continued)

30 June 2011	**Land and buildings KShs million**	**Leasehold land and buildings KShs million**	**Motor vehicles KShs million**	**Furniture and equipment KShs million**	**Total KShs million**
Cost					
At beginning of year	1,086	-	217	4,220	5,523
Transfers from Prepaid operating lease rentals (Note 18)		300			300
Additions	249		48	1,225	1,522
Disposals	-	-	(2)	(1)	(3)
At end of the year	1,335	300	263	5,444	7,342
Accumulated depreciation and impairment losses					
At start of the year	964	-	187	3,348	4,499
Transfers from Prepaid operating lease rentals (Note 18)	-	28	-	-	28
Charge for the year	22	4	29	1,015	1,070
On revaluation	-	-	-	(1,369)	(1,369)
On disposal	-	-	(2)	(1)	(3)
At end of the year	986	32	214	2,993	4,225
Net carrying value					
At 30 June 2011	**349**	**268**	**49**	**2,451**	**3,117**
30 June 2010:					
Cost					
At start of year	988	-	196	3,813	4,997
Transfers from prepaid operating lease rentals (Note 18)	-	300	-	-	300
Reclassification to intangible asset	-	-	-	(115)	(115)
At 30 June 2009 as restated	988	300	196	3,698	5,182
Additions	98	-	30	522	650
Disposals	-	-	(9)	-	(9)
At end of the year	1,086	300	217	4,220	5,823
Accumulated depreciation and impairment losses					
At beginning of the year	954	-	175	2,834	3,963
Transfers from Prepaid operating lease rentals (Note 18)	-	25	-	-	25
Charge for the year	10	3	21	514	548
On disposal	-	-	(9)	-	(9)
At end of the year	964	28	187	3,348	4,527
Net carrying value					
At 30 June 2010	**122**	**272**	**30**	**872**	**1,296**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
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17 PROPERTY AND EQUIPMENT (Continued)

Property and Equipment were revalued by internal professional valuers on an open market basis and the revaluation has been included in the revaluation reserve.

The methods and significant assumptions applied in arriving at the revalued amounts are as follows:

- The Bank's residential properties are all owner-occupied. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property based on the going rentals for similar properties within the same location.

- The Bank has taken into account comparables values of similar properties (plot, construction standards, design, (lay out), size, location, – current sale prices of vacant plots and those developed) to derive the market prices. These were obtained from market transactions of comparable properties.

  The valuation methods used were:

  (i) Contractors cost basis

  Under this method, the Bank has used the cost per square foot/ metre and multiply the square foot/metre cost by the structure square footages/metres for a value estimate. The cost per square foot/metre is derived from the current construction costs prevailing in the market and include professional fees, depreciation etc. This method estimated what it would cost to optimally develop the property taking cognisance of the plot size, plot ratio and coverage and permitted plot user ratios under the local authority bylaws, physical planning requirements. The estimated cost includes among others, value of land, cost of all the buildings, site works, professional fees, statutory fees (council approval fees, NEMA, etc).

  As stated above the unit costs can also be derived from an analysis of actual costs. The commercial properties i.e. the Bank's offices are specialized in that there is insufficient market data to value them using some form of comparison (for instance, currency operations, vaults etc) so contractors cost are used as basis of valuation.

  (ii) Investment cost basis valuation

  Although the Bank properties (residential) are owner occupied, prevailing rental values of similar properties were adopted. In this method annual rent less outgoings and capitalized / added element of land value were used to arrive at a value.

  The bank also used comparables of capital values of comparable properties within the same location.

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18 PREPAID OPERATING LEASE RENTALS

Operating lease rentals are carried at historical cost less amortisation over the period of the lease. The breakdown is as follows:

	2012 KShs million	Restated 2011 KShs million	Restated 2010 KShs million
Cost			
At 30 June	300	300	300
Additions	-	-	-
At year end	300	300	300
Amortisation			
At 1 July and end of the year	32	28	25
Net carrying value at end of the year	**268**	**272**	**275**
Transfer to property, plant & equipment (Note 17)	(268)	(272)	(275)
At end of year – as restated	-	-	-

19 INTANGIBLE ASSETS

2012:	Software	Work-in-Progress	Total
Cost			
At the start of the year	236	1,157	1,393
Additions	11	308	319
Transfer from work in progress	1,465	(1,465)	-
At end of the year	**1,712**	-	**1,712**
Accumulated amortisation and impairment losses			
At the start of the year	222	-	222
Amortisation for the year	78	-	78
At end of the year	300	-	300
Net carrying value at end of the year	**1,412**	-	**1,412**

2011:	Software	Work-in-Progress	Total
Cost			
At the start of the year	220	842	1,062
Additions	19	315	334
Impairment loss	(3)	-	(3)
At end of the year	236	1,157	1,393
Accumulated amortisation and impairment losses			
At the start of the year	209	-	209
Amortisation for the year	13	-	13
At end of the year	222	-	222
Net carrying value at end of the year	**14**	**1,157**	**1,171**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

19 INTANGIBLE ASSETS (Continued)

The costs of software and hardware implemented during the year under System of Integrated Management, Banking and Accounting (SIMBA) Project were fully capitalised during the year.

