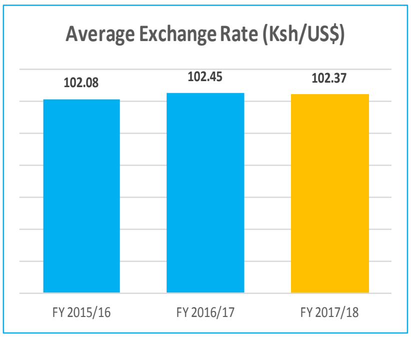
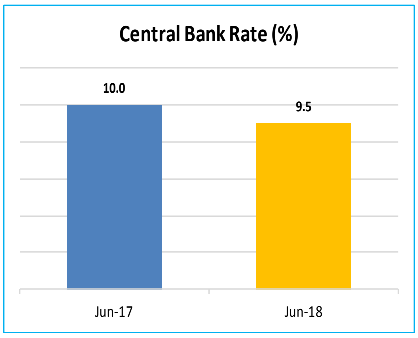
Central Bank of Kenya

THE YEAR OF RESILIENCE

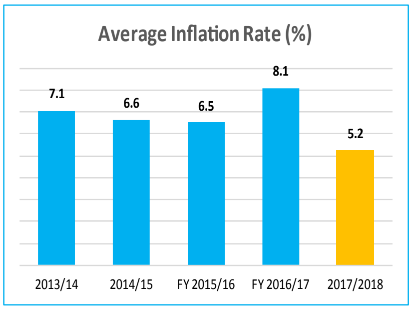
ANNUAL REPORT
AND FINANCIAL STATEMENTS
2017/2018

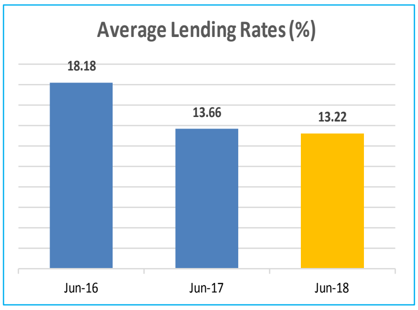
HIGHLIGHTS

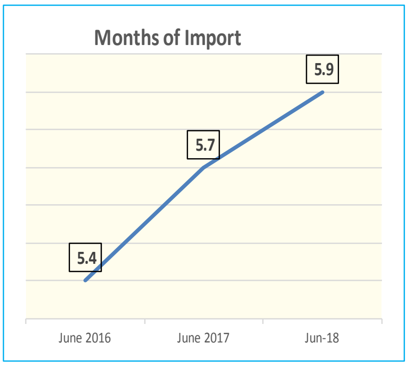


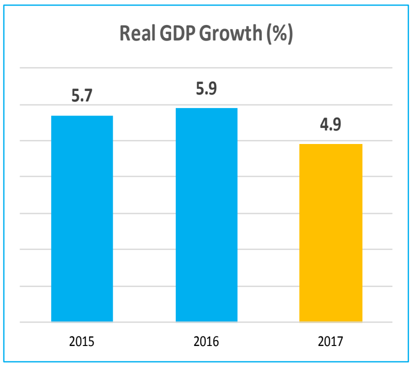


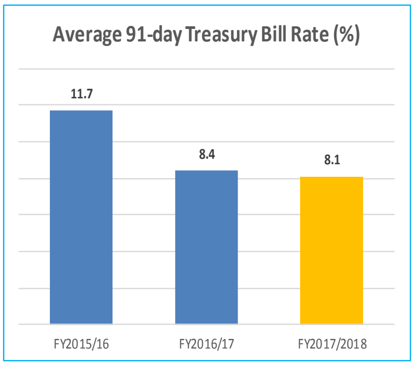
US$ 8.95 billion
The level of Official Forex Reserves at end June 2018.

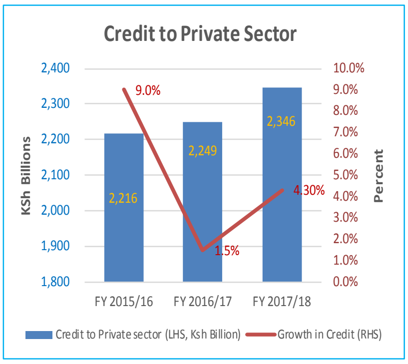


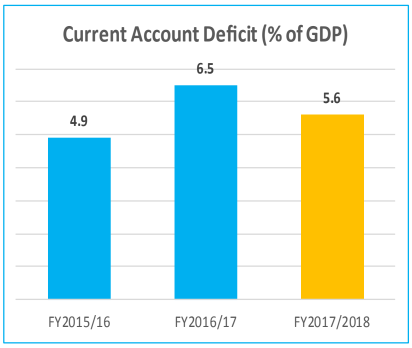


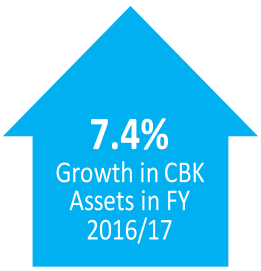


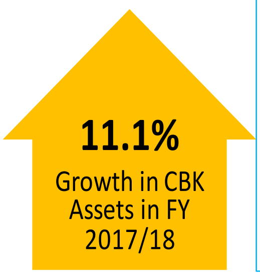


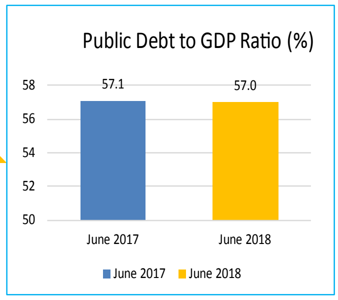












MANDATES

Article 231 of the Constitution of Kenya and Sections 4 and 4A of the Central Bank of Kenya Act outline key mandates of Central Bank of Kenya (CBK) as to:

i). Formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices.
ii). Foster the liquidity, solvency and proper functioning, efficient, sound and stable market-based financial system.
iii). Formulate and implement such policies as best to promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems.
iv). Design, issue and manage efficient distribution of quality currency (notes and coins) that are easily accepted and secure against counterfeiting.
v). Support the Government's economic and financial policies including its objectives for growth and employment.

The other mandates of the Bank include: - formulating and implementing foreign exchange policy; effective management of the nation's foreign exchange reserves; licensing and supervising authorized dealers; act as banker and adviser to, and fiscal agent of the Government.

OUR VISION

The Vision of the Bank is "To be a World Class Modern Central Bank."

OUR MISSION

To formulate and implement monetary policy for price stability, foster a stable market-based financial system and ensure a sound national payment system.

Commitment

The Board and staff are committed to implementing the Bank's mandate as stipulated in the Constitution of Kenya and the CBK Act.

Professionalism and Relevance

The Board and staff will always endeavour to offer quality services to its internal and external customers, diligently observing high professional standards at all times and respecting the rules and regulations set by the Bank. All initiatives and activities undertaken remain relevant to the Bank's strategic objectives in pursuit of its core mandate.

Efficiency & Effectiveness

The Bank will at all times undertake its operations in the most cost efficient and effective manner while maintaining high standards of performance in execution of its mandate.

Innovativeness

The Bank will encourage, nurture and support creativity and the development of new ideas and processes for the continued improvement of organisational performance.

Transparency, Accountability and Integrity:

The Board and staff will always act in a transparent and accountable manner when handling all the affairs of the Bank both internally and with external parties so as to uphold the Bank's image at all times. In addition, the Bank will uphold high standards of ethics, integrity and honesty as guided by the Constitution, act in an ethical manner as guided by the Leadership and Integrity Act and the Public Officers' Ethics Act, and observe high moral standards.

Diversity and Inclusiveness:

The Bank appreciates and embraces the differences in its employees' skills sets and abilities and encourages consultations and inclusiveness in pursuit of its mandate across departments. This is aimed at maximising productivity and enhancing the Bank's overall performance.

Mutual Respect and Teamwork:

Mutual respect shall at all times be observed internally amongst colleagues and when dealing with the Bank's external clients. In addition, the Board and staff will cooperate and collaborate to enhance performance and create a healthy work environment.

ABBREVIATIONS AND ACRONYMS

AACB	Association of African Central Banks
ACH	Automated Clearing House
A-I-A	Appropriation in Aid
AMCP	African Monetary Cooperation Programme
ATM	Automatic Teller Machine
CBK	Central Bank of Kenya
CBKIP	Central Bank of Kenya Internship Program
CBR	Central Bank Rate
COMESA	Common Market for Eastern and Southern Africa
CPIA	Country Policy and Institutional Assessment
EAC	East African Community
EAMU	East African Monetary Union
EAPS	East Africa Payment System
EFTs	Electronic Fund Transfers
Fintech	Financial Technologies
FY	Financial Year
GDP	Gross Domestic Product
IB	Internet Banking
IMF	International Monetary Fund
KEPSS	Kenya Electronic Payments and Settlement System
KIB	Kenya Institute of Bankers
KSh	Kenya Shillings
MFB's	Microfinance Banks
MPC	Monetary Policy Committee
MPCC	Monetary Policy Consultation Clause
MSME	Micro Small and Medium Enterprises
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NFNF	Non-Food-Non-Fuel
NPL	Non-Performing Loan
NSI	Net Settlement Instruction
OPEC	Organization of the Petroleum Exporting Countries
OTC	Over the Counter
POS	Point of Sale
REPSS	Regional Payment and Settlement System
RTGS	Real Time Gross Settlement
SACCOs	Savings and Credit Cooperative Societies
SBA	Stand-By Arrangement
SGR	Standard Gauge Railway
SSA	Sub-Saharan Africa
TMD	Treasury Mobile Direct
TRWA	Total Risk Weighted Assets
VAT	Value Added Tax
WEO	World Economic Outlook

LETTER OF TRANSMITTAL

In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the Annual Report of the Central Bank of Kenya for the Financial Year 2017/18. The Annual Report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Financial Year ended June 30, 2018.

Dr. Patrick Njoroge

Governor

FOREWORD BY THE GOVERNOR

I am pleased to present the Central Bank of Kenya’s Annual Report for Financial Year 2017/18. The economy remained resilient during the year despite increased uncertainties and challenges in the domestic and international environments. The resilience of the economy during the year was underpinned by macroeconomic stability, sustained investor confidence and the strong performance of the services sector that supported robust GDP Growth. The economy shrugged off external shocks arising from uncertainties with respect to U.S. trade policies, escalation of trade and geopolitical tensions, the Brexit resolution and the effects of normalization of monetary policy in the advanced economies. These developments resulted in increased volatility in the global financial markets, particularly for emerging market economies. Domestically, the impact of the severe drought in the first half of 2017, uncertainty occasioned by the long electioneering period, and the constraints posed by the interest rate capping law, were among notable challenges.

Monetary policy during the year aimed at maintaining price stability and ensuring that the banking and financial sector increased its capacity to support the economic growth agenda. The Bank continued to improve on its monetary policy framework through sharpening of its forward-looking tools and indicators, particularly the macroeconomic forecasting framework and the Market Perceptions Surveys. These effectively guided the implementation of monetary policy. Overall inflation remained within its target range through most of the period, supported by a decline in food prices and muted demand-driven inflationary pressures. The foreign exchange market remained stable largely supported by a narrowing current account deficit reflecting strong growth in agricultural exports, diaspora remittances, and recovery of the tourism receipts. The foreign exchange inflows from these and other sources have resulted in historically high levels of reserves that continue to provide a buffer against potential external shocks.

The banking sector remained stable and resilient in the year, with strong liquidity and capital adequacy ratios. However, credit risk remained elevated largely due to delayed payments by government agencies and private sector, and slowdown in business activities. CBK’s overarching vision is for a banking sector that works for and with Kenyans. This vision is underpinned by customer-centricity, risk-based credit pricing, transparency and disclosure of the necessary and timely information to customers and doing the right thing. Given the growing trend towards financial sector integration, CBK recognizes that this vision can only be achieved through the concerted efforts of all financial sector stakeholders, both in Government and the private sector.

The Bank continued to support the modernization of the National Payment System in order to lower transaction costs and improve efficiency and effectiveness of the payment, clearing and settlement systems. In this regard, the Bank issued a Guidance Note on Cyber security outlining the minimum standards that institutions should adopt to develop effective cyber security governance and risk management frameworks.

The Bank continued to enhance its communication to and engagement with stakeholders. It collaborated with the University of Nairobi to hold an inaugural public lecture in February 2018. The event attracted participation from diverse sectors of the economy and the region, and provided an opportunity to debate policy issues of interest in the region.