20 DUE FROM GOVERNMENT OF KENYA

	2012 KShs million	2011 KShs million
At start of the year	32,380	33,102
Accrued interest receivable	875	716
Receipts during the year	(2,381)	(1,438)
At end of the year	**30,874**	**32,380**

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act to limit the Bank's lending to Government of Kenya to 5% of Government of Kenya audited revenue.

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the Government agreed to repay the loan at KShs 1.11 billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

The loan due from the Government of Kenya is categorised as a loan and receivables and is measured at fair value. The Directors have assessed the loan for impairment and the amount of the impairment is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate of 3% per annum. The assessment has indicates that the loan is not impaired.

21 CURRENCY IN CIRCULATION

	2012 KShs million	2011 KShs million
Kenya bank notes	154,325	143,022
Kenya coins	4,885	4,690
Commemorative coins	6	6
	159,216	**147,718**
Balance at the beginning of the year	147,718	125,024
Deposits by banks	(385,210)	(317,596)
Withdrawals by banks	396,708	340,290
Balance at the end of the year	**159,216**	**147,718**

Currency in circulation represents the face value of banknotes and coins in circulation. Notes and coins held by the Bank as cash in main vault, intermediary vault, and cashier/ teller at the end of financial year have been excluded from the liability of banknotes and coins in circulation because they do not represent currency in circulation. Currency banknotes and coins are issued in the following denominations:

Banknotes: 1,000/=, 500/=, 200/=, 100/= and 50/=.
Coins: 40/=, 20/=, 10/=, 5/=, 1/=, /50, /10 and /05.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

22 DEPOSITS

	2012 KShs million	2011 KShs million
Local commercial banks (Note 22 a)	97,790	72,731
Local banks forex settlement accounts (Note 22 b)	7,541	5,129
External banks forex settlement accounts	40	310
Other public entities and project accounts	17,587	10,830
Government of Kenya (Note 22 c)	37,684	46,792
	160,642	**135,792**

(a) Local commercial banks

Clearing accounts and cash reserve ratio	**97,790**	**72,731**

The cash reserve ratio is a statutory ratio for monetary policy. Commercial Banks and Non-Bank Financial Institutions (NBFI's) are required to hold at the Central Bank of Kenya a prescribed percentage of their total deposits. The ratio is, depending on monetary policy stance, revised from time to time and is currently standing at 5.25%. The statutory deposits are determined from commercial banks monthly returns submitted to Central Bank of Kenya on or before the tenth day of every month. The banking institutions are required to maintain balances at the Central Bank equivalent to the cash reserve requirement of 5.25% based on monthly averages, but should not fall below 3% at any time. Currently there are 43 licensed commercial banks and 1 mortgage finance company.

(b) Local banks forex settlement accounts

	2012 KShs million	2011 KShs million
Euro	1,178	930
Dollar	5,553	3,698
Sterling Pound	810	501
	7,541	**5,129**

(c) Government of Kenya

Paymaster General	16,243	20,791
Treasury Funding Account	11,198	17,207
The Exchequer Account	2,672	1,223
Others	7,571	7,571
	37,684	**46,792**

Under the Central Bank of Kenya Act Cap 491 section 4A (e) the Bank acts as the banker, advisor to, and as fiscal agent of the Government. The Bank receives instructions to transfer funds from the Exchequer Account to voted accounts as per the Exchequer and Audit Act 1955, Part IV Paragraph 17 (2). The instructions are given by the Treasury and specify the Exchequer Account to be debited.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

23	**INVESTMENTS BY BANKS**	**KShs million**	**KShs million**
	Term Auction Deposits	22,064	-
	Repos sold to Banks	13,609	-
	At end of the year	**35,673**	**-**

Investments by banks are due to mopping up of excess liquidity in the market which is managed through issue of securities at a discount and term deposits which attract interest from commercial banks

		2012	**2011**
24	**OTHER LIABILITIES**	**KShs million**	**KShs million**
	Impersonal accounts	204	4,095
	Sundry creditors	751	3,285
	Bonds pending payables	214	1,536
	Refundable deposits	586	531
		1,755	**9,447**
25	**DIVIDENDS PAYABLE**		
	Dividends payable	**-**	**2,641**
	The movement in dividends payable is as follows:		
	Balance at 1 July	2,641	2,641
	Dividends approved in the year	-	-
	Paid during the year	(2,641)	-
	Funds earmarked for an on-going project	**-**	**2,641**
26	**ACCRUALS**		
	Leave accrual	101	75
	Gratuity to staff members	48	23
		149	**98**
27	**SHARE CAPITAL**		
	Authorised share capital	**5,000**	**5,000**
	Issued and fully paid	**5,000**	**5,000**

Ownership of the entire share capital is vested in the Permanent Secretary to the Treasury.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

28 GENERAL RESERVE FUND

The general reserve fund is a fund into which at least 10% of the net annual profits of the Bank are transferred at the end of each financial year. This is after allowing for expenses for operation and after allowance has been made for bad and doubtful debts, depreciation of assets, contribution to staff benefit fund, and such other contingencies and provisions as the Bank deems appropriate. The Bank utilises funds accumulated in this account to pay for acquisition of assets, pay dividends once declared by the Board of Directors, increase paid up capital when necessary and to absorb any negative external shocks. The movement during this year is as follows:

	2012 KShs million	2011 KShs million
At 1 July	62,722	23,166
(Loss)/profit for the year	(25,854)	39,556
Fair value on leasehold land	1,489	-
Proposed dividends	(1,500)	-
As at 30 June	**36,857**	**62,722**

29 REVALUATION RESERVE

Revaluation reserves arise from the periodic revaluation of land and buildings. Buildings were revalued by internal professional valuers on an open market basis as per fixed asset policy and as part of harmonisation initiatives within the region partner states Central Banks and the resulting revaluation surplus has been included in the revaluation reserve. The movement during the year is as follows:

	2012 KShs million	2011 KShs million
At 1 July	1,369	-
Revaluation surplus in the year	6,041	1,369
As at 30 June	**7,410**	**1,369**

30 DIVIDENDS

The Board of Directors recommends payment of a dividend of KShs 1.5 billion (2011: Nil).

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

31 NOTES TO THE CASH FLOW STATEMENT

(a) Reconciliation of net (loss)/profit before tax to cash flow from operating activities

Cash flows from operating activities	2012 KShs million	Restated 2011 KShs million
Net (loss)/profit for the year	(25,854)	39,556
Adjustments for:		
Depreciation of property and equipment	191	1,070
Amortization of intangible assets	78	13
Impairment loss on intangible assets	-	3
Exchange rate loss /(gains)effects	25,111	(40,017)
Gain on disposal of property and equipment	(2)	(1)
Surplus in defined benefit scheme	(296)	(4)
Operating (loss)/profit before working capital changes	**(771)**	**620**
Net increase in loans and advances	19,825	(9,968)
Decrease in balance with International Monetary Fund	531	18,553
(Increase)/decrease in Project accounts	(7,038)	1,205
Decrease in accrued interest on balances due from banking institutions	161	16
Decrease/(increase) in items in the course of collection	76	(93)
Increase/(decrease) in deposits	24,850	(7,436)
Decrease/(increase) in other assets	3,161	(583)
Increase in currency in circulation	11,498	22,694
Increase in Investment by banks	35,672	-
Decrease in other liabilities and accruals	(7,641)	(42)
Net cash generated by operations	**80,324**	**24,966**

(b) Cash and cash equivalents

Cash and cash equivalents included in the cash flow statement comprise the following:

	2012 KShs million	2011 KShs million
Term deposits	335,219	316,679
Current accounts	39,032	2,640
Domestic forex cheques clearing	8,098	5,572
Travellers Cheques	-	-
Gold holdings	74	76
	382,423	324,967
Advances to Banks	9,973	49
Investments with RAMP	42,533	37,734
	434,929	**362,750**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

32 RELATED PARTY TRANSACTIONS

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya, the ultimate owner of the Bank, and the Deposit Protection Fund Board.

(i) Loans

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 14) include advances to employees that as at 30 June 2012 amounted to KShs 3,577 million (2011: KShs 3,220 million). The advances are at preferential rates of interest determined by the Bank.

		2012 KShs million	2011 KShs million
(ii)	**Loans to executive directors**		
	At start of the year	3	6
	Loans advanced during the year	3	-
	Loan repayments	(3)	(3)
	At end of the year	**3**	**3**
(iii)	**Loans to key management personnel**		
	At start of the year	62	39
	Loans advanced during the year	22	57
	Loan repayments	(33)	(34)
	At end of the year	**51**	**62**
(iv)	**Directors' emoluments:**		
	Fees to non executive directors	16	7
	Other remuneration to executive directors	53	50
		69	**57**
(v)	**Remuneration to senior management**	**164**	**172**
(vi)	**Post –employment pension**	**2**	**2**

(vii) Government of Kenya

Transactions entered into with the Government include:

(a) Banking services;
(b) Management of issue and redemption of securities at a commission and;
(c) Foreign currency denominated debt settlement and other remittances at a fee.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

32 RELATED PARTY TRANSACTIONS (Continued)

(vii) Government of Kenya - continued

As at the close of business on 30 June, the following balances, which are included in various categories of statement of financial position, were outstanding:

	2012 KShs million	2011 KShs million
Due from Government of Kenya (Note 20)	30,874	32,380
Overdraft account (Note 14)	7,257	7,571
Loan from IMF to the Government of Kenya (Note 14)	-	(3)
Government of Kenya deposits (Note 22)	37,684	46,792

(vii) Deposit Protection Fund Board

The Bank has a close working relationship with the Deposit Protection Fund Board, an entity incorporated under the Banking Act, and provides it with staff and office accommodation. Certain costs incurred on behalf of the Deposit Protection Fund Board are fully reimbursed to the Bank.