Looking ahead, the Bank is rolling out a strategic plan, setting out the strategic focus for the next three years. The strategic initiatives envisaged in the plan are aimed at improving the Bank’s operational effectiveness, enhancing regulatory capacity, modernising systems and processes to ensure effective delivery of our mandate.

Dr. Patrick Njoroge
Governor

STATEMENT BY THE CHAIRMAN OF THE BOARD

The Financial Year (FY) 2017/2018 marked the final year of implementing Central Bank of Kenya’s Strategic Plan for 2015-2018. During the year a number of strategic initiatives were implemented to continue improving systems and processes. The Bank achieved great strides in maintaining price stability and transparency in the conduct of monetary policy, strengthened buoyancy and innovativeness in the banking sector, maintained an effective and efficient payments system and maintained excellent operational effectiveness, amidst domestic and external shocks. The Bank also greatly improved currency management through the installation of a modern banknote processing system and currency destruction machine. During the year the IT systems were modernised and their capacity enhanced. The staff realignments were also undertaken to improve staff morale and performance. These milestones have set the stage for implementation of a new Strategic Plan covering the period 2018-2021.

The CBK Board priorities in the period 2018-2021 will include further modernisation and strengthening of the information technology systems; enhancing research work with the aim of providing thought leadership in economic research in Africa; setting up modern information and data management system through the completion of the Enterprise Data Warehouse System; and developing and enhancing staff competencies and entrenchment of a leadership philosophy that is instrumental in steering the mission of the Bank. In addition, the Bank will support the Government’s growth strategy outlined in the ‘BIG 4’ plan of boosting the manufacturing sector, providing affordable housing, enhancing food security and achieving universal health care.

As the CBK continues its journey to become a world class modern central bank, reflected in its people, processes, and systems, we look forward to the continued support from our domestic, regional and international partners. Accordingly, the Board will continue implementing the monitoring and evaluation framework that tracks the implementation of the strategic plan 2018-2021 on a quarterly basis to achieve its strategic objectives.

I thank the CBK Management, staff and other stakeholders for the great support accorded to the Board in the discharge of its responsibilities during the Financial Year 2017/18.

Mr. Mohamed Nyaoga
Chairman,
Board of Directors
Central Bank of Kenya

OVERVIEW

Global Economic Performance

Performance of the global economy remains strong with output projected at 3.9 percent in 2018 and 2019 from 3.7 percent in 2017. Output among the advanced economies is expected to stabilise at 2.4 percent in 2018 and slowdown to 2.2 percent in 2019 reflecting the ongoing withdrawal of monetary policy accommodation and effects of escalating trade tensions among the advanced economies.

Kenya Economic Performance

The economy remained resilient and expanded by 4.9 percent in 2017, despite domestic shocks of adverse weather conditions, uncertainties associated with prolonged electioneering period, and continued slowdown of credit associated with interest rate caps. The resilience of the economy was attributed to resilience of Micro Small and Medium Enterprises (MSMEs), public investment in infrastructure, increased growth of the digital economy, and strong performance of the tourism sector. In the first quarter of 2018, the economy grew by 5.7 percent, mainly supported by improved weather conditions that led to increased agricultural production.

Inflation

Annual average inflation declined to 5.2 percent in June 2018 from 8.2 percent in July 2017, driven by declining food prices following favourable weather conditions and government measures to stabilise food prices. The 12-month overall inflation declined below the midpoint of the Government target of 5±2.5 percent since November 2017 and stood at 4.3 percent in June 2018 compared to 7.5 percent in July 2017 largely supported by lower food prices. Non-food-non-fuel (NFNF) inflation remained below 5 percent during the Financial Year 2017/18, indicating muted demand pressures supported by appropriate monetary policy stance.

Monetary Policy Operations

The Central Bank of Kenya (CBK) conducted monetary policy focused on achieving and maintaining stability in the general level of prices. The Monetary Policy Committee (MPC) in their first four meetings of the FY2017/18 retained the Central Bank Rate (CBR) at 10.0 percent in order to continue to anchor inflation expectations. In the March 2018 meeting, while noting the risk of perverse outcomes due to interest rate capping, the MPC lowered the CBR by 50 basis points to 9.5 percent as there was room for easing of monetary policy stance to support economic activity as inflation expectations were well anchored within the Government's target range, the increased optimism for growth prospects in the economy and that economic output was below its potential level. In its May 2018 meeting, the MPC retained the CBR at 9.5 percent noting that the impact of March 2018 reduction in the CBR was yet to be fully transmitted to the economy, including determination of any perverse outcomes.

On March 12, 2018, the Executive Board of the International Monetary Fund approved a 6-month extension of the Kenya's Stand-By Arrangement (SBA) to allow additional time to complete outstanding programme reviews. The precautionary arrangement with the International Monetary Fund provided additional buffers against exogenous shocks.

Kenya's foreign exchange market remained relatively stable during FY 2017/18, mainly supported by higher foreign exchange receipts from agriculture exports and tourism, resilient inflows from remittances; and an adequate reserve buffer. The CBK foreign exchange reserves increased to USD 8,954 million, equivalent to 5.9 months of import cover at end-June 2018, and continue to provide an adequate buffer against short term shocks in the foreign exchange market.

OVERVIEW

Government Budget

Government budgetary operations in the FY 2017/18 resulted in a deficit including grants of KSh 596.6 billion (6.7 per cent of GDP) on a commitment basis, compared to KSh 683.1 billion (8.9 per cent of GDP) incurred in the FY 2016/17. The deficit was within the target level of KSh 627.4 billion or 7.1 per cent of GDP. Government expenditure continued to increase steadily, while revenue growth was somewhat constrained, despite tax reform measures. The domestic financing of the deficit rose slightly to 45 per cent, from 44.4 per cent in the FY 2016/17. The domestic financing component has been lower than the external financing component over the last four years, reflecting greater access to cheaper external financing options.

Kenya's public and publicly guaranteed debt increased by 14.3 percent during the FY 2017/18, with both domestic and external debt increasing at 17.4 percent and 11.6 percent, respectively. Public debt portfolio comprised of 49.2 percent and 50.8 percent domestic and external debt respectively by the end of the FY 2017/18. The ratio of public debt to GDP declined marginally to 57.0percent at end-June 2018 as the projected rate of economic expansion surpassed the rate of buildup in public debt.

Banking Sector Developments

Kenya's banking sector remain resilient and stable, despite the shocks including interest rate capping, unfavorable weather conditions and the prolonged electioneering period. The sector continue to grow in terms of inclusiveness and efficiency supported by legal, regulatory and supervisory reforms and initiatives. The sector's asset base grew from KSh 3.95 trillion in June 2017 to KSh.4.27 trillion in June 2018; liquidity ratio improved to 48.5 percent as at June 2018 from 45.0 percent in June 2017; and the deposit base expanded from KSh 2.865 trillion in June 2017 to KSh 3.16 trillion in June 2018. The sector also remains well capitalized with a capital adequacy ratio of 16.5 percent, which was above the minimum prudential requirement of 14.5 percent.

BOARD OF DIRECTORS

Seated (L – R) Dr. Patrick Njoroge (Governor), Mohammed Nyaoga (Chairman), Dr. Kamau Thugge (PS, National Treasury).

Standing L-R Charity S. Kisotu (Member), Nelius W. Kariuki (Member), Ravi J. Ruparel (Member), Rachael Bessie Dzombo (Member), Samson Cherutich (Member).

SENIOR MANAGEMENT

Dr Patrick Njoroge (Ph.D.)
Governor

Mrs Sheila M’Mbijjewe
Deputy Governor

Mr Kennedy Kaunda Abuga
Director, Governors’ Office

Joshua Ngundi Kimoro
Acting Director, Kenya School of Monetary Studies (KSMS)

Mr Charles Gitari Koori
Director, Research

Ms Rose A. Detho
Director, Strategic Management Department

Mr Gerald Arita Nyaoma
Director, Bank Supervision Department

SENIOR MANAGEMENT

Mr. Moses M. Ngotho
Acting Director, Finance Department

Ms Terry Wambui Ng'ang'a
Acting Director, Human Resources

Mr William Nyagaka
Director, Internal Audit

Mr John K. Birech
Acting Director, Financial Markets

Mr Paul K. Wanyagi
Acting Director, Currency Operations and Branch Administration

Perter Kigondu
Acting Director, Department of Procurement and Logistics Services

Mr. Mwenda K. M'Marete
Acting Director, Banking Services, National Payments System and Risk Management Department

MEMBERS OF THE MONETARY POLICY COMMITTEE

Dr Patrick Njoroge (Ph.D.)
Governor, Chairman

Mrs Sheila M'Mbijjewe
Deputy Governor, Vice Chair

Dr. Kamau Thugge (EBS)
PS, National Treasury

Mr Charles Gitari Koori
Member

Mr John K. Birech
Member

1.0
GLOBAL ECONOMY

1.0 GLOBAL ECONOMY

Performance of the **global economy** remains strong with output growth projected at 3.9 percent in 2018 and 2019 from 3.7 percent in 2017 (IMF world economic outlook, July 2018). Output growth among the advanced economies is expected to stabilise at 2.4 percent in 2018 and slowdown to 2.2 percent in 2019 reflecting the ongoing withdrawal of monetary policy accommodation and effects of escalating trade tensions among the advanced economies.

In the **United States**, economic growth is expected to rise to 2.9 percent in 2018 from 2.3 percent in 2017 supported by fiscal stimulus as well as strong trade and investment. However, a moderation in growth is expected in 2019 to 2.7 percent as tightening financial conditions, waning of fiscal stimulus and escalating trade tensions take effect.

In the Euro Area, growth is expected to slow down to 2.2 percent and 1.9 percent respectively in 2018 and 2019 from 2.4 percent in 2017 on account of softer activity during the first quarter of 2018 in France and Germany in addition to tightening financial conditions in Italy.

Output in Japan is also projected to weaken to 1 percent and 0.9 percent respectively in 2018 and 2019 from 1.7 percent in 2017 as a result of weak private consumption and investment.

Among the emerging market and developing economies, an increase in activity is expected at 4.9 percent and 5.1 percent respectively in 2018 and 2019 from 4.7 percent in 2017 reflecting recovery in global commodity prices and macroeconomic stability in these economies.

Economic activity in China is expected to decline to 6.6 percent and 6.4 percent respectively in 2018 and 2019 from 6.9 percent in 2017 as external demand softens and regulatory tightening of the financial sector takes effect. Meanwhile, growth momentum in India was sustained with output expected to increase to 7.3 percent in 2018 and 7.5 percent in 2019 as the impact of the currency exchange initiative and the introduction of the goods and services tax fade.

Growth in Sub-Saharan Africa (SSA) is expected to rise to 3.4 percent and 3.8 percent respectively in 2018 and 2019 supported by the rise in commodity prices. Economic activity in Nigeria is projected to improve by 2.1 percent and 2.3 percent respectively in 2018 and 2019 from 0.8 percent in 2017 supported by an improved outlook on oil prices. Meanwhile, output in South Africa is forecast at 1.5 percent and 1.7 percent respectively in 2018 and 2019 from 1.3 per cent in 2017 largely reflecting strengthening private investment. Table 1.1 summarizes actual and projected world economic outlook, 2016 – 2019, by the IMF.

Table 1.1: Actual and Projected Output in Selected Countries/Regions (Percent Change)

	Actual		Projections	
Country/Region	**2016**	**2017**	**2018**	**2019**
World Output	**3.2**	**3.7**	**3.9**	**3.9**
Advanced Economies	**1.7**	**2.4**	**2.4**	**2.2**
United States	1.5	2.3	2.9	2.7
Euro area	1.8	2.4	2.2	1.9
Japan	1.0	1.7	1.0	0.9
United Kingdom	1.8	1.7	1.4	1.5
Emerging Market and Developing Economies	**4.4**	**4.7**	**4.9**	**5.1**
Emerging and Developing Asia	6.5	6.5	6.5	6.5
China	6.7	6.9	6.6	6.4
India	7.1	6.7	7.3	7.5
Latin America and the Caribbean	-0.6	1.3	1.6	2.6
Brazil	-3.5	1.0	1.8	2.5
Sub-Saharan Africa	1.5	2.8	3.4	3.8
South Africa	0.6	1.3	1.5	1.7
Nigeria	-1.6	0.8	2.1	2.3
Middle East, North Africa, Afghanistan and Pakistan	5.0	2.2	3.5	3.9

Source: IMF, World Economic Outlook, July 2018 update

1.0 GLOBAL ECONOMY

Global commodity prices and inflation. Over the period under review, global commodity prices have picked up consistent with recovery in global economic activity. Oil prices increased by 16 percent between June 2017 and June 2018, driven by strong global demand and muted production by the OPEC countries (IMF, WEO July 2018). Consequently, the rising fuel prices have generated inflationary pressures in the advanced and emerging market economies.

Agricultural commodity prices have also picked-up reflecting increased global demand in line with global growth momentum. Pick up in commodity prices has accelerated the pace of economic recovery in emerging and developing countries.

Exchange rates and capital flows. The increasing downside risks and policy uncertainties has heralded mixed performances of major international currencies and slowdown in capital inflows to emerging economies. Between February and July 2018, the US dollar has generally appreciated while the Euro, Japanese Yen and the Sterling Pound have remained largely unchanged.

Currencies in most emerging market economies have experienced volatilities reflecting macroeconomic imbalances, political uncertainties, escalating trade tensions and monetary policy normalization in advanced economies. The Argentine Peso, Brazilian Real, South African Rand and the Chinese Renminbi have depreciated significantly against the US dollar between February and July 2018.

Risks and uncertainties to the global economic outlook have increased and are diversified (IMF, WEO, July 2018 and World Bank, Global Economic Prospects June 2018).

- Trade tensions among major advanced economies regarding imposition of tariffs on selected imports by the United States from its main trading partners, particularly China, and likely retaliatory measures.

- The prolonged uncertainty regarding the North America Free Trade Agreement (NAFTA) and Brexit negotiations, and political transitions in Mexico and Venezuela will weigh on emerging markets growth outlook for 2018.

- Financial market volatility resulting from uncoordinated and abrupt monetary policy normalization. Increasing trade wars, and rising uncertainties related to political transitions in Latin America and some European countries could trigger global market volatilities with adverse consequences to the global economic prospects.

- Noneconomic factors such as political uncertainties and geopolitics in the Middle East and some countries in the SSA region could erode business confidence, and therefore slow down private investment and weaken economic activity in these regions.

Appropriate policy measures and reforms are necessary to mitigate the above downside risks, strengthen growth, build resilience to withstand external shocks, share growth benefits more broadly, and ensure multilateral policy coordination.

- **In advanced economies**, there is need to ensure macroeconomic stability anchored on gradual normalization of monetary conditions to allow for smooth adjustments globally. Building fiscal buffers by reigning on increasing debt levels cannot be ignored.

- **Emerging and developing countries** should focus on enhancing resilience by applying the right mix of fiscal, monetary and exchange rate policies to minimise any vulnerabilities from tightening global financial conditions, drastic currency movements and potential reversals on capital flows.

- **Greater multilateral cooperation** is necessary to enhance deeper global economic integration and foster international trade and innovation for the benefit of majority of the people.

2.0
DOMESTIC ECONOMY

2.0 DOMESTIC ECONOMY

2.1 Real Sector

Overview

The economy remained resilient and grew by 4.9 percent in 2017, despite domestic shocks related to adverse weather conditions, uncertainties associated with prolonged electioneering period, and continued slowdown in growth of private sector credit partly arising from interest rate caps. The resilience of the economy was attributed to the role of Micro Small and Medium Enterprises (MSMEs), public investment in infrastructure, increased growth of the digital economy, and strong performance of the tourism sector.

Economic growth was mainly driven by strong performance of the non-agriculture sectors, particularly service-oriented sectors such as Wholesale and Retail Trade, Information and Communication, Accommodation and Restaurant, Public Administration, Education, and Health **(Chart 2.1, Chart 2.2, Chart 2.3 and Table 2.1).** However, growth was lower compared to 5.9 percent recorded in 2016.

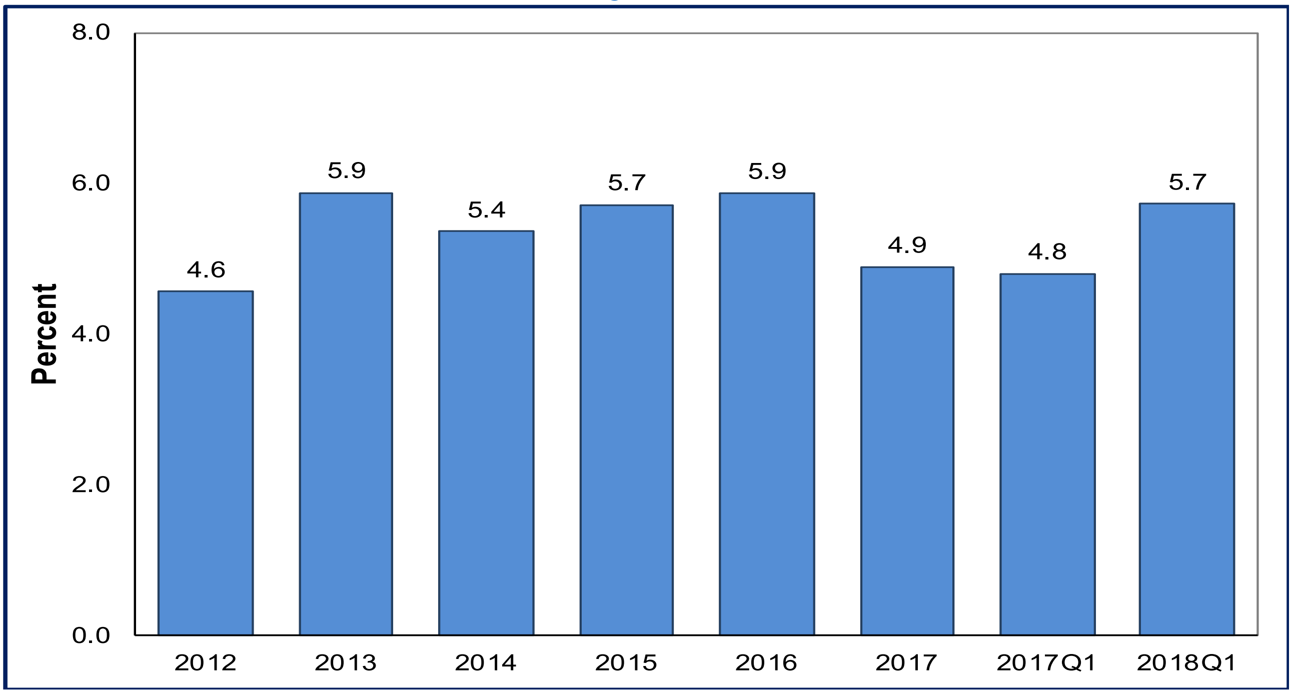
In the first quarter of 2018, GDP growth accelerated to 5.7 percent compared to 4.8 percent recorded in a similar quarter of 2017, mainly supported by improved weather conditions which led to increased agricultural production and agro-processing activity in the manufacturing sector **(Chart 2.1).**

Economic Performance by Sector

Agriculture

Growth in the Agriculture sector slowed to 1.6 percent in 2017 from 4.7 percent in 2016. The poor performance was attributed to low production of most agricultural commodities, particularly tea, maize, wheat and rice, due to drought experienced in the first half of 2017. In addition, horticulture exports, coffee sales, sugarcane deliveries and milk intake declined in the year under review.

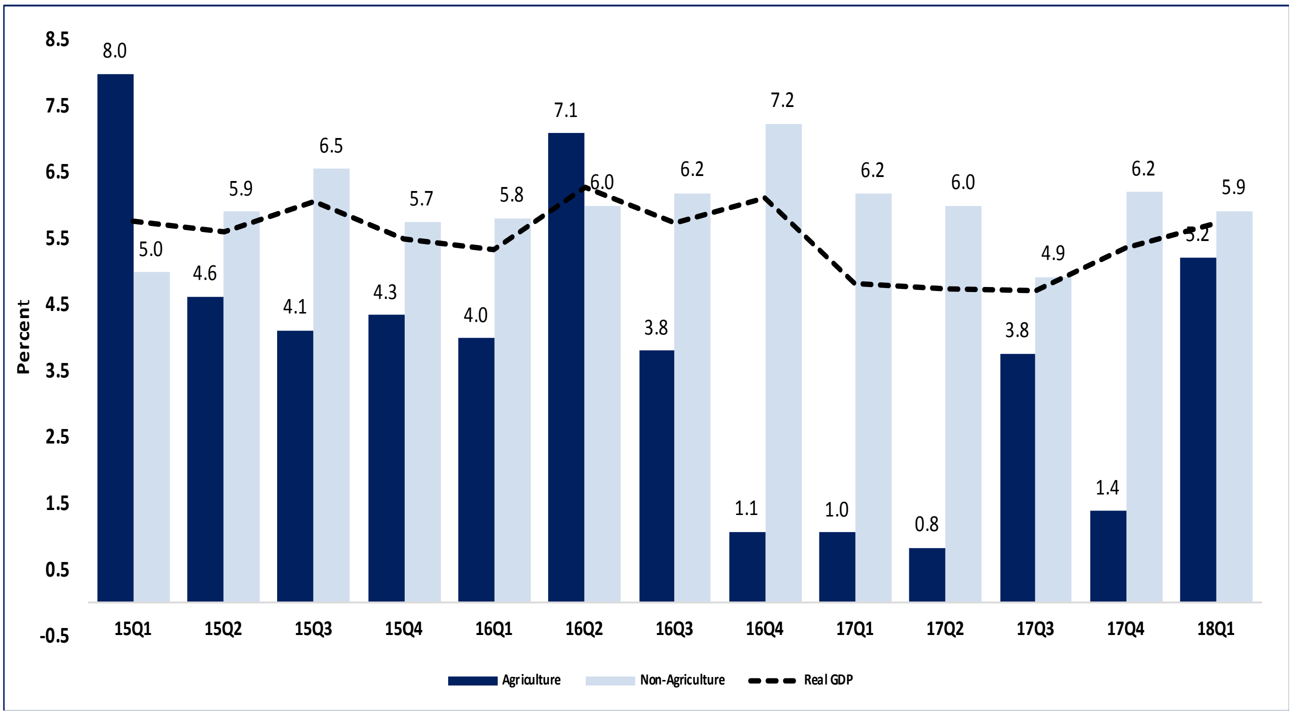
Chart 2.1: Real GDP Growth Rates 2012 – 2018Q1