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was KShs 14 million (2011: KShs 86million).

(viii) Kenya School of Monetary Studies

The Kenya School of Monetary Studies is a registered legal entity wholly owned by the Bank. The School is operated as a department of the Bank and results of its operations are incorporated in the financial statements of the Bank.

33 RISK MANAGEMENT

(a) Structure and Reporting

The Board of Directors is responsible for the overall risk management approach and for approving the risk management policy and strategies. Other organs that monitor the assessment and management of risks within the Bank include:

(i) Audit Committee of the Board

The Audit Committee assists the Board in the fulfilment of its oversight responsibilities. Regarding risk management, the Committee oversees the process of risk management by receiving and discussing risk management reports and guiding and monitoring the implementation of recommended mitigating controls/ initiatives.

(ii) Bank Risk Management Committee

The purpose of the Bank's Risk Management Committee is to identify the nature of risks affecting the Bank and the processes by which these risks are to be managed. The Committee monitors external developments relating to all financial, business and strategic risks associated with the operations of the Bank. The Committee is further charged with the responsibility of reviewing the adequacy and overall effectiveness of the Bank's risk management and business continuity management frameworks and oversees the inculcation of a risk philosophy and implementation of a risk strategy and policy across the Bank. In executing its mandate, the Committee receives and considers risk assessment reports from Internal Audit Department and Risk Management Division in Banking & Risk Management Department.

33 RISK MANAGEMENT (Continued)

(a) Structure and Reporting (continued)

(i) Internal Audit Department (IA)

The Internal Audit Department employs risk-based audit approach in planning and carrying out its audit engagements. The Risk Management function facilitates risk assessments by individual departments where risks are identified, analyzed and mitigating measures agreed upon.

The business processes are assessed with regard to business continuity procedures, physical safety, system safety, conformity to legal requirements and regulations, sufficiency of human resources and information safety. In addition, the financial risks and reputation risks are also determined. Controls that are designed to reduce these risks to acceptable levels are assessed in terms of sufficiency and effectiveness; additional controls are recommended in order to increase effectiveness. Following the risk assessments, the major risks and recommendations are used to update the Bank's risk register and regularly reported to the Bank Risk Management Committee and the Board Audit Committee. Action plans that are taken to reduce the risks to acceptable levels are monitored.

(a) Strategy in using financial instruments

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-debt government and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate volatilities. The Bank can only intervene in the foreign exchange market when there are sharp exchange rate movements which are likely to destabilize the financial market.

Governed by the Bank's reserve management policy of safe investment, liquidity and return, respectively, the Bank, with a prudent approach, subjects its foreign exchange reserves to investments in international markets.

In this framework, almost all the financial risks to which the Bank is exposed arise while fulfilling its duties of managing foreign exchange reserves and rendering certain banking services to the banking sector and the Government of the Republic of Kenya.

The Bank is exposed to credit, market and liquidity risks due to the aforementioned operations. The financial risks that arise during the management of foreign exchange reserves are the outcome of an investment choice. Nevertheless, the Bank endeavours to minimize such risks by managing them with a conservative approach.

Foreign exchange reserves are managed by observing the investment criteria defined in the Bank's Guidelines on Foreign Exchange Reserves Management.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

33 RISK MANAGEMENT (Continued)

(a) Risks facing the Bank

The following are the main types of risks that the Bank is exposed to in the course c executing its operations:

- Financial risks include:
  - Credit risk
  - Market risk:
    - Interest risk
    - Foreign currency exchange risk
  - Liquidity risk
- Non financial risks include:
  - Operational risk
  - Human resource risk
  - Legal risk
  - Reputation risk

(i) Financial risks

Credit risk

During its financial operations, the Bank is exposed to credit risk, defined as th probability of a complete or partial failure of counterparty to fulfil its obligatior arising from a financial transaction. The credit risk basically originates from th investments made of deposit placements, if on their maturity the depository bank : unable to pay.