Sources: Kenya National Bureau of Statistics

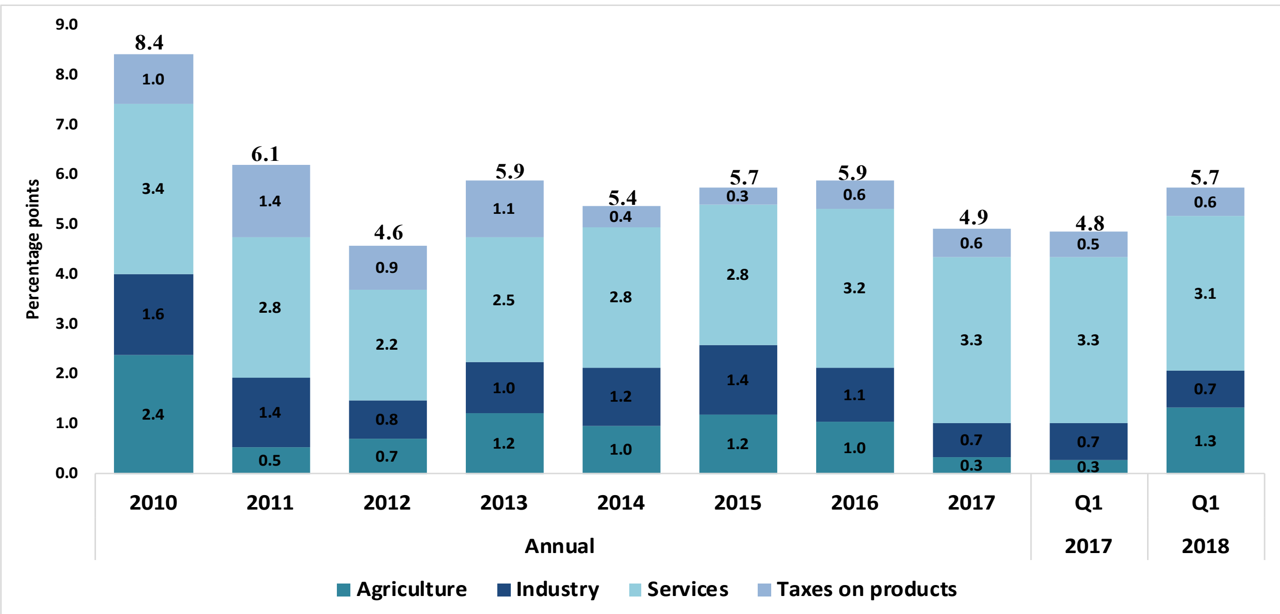
2.0 DOMESTIC ECONOMY

Chart 2.2: Evolution of Agriculture and Non-Agriculture Growth



Source: Kenya National Bureau of Statistics

Chart 2.3: Contribution to Real GDP Growth



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

2.0 DOMESTIC ECONOMY

Table 2.1: Real Gross Domestic Product by Activity

MAIN SECTORS	Growth Rates (Percent)					
	2014+	2015+	2016+	2017*	2017Q1*	2018Q1*
1. Agriculture	**4.4**	**5.3**	**4.7**	**1.6**	**1.0**	**5.2**
2. Non-Agriculture (o/w)	**5.6**	**5.8**	**6.2**	**5.8**	**6.2**	**5.9**
2.1 Industry	**6.1**	**7.3**	**5.7**	**3.6**	**4.1**	**4.1**
Mining & Quarrying	14.9	12.3	9.5	6.1	7.1	4.5
Manufacturing	2.5	3.6	2.7	0.2	1.3	2.3
Construction	6.1	8.5	8.3	5.6	6.1	5.1
Electricity & water supply	13.1	13.8	9.8	8.6	8.2	7.2
2.2 Services	**6.0**	**6.0**	**6.7**	**6.9**	**7.3**	**6.7**
Wholesale & Retail Trade	6.9	5.9	3.4	5.7	4.8	6.3
Accommodation & restaurant	-16.7	-1.3	13.3	14.7	24.5	13.5
Transport & Storage	5.5	8.0	7.8	7.3	9.4	7.1
Information & Communication	14.5	7.4	9.7	11.0	12.5	12.0
Financial & Insurance	8.3	9.4	6.7	3.1	5.3	2.6
Public administration	5.6	5.5	4.8	5.3	4.4	4.7
Professional, Administration & Support Services	3.2	2.5	5.0	4.0	3.5	5.4
Real estate	5.6	7.2	8.8	6.1	6.1	6.8
Education	7.8	4.9	5.4	6.1	5.7	6.7
Health	8.1	5.8	4.8	6.0	4.7	5.7
Other services	4.2	3.9	4.1	5.0	6.6	2.4
FISIM	11.3	13.5	2.1	-5.7	-1.3	1.2
All Industries at basic prices	**5.6**	**6.1**	**6.0**	**4.9**	**4.8**	**5.8**
2.3 Taxes on products	**3.4**	**2.8**	**4.8**	**5.1**	**4.9**	**5.4**
Real GDP Growth	**5.4**	**5.7**	**5.9**	**4.9**	**4.8**	**5.7**

+ Revised
*** Provisional**

Source: Kenya National Bureau of Statistics

In the first quarter of 2018, the Agriculture sector recovered and recorded growth of 5.2 percent compared to 1.0 percent in a similar quarter of 2017, supported by improved weather conditions. In addition, available agricultural indicators for the first half of 2018 show improved output of key agricultural commodities compared to a similar period of 2017 **(Table 2.1 and Table 2.2).**

Manufacturing

Growth in the Manufacturing sector decelerated to 0.2 percent in 2017 from 2.7 percent in 2016. The weak performance mainly reflected reduced agro-processing due to constrained supply of agricultural raw materials, uncertainties related to elections, high cost of inputs, and stiff competition from imported goods. Consequently, production of sugar, cement and assembled motor vehicles declined in 2017. However, production of galvanized sheets and soft drinks increased by 6.3 percent and 1.1 percent, respectively, in 2017.

The Manufacturing sector recorded improved growth of 2.3 percent in the first quarter of 2018 compared to 1.3 percent in a similar quarter of 2017, mainly supported by increased agro-processing. However, available indicators for the first half of 2018 point to mixed performance compared to a similar period in 2017 **(Table 2.1 and Table 2.3).**

2.0 DOMESTIC ECONOMY

Table 2.2: Output Growth in Key Crops and Milk

	2011	2012	2013	2014	2015	2016	2017	Jan-Jun 2017	Jan-Jun 2018
Tea									
Production (Tonnes)	377,913	369,562	432,453	445,106	399,211	471,234	439,857	200,912	230,995
Annual Growth, percent	*-5.3*	*-2.2*	*17.0*	*2.9*	*-10.3*	*18.0*	*-6.7*	*-19.4*	*15.0*
Coffee									
Sales (Tonnes)	29,984	46,051	37,943	42,450	32,219	39,672	33,728	22,933	24,671
Annual Growth, percent	*-23.0*	*53.6*	*-17.6*	*11.9*	*-24.1*	*23.1*	*-15.0*	*-7.3*	*7.6*
Horticulture									
Exports (Tonnes)	238,562	250,814	309,029	303,254	310,458	365,357	334,933	170,037	197,117
Annual Growth, percent	*-11.2*	*5.1*	*23.2*	*-1.9*	*2.4*	*17.7*	*-8.3*	*-16.0*	*15.9*
Sugar Cane									
Deliveries (Tonnes)	5,338,571	5,716,379	6,671,800	6,477,650	6,849,224	7,160,840	4,611,751	1,876,520	2037540**
Annual Growth, percent	*-6.5*	*7.1*	*16.7*	*-2.9*	*5.7*	*4.5*	*-35.6*	*-29.0*	*8.6*
Milk									
Intake (Million Litres)	544	495	523	540	607	648	591	224	253
Annual Growth, percent	*5.5*	*-9.0*	*5.6*	*3.3*	*12.4*	*6.8*	*-8.8*	*-14.3*	*12.7*

Data available up to April 2018

Source: Kenya National Bureau of Statistics

Energy Sector

The electricity and water supply sector grew by 8.6 percent in 2017 compared to 9.8 percent in 2016, despite the drought conditions which affected hydroelectricity generation and water supply. Total electricity generation increased by 2.0 percent in 2017, driven by increased generation of geothermal, thermal and wind electricity, as hydroelectricity generation declined. Conversely, consumption of electricity increased by 11.7 percent in 2017, indicating resilience of economic activities.

The Energy sector grew by 7.2 percent in the first quarter of 2018, compared to 8.2 percent in the first quarter of 2017, driven by increased generation of hydro and geothermal electricity. In the first half of 2018, total electricity

Table 2.3: Production of Selected Manufactured Goods

	2011	2012	2013	2014	2015	2016	2017	Jan-Jun 2017	Jan-Jun 2018
Processed Sugar									
Production (Tonnes)	475,061	494,030	600,210	616,852	631,957	491,144	377,126	170,633	185,156**
Annual Growth, percent	*-9.2*	*4.0*	*21.5*	*2.8*	*2.4*	*-22.3*	*-23.2*	*-1.8*	*8.5*
Soft Drinks									
Production ('000 Litres)	371,353	359,518	403,981	459,464	490,570	551,387	557,545	144,385	154,842***
Annual Growth, percent	*2.8*	*-3.2*	*12.4*	*13.7*	*6.8*	*12.4*	*1.1*	*-6.1*	*7.2*
Galvanised Sheets									
Production (Tonnes)	268,095	235,812	306,100	284,509	256,936	247,278	262,849	118,194	111,562*
Annual Growth, percent	*33.1*	*-12.0*	*29.8*	*-7.1*	*-9.7*	*-3.8*	*6.3*	*10.8*	*-5.6*
Cement									
Production (Tonnes)	3,969,003	4,639,693	5,059,129	5,856,828	6,338,185	6,707,230	6,162,594	3,158,405	2,842,555
Annual Growth, percent	*7.0*	*16.9*	*9.0*	*15.8*	*8.2*	*5.8*	*-8.1*	*-4.5*	*-10.0*
Assembled Vehicles									
Production (Units)	6,049	6,218	6,948	9,246	10,181	6,295	4,884	1,935	1,897**
Annual Growth, percent	*5.7*	*2.8*	*11.7*	*33.1*	*10.1*	*-38.2*	*-22.4*	*-14.3*	*-2.0*

*** Data available up to May 2018**
**** Data available up to April 2018**
***** Data available up to March 2018**

Source: Kenya National Bureau of Statistics

2.0 DOMESTIC ECONOMY

generation grew by 7.9 percent compared to 1.8 percent growth recorded in the first half of 2017, mainly boosted by increased generation of hydroelectricity by 33.9 percent due to favorable weather conditions **(Table 2.1 and Table 2.4).**

Building and Construction

Building and Construction sector was adversely affected by uncertainties relating to elections in 2017 and the completion of the first phase of Standard Gauge Railway (SGR). Growth in the construction sector slowed to 5.6 percent in 2017 from 8.3 percent in 2016. Moreover, no building plans were approved from August - October 2017 and the value of approved buildings declined by 39.9 percent.

In the first quarter of 2018, the sector grew by 5.1 percent, which was lower than 6.1 percent in the first quarter of 2017. Available data for the first half of 2018 points to reduced activity in the sector compared to the first half of 2017 **(Table 2.1 and Table 2.5).**

Table 2.4: Performance of Energy Sub-Sectors

	2011	2012	2013	2014	2015	2016	2017	Jan-Jun 2017	Jan-Jun 2018
Electricity Generation									
Output (Million KWH)	7,161	7,517	8,217	8,889	9,315	9,943	10,141	4,968	5,359
Annual Growth, percent	*11.8*	*5.0*	*9.3*	*8.2*	*4.8*	*6.7*	*2.0*	*1.8*	*7.9*
Of which:									
Hydro-power Generation (Million KWH)	3,183	4,032	4,387	3,411	3,463	3,960	2,777	1,321	1,768
Annual Growth, percent	*-0.4*	*26.6*	*8.8*	*-22.2*	*1.5*	*14.3*	*-29.9*	*-31.9*	*33.9*
Geo-Thermal Generation (Million KWH)	1,444	1,522	1,781	2,917	4,521	4,484	4,756	2,273	2,570
Annual Growth, percent	*0.1*	*5.4*	*17.0*	*63.8*	*55.0*	*-0.8*	*6.1*	*-1.4*	*13.1*
Thermal (Million KWH)	2,533	1,963	2,049	2,561	1,332	1,443	2,546	1,340	1,000
Annual Growth, percent	*43.2*	*-22.5*	*4.4*	*24.9*	*-48.0*	*8.4*	*76.4*	*120.3*	*-25.4*
Wind (Million KWH)						*56*	*61*	*34*	*20*
Annual Growth, percent							8.6	24.9	- 39.8
Consumption of Electricity (Million KWH)	6,152	6,298	6,564	7,406	8,277	7,808	8,723	4,230	4,288
Annual Growth, percent	4.8	2.4	4.2	12.8	11.8	-5.7	11.7	12.0	1.4
Consumption of Fuels ('000 tonnes)	3,545	3,764	3,649	3,873	4,439	5,206	4,877	2,546	2,704
Annual Growth, percent	11.6	6.2	-3.1	6.2	14.6	17.3	-6.3	2.9	6.2
International Oil Prices									
Murban crude oil (USD per barrel)	*110.6*	*113.0*	*110.1*	*99.5*	*52.5*	*44.2*	*54.9*	*52.7*	*69.9*
Annual Growth, percent	39.7	2.1	-2.5	-9.7	-47.2	-15.9	24.3	32.0	32.7

Source: Kenya National Bureau of Statistics

Tourism

The tourism sector recorded strong performance in 2017, despite uncertainties surrounding the general elections and negative travel advisories. The Accommodation and Restaurant sector grew by 14.7 percent in 2017 compared to 13.3 percent in 2016. Overall, tourist arrivals increased by 10.1 percent in 2017, with all major points of entry recording increased arrivals.

The Accommodation and Restaurant sector grew by 13.5 percent in the first quarter of 2018. Available data for the first half of 2018 shows continued positive performance of the sector compared to a similar period in 2017 **(Table 2.1 and Table 2.6).**

2.0 DOMESTIC ECONOMY

Table 2.5: Performance of Construction Sector

	2011	2012	2013	2014	2015	2016	2017	Jan-Jun 2017	Jan-Jun 2018
Cement Consumption									
(Tonnes)	3,433,004	3,937,263	4,266,486	5,196,681	5,694,146	6,301,977	5,785,150	2,968,113	2,747,900
Annual Growth, percent	*10.6*	*14.7*	*8.4*	*21.8*	*9.6*	*10.7*	*-8.2*	*-3.2*	*-7.4*
Value of Building Plans Approved by Nairobi County									
Residential (KSh, millions)	153,641	75,185	129,634	132,128	146,953	186,571	112,063	70,367	63,177
Annual Growth, percent	*132.6*	*-51.1*	*72.4*	*1.9*	*11.2*	*27.0*	*-39.9*	*-22.6*	*-10.2*
Non-residential (KSh, millions)	57,666	115,270	107,128	95,890	95,177	127,713	72,657	58,304	37,585
Annual Growth, percent	*-8.0*	*99.9*	*-7.1*	*-10.5*	*-0.7*	*34.2*	*-43.1*	*-8.4*	*-35.5*
Total (KSh, millions)	**211,307**	**190,455**	**236,762**	**228,018**	**242,130**	**314,284**	**184,721**	**128,671**	**100,762**
Annual Growth, percent	*64.2*	*-9.9*	*24.3*	*-3.7*	*6.2*	*29.8*	*-41.2*	*-16.8*	*-21.7*

Source: Kenya National Bureau of Statistics

Table 2.6: Tourist Arrivals by Point of Entry

	2011	2012	2013	2014	2015	2016	2017	Jan-Jun 2017	Jan-Jun 2018
JKIA	1,036,486	1,053,361	912,998	743,600	672,789	780,422	859,315	394,582	384,788
Growth, percent	*20.2*	*1.6*	*-13.3*	*-18.6*	*-9.5*	*16.0*	*10.1*	*12.0*	*-2.5*
MIAM	227,794	187,151	168,654	117,796	75,921	92,874	103,887	43,131	59,162
Growth, percent	*-2.1*	*-17.8*	*-9.9*	*-30.2*	*-35.5*	*22.3*	*11.9*	*9.0*	*37.2*
Total	**1,264,280**	**1,240,512**	**1,081,652**	**861,396**	**748,710**	**873,296**	**963,202**	**437,713**	**443,950**
Growth, percent	*15.4*	*-1.9*	*-12.8*	*-20.4*	*-13.1*	*16.6*	*10.3*	*11.7*	*1.4*

Source: Kenya Tourism Board

2.0 DOMESTIC ECONOMY

2.2 Inflation

Overview

Annual average inflation declined to 5.2 percent in June 2018 from 8.2 percent in July 2017, driven by declining food prices following favourable weather conditions and government measures to stabilise food prices.

Overall 12 month inflation declined below the midpoint of the target band since November 2017 and stood at 4.3 percent in June 2018 compared to 7.5 percent in July 2017 on account of lower food prices **(Table 2.7).**

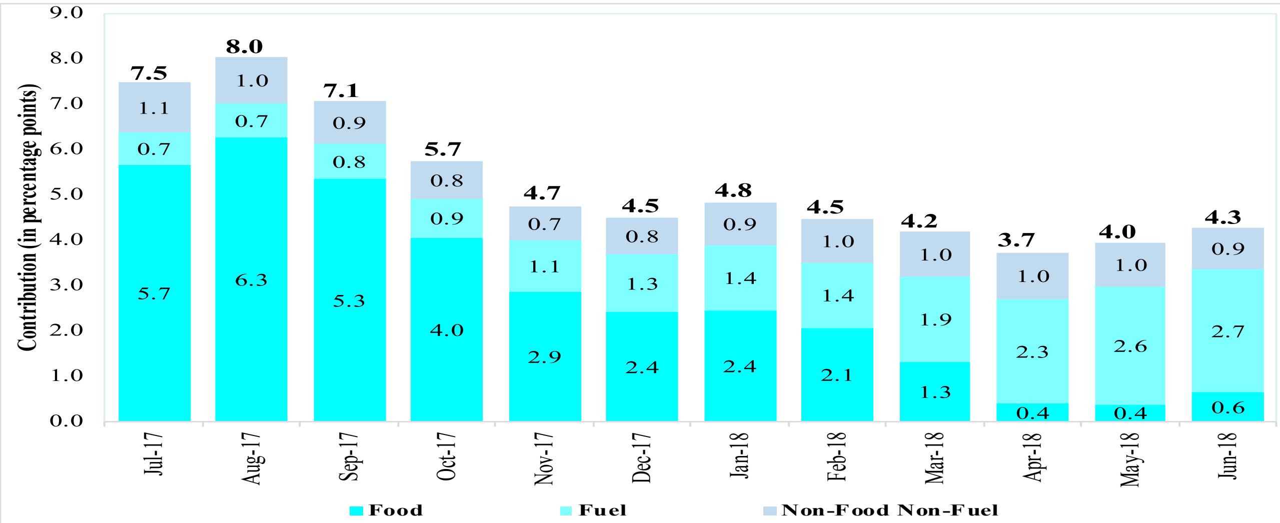
The evolution of overall inflation in the FY 2017/18 largely mirrors developments in food prices. The contribution of food inflation to overall inflation in the first three months of the financial year was elevated, due to drought experienced in the first half of 2017. However, as weather conditions improved, supplies increased resulting in lower food prices. Whereas the contribution of food to overall inflation declined from 6.3 percentage points in August 2017 to 0.6 percentage points in June 2018, that of fuel inflation increased from 0.7 percentage points to 2.7 percentage points over the same period owing to high prices of oil and other energy sources **(Chart 2.4).** However, the contribution of Non-Food-Non-Fuel (NFNF) inflation remained stable reflective of muted demand-driven inflationary pressures in the economy.

Table 2.7: Developments in Inflation

	2017						2018					
Percent	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Overall 12-month inflation	7.47	8.05	7.06	5.72	4.73	4.50	4.83	4.46	4.18	3.73	3.95	4.28
Food Inflation	11.55	12.80	10.89	8.23	5.80	4.86	4.92	4.11	2.58	0.75	0.74	1.24
Fuel Inflation	2.94	3.07	3.28	3.65	4.77	5.37	6.10	6.16	8.17	10.17	11.44	11.89
Non-(Food & Fuel) Inflation	4.08	3.87	3.45	2.99	2.74	3.06	3.53	3.62	3.77	4.02	3.89	3.58
Average annual	8.21	8.35	8.40	8.33	8.15	7.98	7.79	7.40	6.89	6.24	5.61	5.20
Three months annualised	-5.56	-6.07	-3.67	-2.37	-5.61	-1.31	6.66	13.66	17.58	17.70	15.87	5.78

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

Chart 2.4: Contributions of Food, Fuel, and Non-Food-Non-Fuel Inflation to Overall Inflation



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

2.0 DOMESTIC ECONOMY

Food inflation

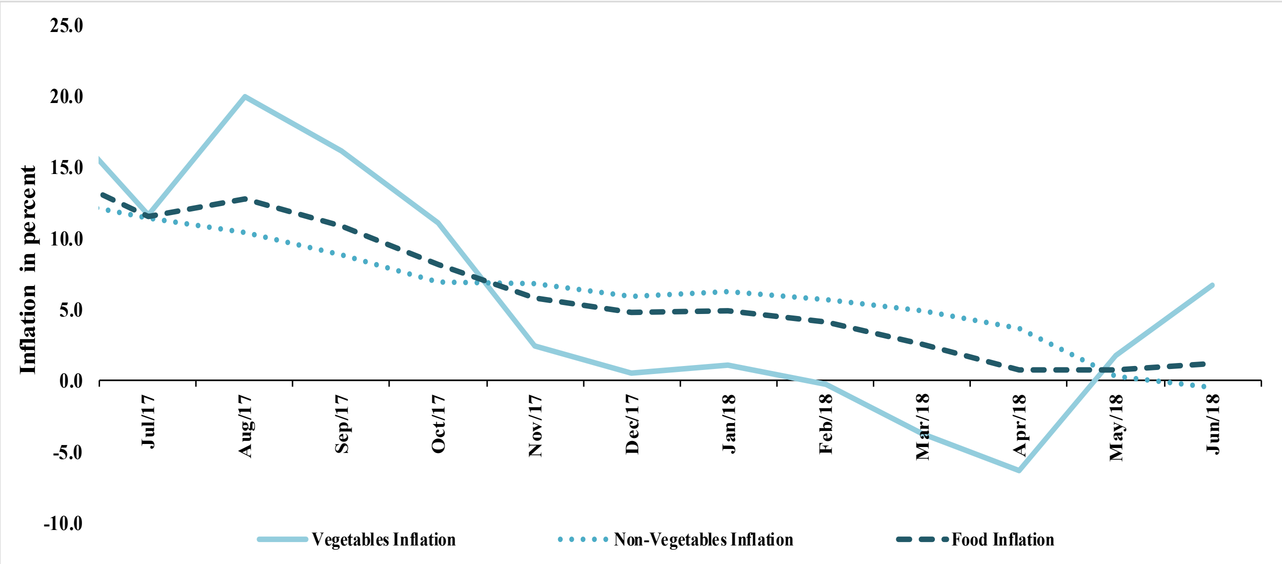
Food inflation declined to 1.2 percent in June 2018 from 11.6 percent in July 2017 mainly driven by falling agricultural commodity prices. The scarcity of fast growing vegetables sustained the high vegetable inflation. However, as the weather conditions improved, vegetables production recovered, with prices declining. The non-vegetables inflation continued to decline thus moderating food inflation **(Chart 2.5).**

Fuel Inflation

Fuel inflation increased to 11.9 percent in June 2018 from 2.9 percent in July 2017 mostly driven by rising domestic and international energy prices. The surge in energy inflation from March 2018 is on account of government ban on logging and charcoal trade which resulted in a sharp increase in the contribution of charcoal to energy inflation **(Charts 2.6 and 2.7).**

In addition, international oil prices have been rising gradually and this is reflected in the local fuel prices. Meanwhile, non-energy inflation remained low and stable during the financial year under review.