The management of the credit risk that the Bank is exposed to during the foreig exchange reserve management is based on the principle of minimizing defau probabilities of the counterparties and the financial loss in case of default. Th choice of depository banks for deposit placements is a crucial consideration in cred and sovereign risk management. Currently, the Bank's choice of depository banks : confined to the top 200 international banks that meet the set eligibility criteria c financial soundness on long-term credit rating, short-term credit rating, composit rating and capital adequacy. The current active approved depository banks holdin the Bank's deposits number twenty one (21) and their performance is reviewe periodically, based on performance ratings provided by international rating agency Fitch IBCA. Deposit placement limits are allocated to individual banks based o their financial strength, and no individual bank holds more than 10% of the entir deposit portfolio.

To minimize the sovereign risk exposure, the eligible banks are distributed among 1 countries under the following set criteria; long-term credit rating of A+, short-terı credit rating of F1, composite rating of B and BIS capital adequacy ratio of 8%.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Credit risk - continued

Analysis of staff loans and advances, Due from Government loan and Government overdraft):

	2012 KShs million	2011 KShs million
Individually impaired:		
Staff loans	42	49
Other financial asset	4,686	-
Banks in liquidation	3,706	3,766
	8,434	3,815
Allowance for impairment	(8,411)	(3,784)
	23	**31**
Loans past due but not impaired:		
Past due up to 30 days	30,874	32,380
Past due 31 – 60 days	-	-
Past due 61 – 90 days	-	-
Past due 91 – 150 days	-	-
	30,874	**32,380**
Loans neither past due nor impaired:		
Staff loans and advances	3,534	3,171
Overnight lending to commercial banks	-	19,873
Goverment Overdraft	7,257	7,571
	10,791	**30,615**

The Bank undertakes its operations in the Republic of Kenya. An analysis of the Bank's financial assets and financial liabilities by geographical area is given below: The bank's exposure to credit risk is analysed as follows:

	2012 KShs Millions	2011 KShs Millions
Financial assets		
Republic of Kenya	9,973	49
United Kingdom	58,785	75,503
Rest of Europe	114,876	82,717
United states of America	59,192	209,025
Rest of the World	148,445	40
	391,271	**367,334**
Financial liabilities		
Republic of Kenya	**295,241**	**217,621**

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk

This table shows the extent to which the Bank's interest rate exposures on assets and liabilities are matched. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and maturity date.

	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings	0.21-1.18%	424,956	127	-	12,878	437,961
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	2,200	-	2,200
Items in the course of collection	-	-	-	-	333	333
Advances to Banks	-	9,973	-	-	-	9,973
Loans and advances	3%	93	333	10,391	-	10,817
Other assets	-	-	-	-	2,224	2,224
Property, plant and equipment	-	-	-	-	12,083	12,083
Intangible assets	-	-	-	-	1,412	1,412
Retirement benefit assets	-	-	-	-	2,193	2,193
Due from Government of Kenya	3%	875	1,110	28,889	-	30,874
Total assets		**435,897**	**1,570**	**41,480**	**31,123**	**510,070**

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk - continued

As at 30 June 2012	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Liabilities and equity						
Currency in circulation	-	-	-	-	159,216	159,216
Deposits	-	-	-	-	160,642	160,642
Amounts due to International Monetary Fund	-	-	-	-	101,868	101,868
Investments by Banks	-	-	-	-	35,673	35,673
Other liabilities	-	-	-	-	1,755	1,755
Provisions	-	-	-	-	149	149
Dividends payable	-	-	-	-	-	-
Equity and reserves	-	-	-	-	50,767	50,767
Total liabilities and equity		**-**	**-**	**-**	**510,070**	**510,070**
Interest sensitivity gap 2012		**435,897**	**1,570**	**41,480**	**478,947**	**-**

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

As at 30 June 2011	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings	0.21-1.18%	362,655	334	-	5,846	368,835
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	2,731	-	2,731
Items in the course of collection	-	-	-	-	409	409
Advances to Banks	-	49	-	-	-	49
Loans and advances	3%	19,984	333	10,325	-	30,642
Other assets	-	-	-	-	5,385	5,385
Property, plant and equipment	-	-	-	-	3,117	3,117
Retirement benefit asset	-	-	-	-	1,897	1,897
Intangible assets	-	-	-	-	1,171	1,171
Due from Government of Kenya	3%	1,271	1,110	29,999	-	32,380
Total assets		**383,959**	**1,777**	**43,055**	**17,825**	**446,616**
Liabilities and equity						
Currency in circulation	-	-	-	-	147,718	147,718
Deposits	-	-	-	-	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829
Other liabilities	-	-	-	-	9,447	9,447
Provisions	-	-	-	-	98	98
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	69,091	69,091
Total liabilities and equity		-	-	-	**446,616**	**446,616**
Interest sensitivity gap 2011		**383,959**	**1,777**	**43,055**	**446,616**	-

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Sensitivity analysis on interest rate risk

The Bank uses models to assess the impact of possible changes in market risks. These risks include interest rate risk and foreign exchange risk.