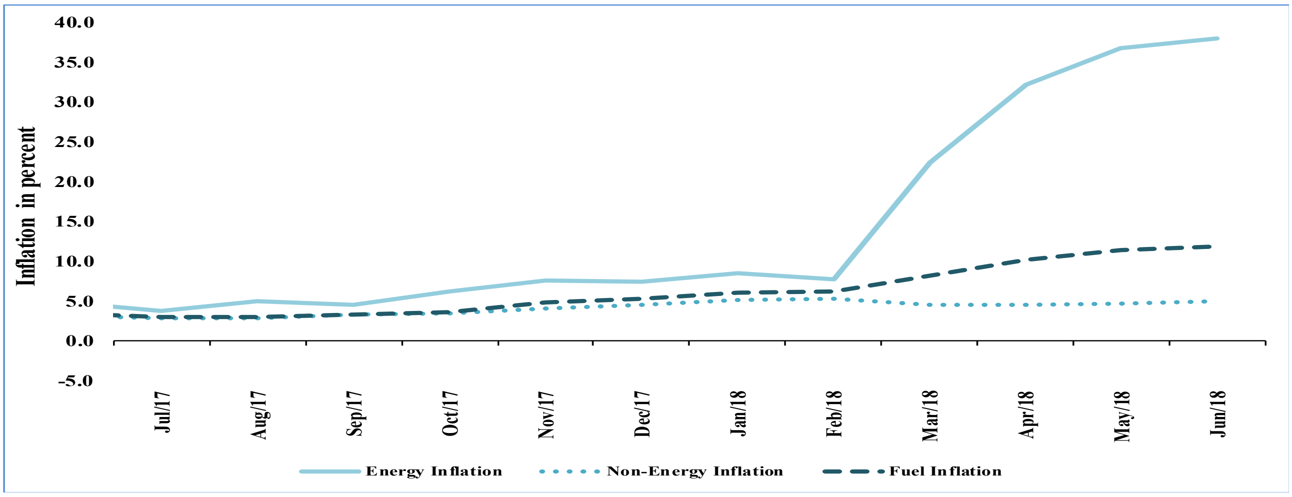
Chart 2.5: Evolution of Food Inflation



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

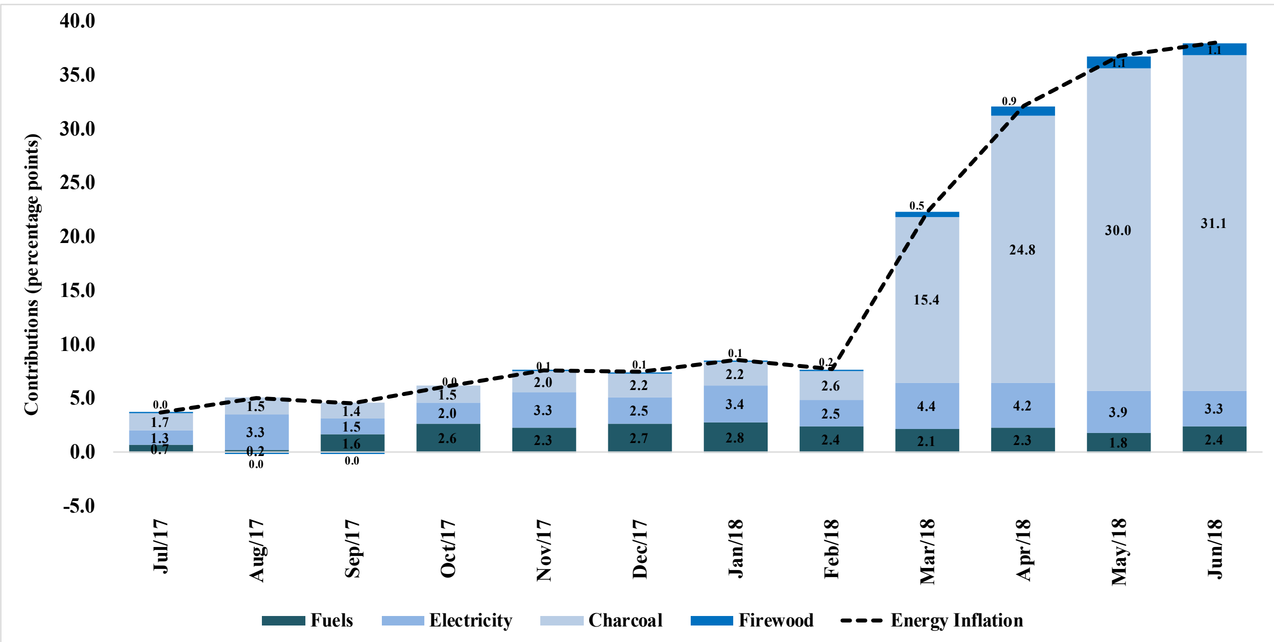
2.0 DOMESTIC ECONOMY

Chart 2.6: Evolution of Fuel Inflation



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

Chart 2.7: Contributions to Energy Inflation



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

2.0 DOMESTIC ECONOMY

Non-Food-Non-Fuel Inflation

Non-Food-Non-Fuel inflation remained low and stable during FY 2017/18 pointing to muted demand-driven inflationary pressures supported by appropriate monetary policy stance. It declined to 3.6 percent in June 2018 from 4.1 percent in July 2017, with minimal movements during the year **(Table 2.8).**

Overall Inflation Across Income Groups

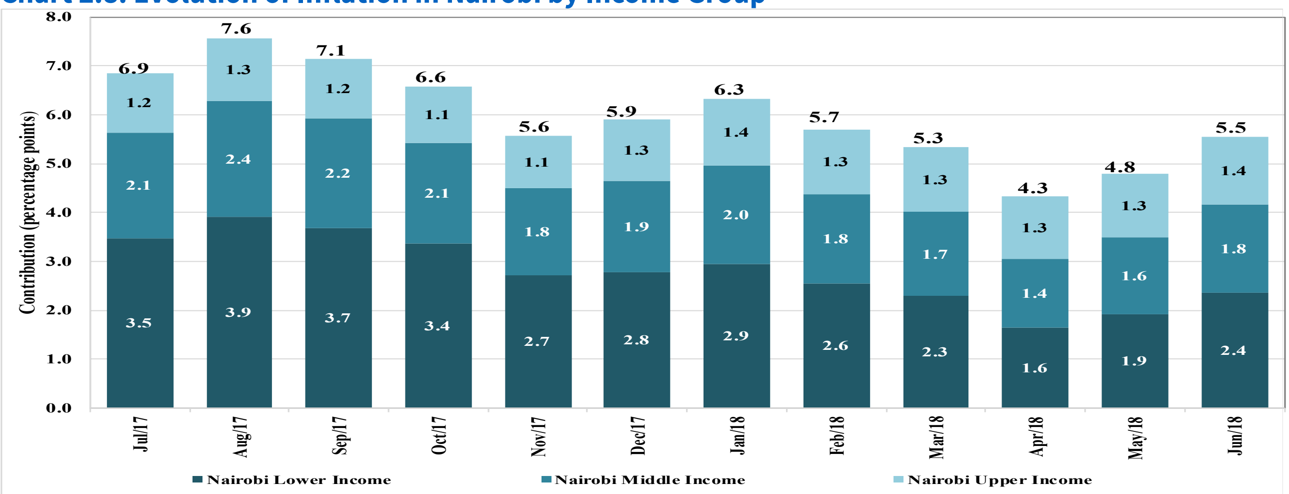
Inflation in Nairobi was 5.5 percent in June 2018 compared to 6.9 percent in July 2017. During the year, inflation in Nairobi was in most part on account of lower income group, whose contribution remained high, but eased as food prices continued to decline. Meanwhile, the contribution of the middle and upper income groups to inflation in Nairobi remained relatively stable during the period **(Chart 2.8).**

Table 2.8: Evolution of Non-Food-Non-Fuel Inflation

	Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Furnishings, Household Equipment and Routine Household Maintenance	Health	Communication	Recreation & Culture	Education	Miscellaneous Goods & Services	Non-food Non-Fuel
	Percent								
Jul-17	3.1	4.1	3.4	2.7	0.1	1.4	2.8	3.8	4.1
Aug-17	2.9	3.8	3.2	3.4	0.3	1.2	2.8	3.5	**3.9**
Sep-17	2.9	3.5	3.0	3.3	0.4	1.1	3.0	3.3	**3.5**
Oct-17	3.0	2.9	3.2	3.2	0.4	1.0	3.1	3.3	**3.0**
Nov-17	3.0	2.9	3.0	4.4	0.5	1.0	3.1	3.6	**2.7**
Dec-17	3.1	3.0	3.3	4.9	0.5	1.6	3.2	3.6	**3.1**
Jan-18	3.0	3.6	3.6	4.3	0.6	1.7	5.4	4.1	**3.5**
Feb-18	3.2	3.8	4.3	3.3	0.8	1.7	5.1	4.6	**3.6**
Mar-18	2.6	3.9	4.3	3.3	0.8	1.4	5.1	4.6	**3.8**
Apr-18	2.8	4.1	4.6	3.5	0.8	1.4	5.1	4.7	**4.0**
May-18	2.3	4.3	4.5	4.0	0.8	1.5	5.1	4.2	**3.9**
Jun-18	2.8	4.2	4.6	4.2	0.9	1.5	5.1	4.1	**3.6**

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

Chart 2.8: Evolution of Inflation in Nairobi by Income Group



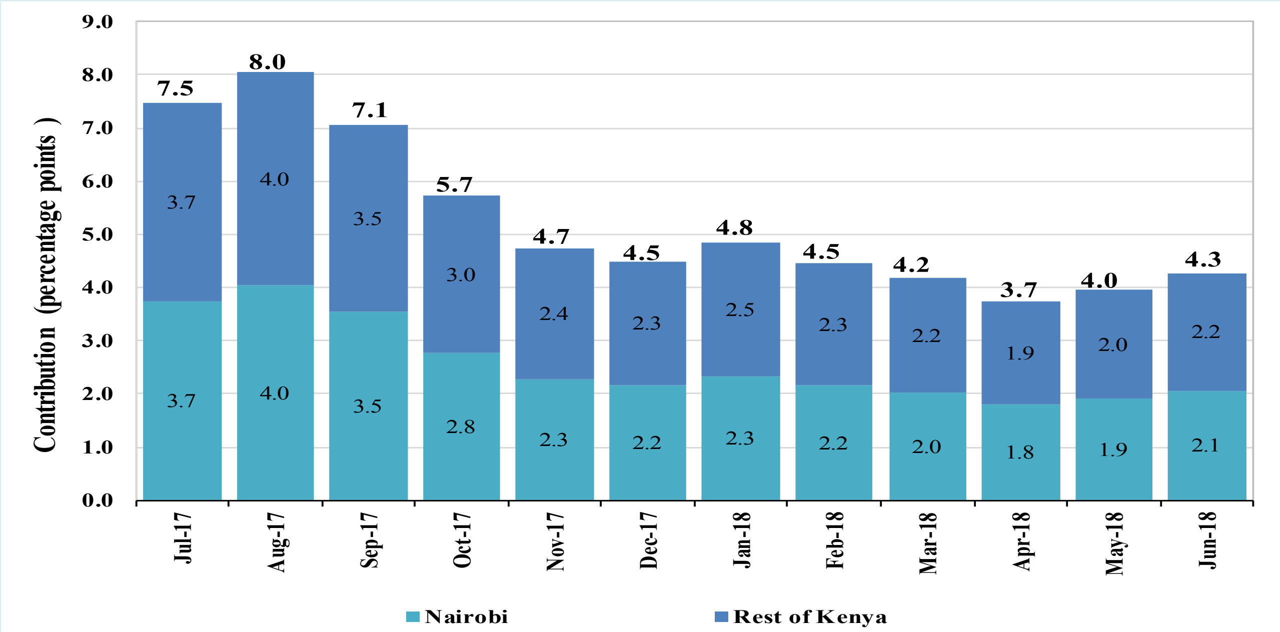
Source: Kenya National Bureau of Statistics and Central Bank of Kenya

2.0 DOMESTIC ECONOMY

Overall Inflation Across Regions

The contribution of the Nairobi region and the rest of Kenya to overall inflation in Kenya was balanced during the FY 2017/2018. Moreover, inflation across the two regions exhibited similar trends, and declined with declines in food prices **(Chart 2.9).**

Chart 2.9: Evolution of Inflation by Region



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

2.0 DOMESTIC ECONOMY

2.3 Balance of Payments

The overall balance comprises the balance on the current account, the capital and the financial account including net errors and omissions. The overall balance was a deficit of USD 497 million during the period under review compared with a deficit of USD 413 million the previous year **(Table 2.9).**

Table 2.9: Balance of Payments (USD Million)

ITEM	FY 2016_17*	FY 2017_18 Jul-Sep Q1	Oct-Dec Q2	Jan-Mar Q3	Apr-Jun Q4	FY 2017_18**	FY 2017/18-2016/17 Change	% Change
1. Overall Balance	**-413**	**677**	**518**	**-2,025**	**333**	**-497**	**-83**	**20.2**
2. Current account	**-4,753**	**-1,443**	**-1,187**	**-1,057**	**-1,134**	**-4,821**	**-67**	**1.4**
Goods:Exports (fob)	5,701	1,413	1,457	1,600	1,575	6,043	343	6.0
Goods:Imports (fob)	14,801	4,167	3,979	4,118	4,593	16,856	2,055	13.9
Services:Credit	4,348	1,160	1,139	1,268	1,334	4,902	553	12.7
Services:Debit	2,900	816	746	908	956	3,426	525	18.1
Balance on goods and services	-7,652	-2,410	-2,129	-2,158	-2,640	-9,337	-1,684	22.0
Primary Income:Credit	425	92	101	122	140	455	30	7.1
Primary Income:Debit	1,182	286	350	292	420	1,347	165	13.9
Balance on goods, services, and primary income	-8,410	-2,604	-2,378	-2,327	-2,920	-10,229	-1,819	21.6
Secondary Income: Credit	3,706	1,173	1,207	1,280	1,800	5,460	1,754	47.3
o.w Remittances	1,759	495	565	642	737	2,438	678	38.6
Secondary Income:Debit	49	12	16	10	14	52	3	6.3
3. Capital Account	**153**	**-2**	**85**	**83**	**107**	**273**	**120**	**78.6**
4. Financial Account	**-5,671**	**-150**	**-1,085**	**-3,133**	**-833**	**-5,202**	**469**	**-8.3**

** Revised*

***Provisional*

Fob - free on board

Source: Central Bank of Kenya

The Current Account

The current account comprises the balance on goods and services (trade balance); and the balance on primary and secondary income. During the year to June 2018, the current account deficit narrowed to 5.6 percent from 6.5 percent over a similar period in 2017. The improvement was on account of a narrowing trade deficit coupled with an improvement in the secondary income account.

The balance on goods and services worsened by 22 percent in the year to June 2018, a slower rate compared with 29 percent during the year to June 2017 as imports of food - in the context of the Governments maize subsidy program - to meet domestic shortfalls slowed down in the second half of 2017/18. However, oil imports increased reflecting rising international oil prices due to production cuts by OPEC and non-OPEC countries and, production losses in Venezuela and some African countries.

The value of merchandise exports increased by 6 percent over the same period mainly supported by exports of tea and horticulture. The value of tea exported increased on account of improved domestic production due to favourable weather conditions. The increase in horticulture exports reflected higher volumes of fresh vegetables and fruits and nuts as a result of increased domestic production as well as strong consumer demand especially for avocado in the EU market. The export value of cut flowers was mainly driven by improved prices.

2.0 DOMESTIC ECONOMY

The services account recorded 1.9 percent improvement to USD 1,476 million during the year to June 2018 on account of higher receipts from transport and tourism services **(Table 2.10).** The increase in transport services was reflective of higher receipts related to freight services. The improved performance in travel receipts is attributed to better security conditions in the country, lifting of negative travel advisories and completion of 2017 electioneering period. Continuous marketing by the Government also boosted Kenya's image in key international markets such as Europe and America.

Meanwhile, the primary income balance worsened by 17.8 percent to deficit of USD 892 million during the year to June 2018 on account of higher outflows towards foreign interest payments. The secondary income balance, however, improved by 47.9 percent, on account of higher remittance inflows.

Table 2.10: Balance on Current Account (USD Million)

USD Million		FY 2017_18					FY 2017/18-2016/17	
ITEM	FY 2016_17*	Jul-Sep Q1	Oct-Dec Q2	Jan-Mar Q3	Apr-Jun Q4	FY 2017_18**	Change	% Change
CURRENT ACCOUNT	**-4,753**	**-1,443**	**-1,187**	**-1,057**	**-1,134**	**-4,821**	**-67**	**1.4**
Goods	**-9,101**	**-2,754**	**-2,522**	**-2,518**	**-3,019**	**-10,813**	**-1,712**	**18.8**
Exports (fob)	**5,701**	**1,413**	**1,457**	**1,600**	**1,575**	**6,043**	**343**	**6.0**
o.w Coffee	241	47	34	51	88	220	-21	-8.6
Tea	1,268	351	382	393	337	1,463	195	15.4
Horticulture	805	201	210	258	255	924	119	14.8
Oil products	56	12	12	12	12	49	-7	-12.9
Manufactured Goods	409	102	98	90	98	389	-20	-4.8
Raw Materials	528	115	135	154	136	540	11	2.2
Chemicals and Related Products (n.e.s)	397	110	100	107	107	424	27	6.8
Miscelleneous Man. Articles	568	157	133	129	159	578	10	1.8
Re-exports	677	143	157	194	185	679	2	0.4
Other	752	175	195	211	195	777	25	3.3
Imports (fob)	**14,801**	**4,167**	**3,979**	**4,118**	**4,593**	**16,856**	**2,055**	**13.9**
o.w Oil	2,429	667	774	769	921	3,131	701	28.9
Chemicals	2,282	563	557	657	616	2,393	111	4.9
Manufactured Goods	2,589	615	619	749	834	2,817	228	8.8
Machinery & Transport Equipment	4,749	1,106	1,066	1,044	1,257	4,472	-277	-5.8
Machinery	3,196	728	616	646	794	2,783	-412	-12.9
Transport equipment	1,550	378	449	398	463	1,688	138	8.9
Other	2,278	1,052	953	1,342	1,674	5,021	2,743	120.4
o.w Food	1,492	857	584	535	618	2,594	1,102	73.8
Services	**1,448**	**344**	**393**	**361**	**378**	**1,476**	**28**	**1.9**
Transport Services (Net)	**490**	**120**	**200**	**171**	**140**	**630**	**140**	**28.6**
Travel Services (Net)	**758**	**147**	**151**	**194**	**243**	**736**	**-22**	**-3.0**
Other Services (Net)	**200**	**77**	**42**	**-4**	**-5**	**110**	**-90**	**-45.1**
Primary Income (Net)	**-758**	**-194**	**-249**	**-170**	**-280**	**-892**	**-135**	**17.8**
Secondary Income (Net)	**3,657**	**1,161**	**1,191**	**1,270**	**1,786**	**5,408**	**1,751**	**47.9**

** Revised*
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fob - free on board

Source: Central Bank of Kenya

2.0 DOMESTIC ECONOMY

Remittances

In the year to June 2018, total remittance inflows at USD 2,438 million were 38.6 percent higher compared to USD 1,759 million in the year to June in 2017 **(Table 2.11).** The continued resilience of remittances is mainly supported by new partnerships between commercial banks and international money remittance providers which has brought down the cost of international money transfers.

Direction of Trade

Imports from China accounted for 22.1 percent of total imports to Kenya during the year to June 2018 making it the largest source of imports and were mainly in form of machinery and transport equipment related to the Standard Gauge Railway. Over the same period, imports from the European Union accounted for 12.4 percent of total imports, and increased to USD 2,089 million while the share of imports from Africa increased to 14 percent to USD 2,361 million **(Table 2.12).**

Table 2.11 Remittance Inflows US$ Million (Cumulative 12 Months)

Month/Year	2011	2012	2013	2014	2015	2016	2017	2018
January	661	917	1,184	1,299	1,432	1,571	1,729	2,013
February	675	960	1,183	1,307	1,445	1,585	1,735	2,081
March	695	995	1,180	1,323	1,452	1,599	1,741	2,156
April	712	1,020	1,189	1,331	1,463	1,619	1,736	2,234
May	729	1,053	1,198	1,341	1,472	1,636	1,751	2,327
June	748	1,081	1,199	1,357	1,492	1,647	1,759	2,438
July	770	1,101	1,219	1,361	1,506	1,650	1,777	
August	798	1,116	1,231	1,383	1,510	1,664	1,797	
September	824	1,123	1,246	1,403	1,511	1,679	1,830	
October	847	1,134	1,267	1,411	1,527	1,684	1,873	
November	871	1,150	1,283	1,412	1,544	1,697	1,904	
December	891	1,171	1,291	1,428	1,548	1,724	1,947	

Source: Central Bank of Kenya

Meanwhile, the share of Kenya's exports to the Africa region declined to 35.9 percent during the year to June 2018 reflecting lower exports to the EAC (Uganda) and COMESA (mainly DRC). Exports to the rest of the world increased mainly on account of higher exports to the European Union. The share of exports to the European Union increased to 21.1 percent in the year to June 2018 from 20.8 percent during the year to June 2017.

Capital and Financial Account

The capital account recorded a decrease of USD 120 million to USD 273 million during the year to June 2018.

The financial account recorded lower net inflows of USD 5,202 million during the year to June 2018 reflecting a decline in 'other investment liabilities' owing to slowdown in uptake of external loans by Government. The issuance of Kenya's second Eurobond in March 2018 largely contributed to the rise in portfolio liabilities over the review period while direct investment to Kenya increased by 30.9 percent to USD 703 million during the period under review **(Table 2.13).**

2.0 DOMESTIC ECONOMY

Table 2.12: Kenya's Direction of Trade

IMPORTS (in millions of US dollars)				Share of Imports (%)		
	Year to June			Year to June		
Country	2016	2017	2018	2016	2017	2018
Africa	**1,362**	**1,632**	**2,361**	**10.1**	**11.0**	**14.0**
Of which						
South Africa	542	567	637	4.0	3.8	3.8
Egypt	257	332	359	1.9	2.2	2.1
Others	563	732	1,364	4.2	4.9	8.1
EAC	**323**	**417**	**969**	**2.4**	**2.8**	**5.8**
COMESA	**625**	**854**	**1,412**	**4.7**	**5.8**	**8.4**
Rest of the World	**12,069**	**13,170**	**14,496**	**89.9**	**89.0**	**86.0**
Of which						
India	2,329	1,826	1,628	17.3	12.3	9.7
United Arab Emirates	896	1,029	1,635	6.7	7.0	9.7
China	3,146	3,904	3,720	23.4	26.4	22.1
Japan	858	809	819	6.4	5.5	4.9
USA	978	515	568	7.3	3.5	3.4
United Kingdom	384	312	299	2.9	2.1	1.8
Singapore	91	65	43	0.7	0.4	0.3
Germany	449	385	460	3.3	2.6	2.7
Saudi Arabia	512	964	1,315	3.8	6.5	7.8
Indonesia	439	506	481	3.3	3.4	2.9
Netherlands	185	163	219	1.4	1.1	1.3
France	221	246	224	1.6	1.7	1.3
Bahrain	63	117	46	0.5	0.8	0.3
Italy	221	241	238	1.6	1.6	1.4
Others	1,295	2,085	2,801	9.6	14.1	16.6
Total	**13,431**	**14,801**	**16,856**	**100.0**	**100.0**	**100.0**
EU	2,198	1,947	2,089	16.4	13.2	12.4
China	3,146	3,904	3,720	23.4	26.4	22.1

EXPORTS (in millions of US dollars)				Share of Exports (%)		
	Year to June			Year to June		
Country	2016	2017	2018	2016	2017	2018
Africa	**2,462**	**2,199**	**2,168**	**40.4**	**38.6**	**35.9**
Of which						
Uganda	683	611	601	11.2	10.7	9.9
Tanzania	365	281	294	6.0	4.9	4.9
Egypt	220	170	213	3.6	3.0	3.5
Sudan	58	54	67	1.0	0.9	1.1
South Sudan	165	157	152	2.7	2.8	2.5
Somalia	164	201	167	2.7	3.5	2.8
DRC	197	197	167	3.2	3.5	2.8
Rwanda	183	167	175	3.0	2.9	2.9
Others	428	362	333	7.0	6.3	5.5
EAC	**1,466**	**1,291**	**1,281**	**24.1**	**22.7**	**21.2**
COMESA	**1,621**	**1,470**	**1,459**	**26.6**	**25.8**	**24.1**
Rest of the World	**3,628**	**3,502**	**3,875**	**59.6**	**61.4**	**64.1**
Of which						
United Kingdom	413	357	397	6.8	6.3	6.6
Netherlands	450	418	447	7.4	7.3	7.4
USA	412	463	446	6.8	8.1	7.4
Pakistan	390	516	644	6.4	9.0	10.7
United Arab Emirates	319	273	307	5.2	4.8	5.1
Germany	113	123	109	1.9	2.2	1.8
India	115	81	76	1.9	1.4	1.3
Afghanistan	166	36	29	2.7	0.6	0.5
Others	1,250	1,235	1,418	20.5	21.7	23.5
Total	**6,090**	**5,701**	**6,043**	**100.0**	**100.0**	**100.0**
EU	1,291	1,183	1,273	21.2	20.8	21.1
China	79	122	75	1.3	2.1	1.2

Source: Kenya Revenue Authority

Table 2.13: Balance on the Capital and Financial Account (USD Million)

		FY 2017_18					FY 2017/18-2016/17	
ITEM	FY 2016_17*	Jul-Sep Q1	Oct-Dec Q2	Jan-Mar Q3	Apr-Jun Q4	FY 2017_18**	Change	% Change
Capital account credit	**153**	**-2**	**85**	**83**	**107**	**273**	**120**	**78.6**
Capital account credit	153	-2	85	83	107	273	120	78.6
Capital account: debit	0	0	0	0	0	0	0	0.0
Financial Account	**-5,671**	**-150**	**-1,085**	**-3,133**	**-833**	**-5,202**	**469**	**-8.3**
Direct investment: assets	264	49	36	12	21	118	-146	-55.2
Direct investment: liabilities	537	161	143	130	269	703	166	30.9
Portfolio investment: assets	647	192	145	218	317	872	225	34.8
Portfolio investment: liabilities	17	-107	-1	1,920	-81	1,731	1,713	9,879.4
Financial derivatives: net	0	0	0	0	0	0	0	0.0
Other investment: assets	223	40	-109	195	662	787	564	252.2
Other investment: liabilities	6,251	377	1,015	1,508	1,645	4,546	-1,705	-27.3

** Revised*

***Provisional*

Source: Central Bank of Kenya

2.0 DOMESTIC ECONOMY

2.4 Government Budget

Overview

Government budgetary operations in the Fiscal Year 2017/18 resulted in a deficit including grants of KSh 596.6 billion (6.7 per cent of GDP) on a commitment basis, compared to KSh 683.1 billion (8.9 per cent of GDP) incurred in the FY 2016/17. The deficit was within the target level of KSh 627.4 billion or 7.1 per cent of GDP. Government expenditure continued to increase, while revenue growth was somewhat constrained, despite tax reform measures **(Table 2.14 and Chart 2.10).** The domestic financing of the deficit rose slightly to 45.02 per cent, from 44.4 per cent in the FY 2016/17. The domestic financing has been lower than the external financing over the last four years, reflecting greater access to cheaper external financing options.