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. The Bank bases its analysis on the interest sensitivity gap (Note 33(c). The sensitivity computations assume that financial assets maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	2012 KShs million	2011 KShs million
Effect on profit before tax of a +10% change in interest rates	630	621
Effect on profit before tax of a -10% change in interest rates	(630)	(621)

Foreign currency exchange rate risk

Foreign currency exchange rate risk signifies the probability of incurring a loss stemming from adverse market movements, usually in interest rates, currency exchange rates and asset prices.

For the purpose of managing foreign currency exchange rate risk, the Bank holds a diversified portfolio that spreads over the major world currencies with the following features; stability, widely traded, international acceptability and offering the best range of investment instruments. Guided by these features and the need to minimize transaction costs in external payments, the Bank invests its reserves in four key international currencies, namely, US dollar (USD), British pound (GBP), Euro (EUR) and the Swiss Franc (CHF).

The distribution of these currencies in the portfolio is subject to review from time to time. However, to allow for flexibility in portfolio management, the mix benchmarks are allowed +5% within the following ranges:

USD: 58 - 68%
GDP: 09 - 19%
EUR: 18 - 28%
CHF: 00 - 5%

The net foreign currency position of the Bank as of 30 June 2012 and 2011 is summarized below. The table presented below provides the Bank's financial assets, and financial liabilities, at carrying amounts, categorized by currency.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

The various currencies to which the Bank is exposed at 30 June 2012 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	285,886	69,844	81,792	-	-	365	437,887
Special Drawing Rights	-	-	-	2,200	-	-	2,200
Gold holdings	-	-	-	-	74	-	74
Total financial assets	285,886	69,844	81,792	2,200	74	365	440,161
Liabilities							
Balances due to IMF	-	-	-	101,868	-	-	101,868
Local Banks forex settlements	5,553	810	1,178	-	-	-	7,541
Local bank guarantees	376	-	-	-	-	-	376
Bonds pending payables	214	-	-	-	-	-	214
Forex bureaux deposits	210	-	-	-	-	-	210
Total financial liabilities	6,353	810	1,178	101,868	-	-	110,209
Net statement of financial position at 30 June 2012	**279,533**	**69,034**	**80,614**	**-99,668**	**74**	**365**	**329,952**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

The various currencies to which the Bank is exposed at 30 June 2011 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	167,589	95,438	105,643	-	-	92	368,762
Special Drawing Rights	-	-	-	2,731	-	-	2,731
Gold holdings	-	-	-	-	76	-	76
Total financial assets	167,589	95,438	105,643	2,731	76	92	371,569
Liabilities							
Balances due to IMF	-	-	-	81,829	-	-	81,829
Local Banks forex settlements	3,698	501	930	-	-	-	5,129
Local bank guarantees	339	-	-	-	-	-	339
Bonds pending payables	1,536	-	-	-	-	-	1,536
Forex bureaux deposits	192	-	-	-	-	-	192
Total financial liabilities	5,765	501	930	81,829	-	-	89,025
Net statement of financial position at 30 June 2011	**161,824**	**94,937**	**104,713**	**-79,098**	**76**	**92**	**282,544**

Sensitivity analysis on currency risk

Currency risk is the risk of loss resulting from changes in exchange rates. The Bank bases its analysis on the interest sensitivity gap (Note 30). The Bank has assets and liabilities in various currencies; however, the most significant exposure arises from assets denominated in the US dollar, GBP and Euro currencies. The following table demonstrates the sensitivity to reasonably possible change in the KShs/ US dollar exchange rate, with all other variables held constant, of the Bank's profit earned.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

	2012 KShs million	2011 KShs million
Effect on profit before tax of a +7% change in exchange rates	23,096	19,778
Effect on profit before tax of a -7% change in exchange rates	(23,096)	(19,778)

Liquidity risk

Liquidity risk is defined as not having sufficient cash to meet the commitments that are due or being compelled to convert assets into cash at a price lower than their fair value. The choice of the types of instruments to invest the reserves in is part of liquidity risk management. The available instruments are governed by Section 26 of the Central Bank of Kenya Act which specifies the eligible instruments in which the Bank can invest its reserves including; gold, demand or time deposits and convertible and marketable securities of or, guaranteed by foreign governments or international financial institutions.

In order to manage liquidity risk, the Bank invests its surplus reserves in time deposits with maturities concentrated in short-term maturity span of one to three months. The portfolio is structured in such a manner that a mix of deposits matures every week to ensure availability of funds to meet scheduled government and the Bank's obligations.

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses financial liabilities into relevant maturity groupings based on the remaining period at 30 June 2012 to the contractual maturity date.

LIABILITIES	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	.	.	-	-	159,216	159,216
Deposits	147,764	-	12,878	-	-	160,642
Amounts due to International Monetary Fund	.	-	-	-	101,868	101,868
Other liabilities	.	-	1,755	-	-	1,755
Accruals		-	149	-	-	149
Investment by banks	-	35,672	-	-	-	35,672
TOTAL FINANCIAL LIABILITIES	147,764	35,672	14,782	-	261,084	459,302
Liquidity gap 2012	**(147,764)**	**(35,672)**	**(14,782)**	**-**	**(261,084)**	**(459,302)**

32 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2011to the contractual maturity date.

LIABILITIES	On Demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	.	.	-	-	147,718	147,718
Deposits	129,946	-	5,846	-	-	135,792
Amounts due to International Monetary Fund	.	-	-	-	81,829	81,829
Other liabilities	.	-	9,447	-	-	9,447
Provisions		-	98	-	-	98
Dividends payable	-	980	1,661	-	-	2,641
TOTAL FINANCIAL LIABILITIES	129,946	980	17,052	-	229,547	377,525
Liquidity gap 2011	**(129,946)**	**(980)**	**(17,052)**	**-**	**(229,547)**	**(377,525)**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Non-financial risks

Operational risk

Operational risk is the risk of loss due to human or system errors, incompatibility or failure of internal business processes, or external events. The Bank seeks to minimize losses from operational risk by establishing effective internal control systems which prevent or detect all errors and situations which might cause loss through failure of people or processes in such a way that losses are avoided or reduced to the minimum possible extent. The Bank has assigned the responsibility for managing operational risks to the management of the departments.

The assessment of risks in terms of their effects and probabilities of occurrence and the adequacy, effectiveness and efficiency of the controls established to mitigate the risks is done through audits and risk assessments conducted by the Risk Management Department Division.

Human Resource risk

The particular nature of the activities of the Bank necessitates specialized knowledge in many areas.

The Bank ensures that there is an adequate knowledge base for all specialized job requirements by investing significantly in human resource development in terms of capacity building and practical exposure. The Bank also organizes workshops, seminars, conferences and job attachments for its staff as an effort to improve its human resource requirements.

Legal risk

Legal risks arise from any uncertainty of enforceability, whether through legal or judicial processes, of the obligations of the Bank's clients and counter parties. These are the risks that the Bank may not be complying fully with the relevant laws and legislations. The Bank aims at minimizing such uncertainties through continuous consultations with all relevant parties. In mitigating these types of the risks, the Bank ensures that all business agreements are subjected to extensive legal reviews before contracting.

Reputation risk

The concern about reputation flows from the fact that the Bank is a public institution with important responsibilities for stability in the value of money, the soundness and efficiency of the financial system and the issue of currency (banknotes and coins). All of these matters have direct impact on all citizens and the credibility and the reputation of the Bank is an important factor in the successful fulfilment of these responsibilities.

In managing this risk, the Bank adheres to the best practices and applies principles of sound corporate governance. It also ensures that all key staff has a clear understanding of the appropriate processes in respect of the best practice and principles of good corporate governance.

The Bank therefore, sets out policies and guidelines that govern sound functional operations within the Bank. The performance of these policies and guidelines are periodically reported to different levels of the Bank's Management for Control and Compliance Monitoring.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

34 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In the opinion of the directors, the fair values of the Bank's financial assets and financial liabilities approximate their respective carrying amounts. Fair values are based on discounted cash flows using a discount rate based on the borrowing rate that directors expect would be available to the Bank at the reporting date.

The table below sets out the carrying amounts of each class of financial assets and financial liabilities, and their fair values:

30 June 2012:	Held for trading KShs million	Held-to-maturity KShs million	Loans and receivables KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Financial assets						
Balances due from banking institutions and Gold holdings	42,612	335,637	60,082	-	438,331	438,331
Funds held at International Monetary Fund	-	-	2,200	-	2,200	2,200
Items in the course of collection	-	-	333	-	333	333
Advances to Banks	-	-	9,973	-	9,973	9,973
Loans and advances	-	-	10,817	-	10,817	10,817
Other assets	-	-	2,224	-	2,224	2,224
Due from Government of Kenya	-	-	30,874	-	30,874	30,874
Total financial assets	**42,612**	**335,637**	**116,503**	**-**	**494,752**	**494,752**
Financial liabilities						
Currency in circulation	-	-	-	159,216	159,216	159,216
Deposits	-	-	-	160,642	160,642	160,642
Amounts due to International Monetary Fund	-	-	-	101,868	101,868	101,868
Investment by banks	-	-	-	35,672	35,672	35,672
Other liabilities and provisions	-	-	-	1,755	1,755	1,755
Total financial liabilities	**-**	**-**	**-**	**459,153**	**459,153**	**459,153**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

34 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

30 June 2011:	Held for trading KShs million	Held-to-maturity KShs million	Loans and receivables KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Financial assets						
Balances due from banking institutions and Gold holdings	37,734	316,967	14,134	-	368,835	368,835
Funds held at International Monetary Fund	-	-	2,731	-	2,731	2,731
Items in the course of collection	-	-	409	-	409	409
Advances to Banks	-	-	49	-	49	49
Loans and advances	-	-	30,642	-	30,642	30,642
Other assets	-	-	5,385	-	5,385	5,385
Due from Government of Kenya	-	-	32,380	-	32,380	32,380
Total financial assets	**37,734**	**316,967**	**85,730**	**-**	**440,431**	**440,431**
Financial liabilities						
Currency in circulation	-	-	-	147,718	147,718	147,718
Deposits	-	-	-	135,792	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	81,829	81,829	81,829
Other liabilities and provisions	-	-	-	9,545	9,545	9,545
Total financial liabilities	**-**	**-**	**-**	**374,884**	**374,884**	**374,884**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

34 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

Valuation hierarchy

The valuation hierarchy, and types of instruments classified into each level within that hierarchy, is set out below:

	Level 1	**Level 2**	**Level 3**
Fair value determined using:	Unadjusted quoted prices in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs	Valuation models using significant non-market observable inputs
Types of financial assets:	Actively traded government and other agency securities Listed derivative instruments Listed equities	Corporate and other government bonds and loans Over-the-counter (OTC) derivatives	Highly structured OTC derivatives with unobservable parameters Corporate bonds in illiquid markets
Types of financial liabilities:	Listed derivative instruments	Over-the-counter (OTC) derivatives	Highly structured OTC derivatives with unobservable parameters

The table below shows the classification of financial instruments held at fair value into the valuation hierarchy set out below as at 30 June 2012:

30 June 2012:	**Level 1 KShs million**	**Level 2 KShs million**	**Level 3 KShs million**	**Tota KShs millio**
Assets				
Balances due from banking institutions and Gold holdings	42,612	-	-	42,61
Staff loans and advances	-	3,577	-	3,57
Total assets	**42,612**	**3,577**	**-**	**46,18**

30 June 2011:	**Level 1 KShs million**	**Level 2 KShs million**	**Level 3 KShs million**	**Tota KShs millio**
Assets				
Balances due from banking institutions and Gold holdings	37,734	-	-	37,73
Staff loans and advances	-	3,220	-	3,22
Total assets	**37,734**	**3,220**	**-**	**40,95**

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

34 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

The effective interest rates for the principal financial assets and financial liabilities at 30 June 201 and 2011 were in the following ranges:

	2012	2011
Financial assets		
Government securities	6.00%	6.00%
Deposits with overseas correspondent banks:		
- current accounts		
- term deposits (USD)	0.17%	0.21%
- term deposits (Sterling Pounds)	0.40%	0.71%
- term deposits (Euro)F	0.18%	1.18%
Loans and advances:		
- commercial banks	6.50%	6.50%
- Government of Kenya	3.0%	3.0%
- employees	3.0%	3.0%
Financial liabilities	0.0%	0.0%
- deposits	0.36%	0.36%

35 CONTINGENCIES

The Bank is party to various legal proceedings with potential liability of KShs 266.5 million as at 30 June 2012 (2011- KShs 266.5 million). Having regard to all circumstances and the legal advice received, the directors are of the opinion that these legal proceedings will not give rise to liabilities.

36 COMMITMENTS

	2012 KShs million	2011 KShs million
Capital: Authorised and not contracted for		
Office furniture	-	1
Office equipment	24	26
Computer equipment	10	27
Computer equipment - SIMBA Software	12	4
Fixtures & fittings	5	1
Motor vehicles	-	31
Other	2	64
	53	**154**

37 TAXES

No provision for tax is made as Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

34 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

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- current accounts		
- term deposits (USD)	0.17%	0.21%
- term deposits (Sterling Pounds)	0.40%	0.71%
- term deposits (Euro)F	0.18%	1.18%
Loans and advances:		
- commercial banks	6.50%	6.50%
- Government of Kenya	3.0%	3.0%
- employees	3.0%	3.0%
Financial liabilities	0.0%	0.0%
- deposits	0.36%	0.36%

35 CONTINGENCIES

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CENTRAL BANK OF KENYA
NOTES TO THE FINANCIAL STATEMENT
FOR THE YEAR ENDED 30 JUNE 2012 (continued)

38 RESTATEMENT OF PRIOR YEAR BALANCE SHEETS

During the year, the bank amended its accounting policy on leasehold land and property to comply with International Accounting Standards number 17 (Leases) with respect to valuation of leasehold land and properties. The accounting policy was changed to carry leasehold land and properties at valuation rather than cost. The balance sheets as at 30 June 2011 and 2010 have been restated to present the changes noted above. The effect of the restatement is shown in Notes 17 and 18 of these financial statements.