Government Revenue

Government revenue (inclusive of grants) increased by 6.2 per cent to KSh 1,514.8 billion during the fiscal year 2017/18 from KSh 1,426.9 billion in fiscal year 2016/17 **(Chart 2.10).** As a proportion of GDP, total revenue and grants declined from 18.5 per cent during the FY 2016/17 to 17.1 per cent during the FY 2017/18. Tax revenue in fiscal year 2017/18 increased by 5.2 per cent and remained the dominant component of total revenue and grants, accounting for 84.7 per cent. Appropriations-in-aid rose by 28.9 per cent in the FY 2017/18 but remained below target. The shortfall in A-I-A is attributed to under reporting in ministerial expenditure returns. Meanwhile, external grants rose by 4.9 per cent in the FY2017/18, but still remained significantly below target **(Table 2.14).**

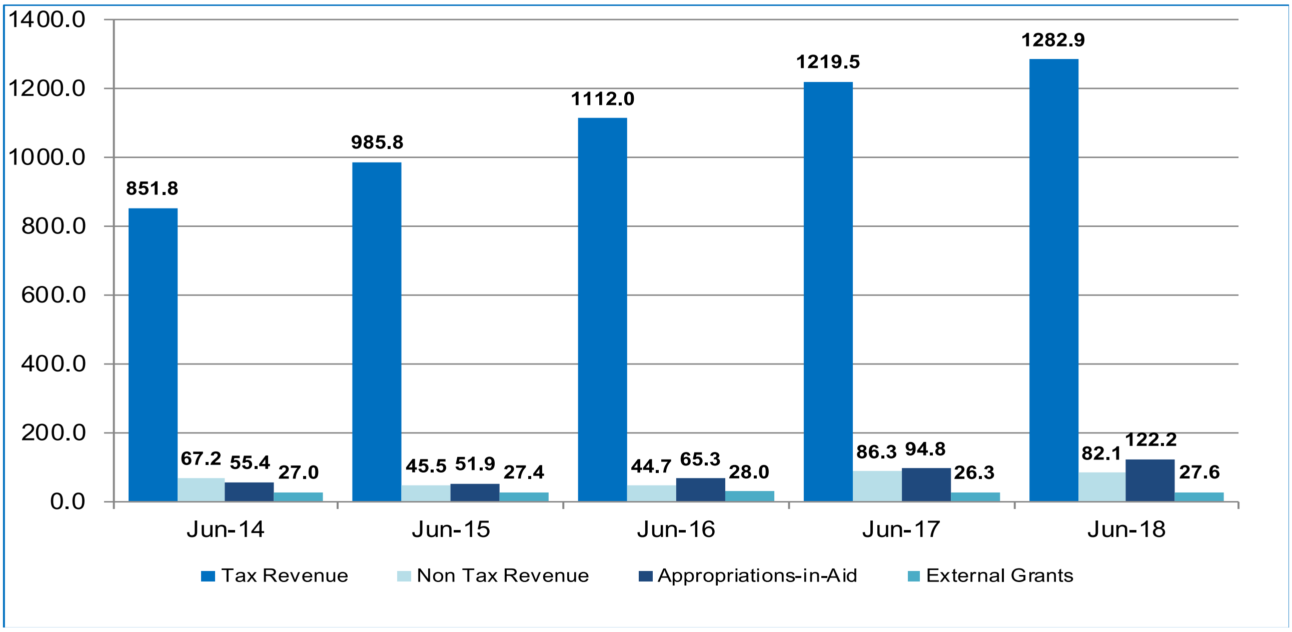
Table 2.14: Government Budget Performance (KSh Billion)

	FY 2014/15	FY 2015/16	FY 2016/17	FY 2017/18		
	Actual	Actual	Actual	Provisional	Target	Over(+) / Below (-)
1. REVENUE & GRANTS	**1,110.5**	**1,267.5**	**1,426.9**	**1,514.8**	**1,702.6**	**-187.7**
Revenue	1,083.2	1,237.9	1,305.8	1,365.1	1,659.6	-294.5
Tax Revenue	985.8	1,113.5	1,219.5	1,282.9	1,428.0	-145.0
Non Tax Revenue	45.5	44.7	86.3	82.1	61.7	20.5
Appropriations-in-Aid	51.9	79.7	94.8	122.2	170.0	-47.8
External Grants	27.4	29.6	26.3	27.6	43.0	-15.4
2. EXPENDITURE AND NET LENDING	**1,610.8**	**1,776.9**	**2,110.0**	**2,111.5**	**2,330.0**	**-218.5**
Recurrent Expenditure	864.2	1,027.5	1,179.5	1,319.6	1,453.0	-133.4
Development Expenditure	512.2	485.4	639.8	485.7	584.8	-99.1
County Transfers	229.3	264.0	284.7	306.2	292.2	14.0
Equalization fund			6.0			
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-500.3**	**-509.5**	**-683.1**	**-596.6**	**-627.4**	**30.8**
Deficit on a commitment basis as a % of GDP*	-9.3	-7.6	8.9	6.7	7.1	
4. ADJUSTMENT TO CASH BASIS	**16.9**	**22.4**	**0.0**	**0.0**	**0.0**	**0.0**
5. DEFICIT ON A CASH BASIS	**-483.3**	**-531.9**	**-683.1**	**-596.6**	**-627.4**	**30.8**
Deficit on a cash basis as a % of GDP*	-9.0	-7.9	8.9	6.7	7.1	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**5.5**	**-57.3**	**14.2**	**-36.0**	**0.0**	**-36.0**
7. FINANCING	**488.8**	**474.6**	**697.3**	**608.0**	**627.4**	**-19.4**
Domestic (Net)	130.9	202.3	309.8	273.7	248.7	25.0
External (Net)	217.5	269.9	385.7	331.6	374.6	-43.0
Capital Receipts (net of restructuring costs)	0.0	2.4	1.8		3.8	-3.8
Others	140.5	0.0	0.0	2.6	0.2	2.4

Source: The National Treasury- Provisional BOT June 2018- Published in QEBR June 2018

2.0 DOMESTIC ECONOMY

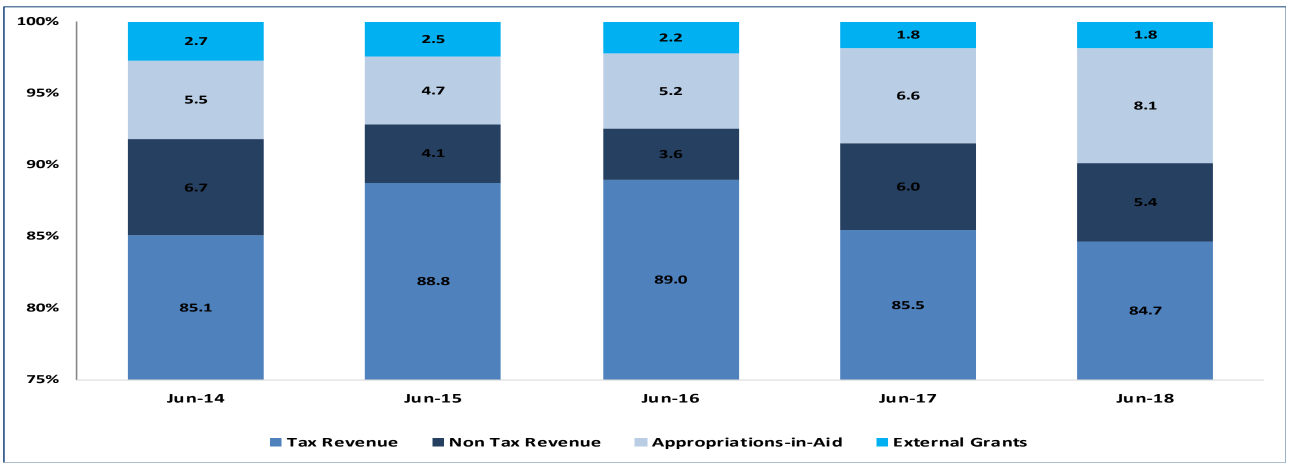
Chart 2.10: Composition of Government Revenue in KSh Billion



Source: The National Treasury- Provisional BOT June 2018-Published in QEBR June 2018

The Government continues to make progress towards broadening the tax base and improving revenue administration. The growth in tax revenue going forward is expected to benefit from the Government's on-going reform of tax policies, improved revenue administration systems and the re-introduction of withholding VAT. The contribution of tax revenue to total government receipts is, therefore, expected to remain high **(Chart 2.11).**

Chart 2.11: Composition of Government Revenue (Percentage of Total)



Source: The National Treasury- Provisional BOT June 2018- Published in QEBR June 2018

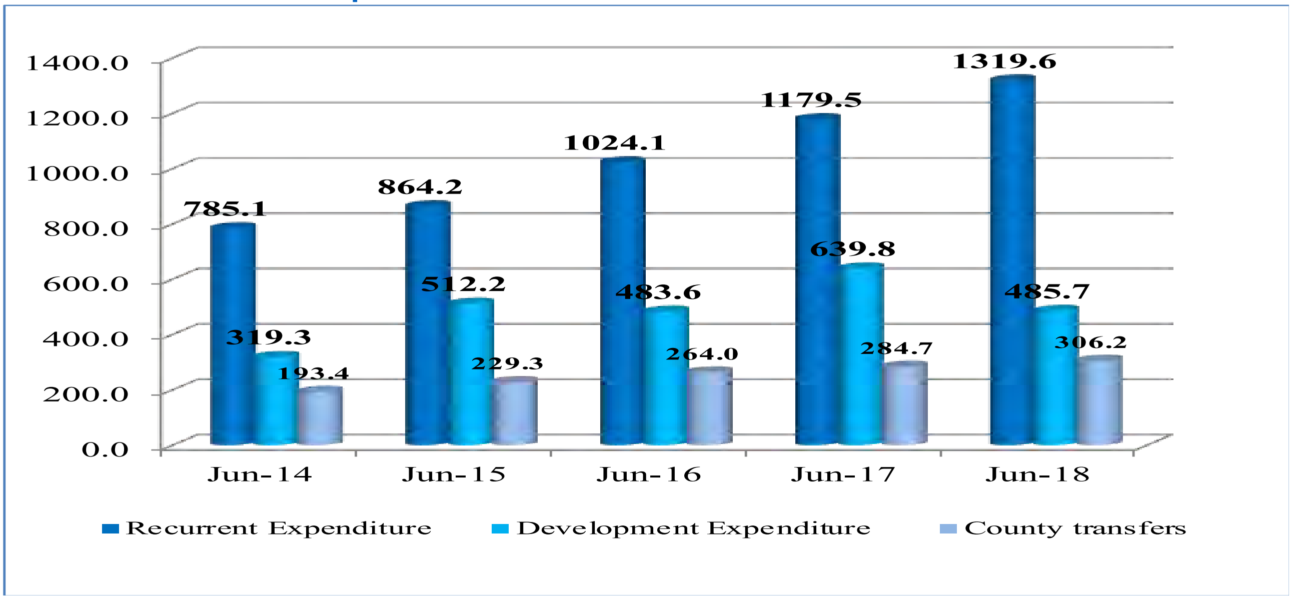
2.0 DOMESTIC ECONOMY

Expenditure and Net Lending

Government expenditure and net lending remained stable, increasing by only 0.1 per cent, from KSh 2,110 billion in the FY 2016/17 to KSh 2,111.5 billion in the FY 2017/18 **(Chart 2.12).** Development expenditure reduced significantly by 24.1 per cent, and accounted for 23 per cent of the total Government expenditure and net lending. Recurrent expenditure increased by 11.9 per cent and accounted for 62.5 per cent of total central government expenditure and transfers to counties. Despite the increase in recurrent expenditure, it remained below target, with under-performance recorded in operations and maintenance, pension, as well as wages and salaries.

Expenditures generally fell short of target due to slow absorption in both recurrent and development components. Additionally, the discrepancy between actual and target expenditures partly reflect the non-capture of district expenditures and hence under reporting by ministries. County transfers increased by 7.5 per cent to KSh 306.2 billion **(Table 2.14).**

Chart 2.12: Government Expenditure



Source: The National Treasury- Provisional BOT June 2018- Published in QEBR June 2018

2.0 DOMESTIC ECONOMY

Financing

Net domestic borrowing during FY 2017/18 amounted to KSh 273.7 billion and was within target. The borrowing comprised KSh 124.3 billion from Commercial Banks, KSh 172.8 billion from Non-Banking Financial Institutions and KSh 2.9 billion from Non Residents, and a repayment of KSh 26.4 billion to the Central Bank of Kenya **(Table 2.15).**

Domestic financing in FY 2017/18 was 11.6 percent lower than in the previous year, and represented 45.0 per cent of total financing.

Table 2.15: Domestic Financing (Ksh Billion)

	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18
1. From CBK	(121.09)	136.30	(111.11)	(22.37)	(26.35)
2.From commercial banks	73.44	108.00	187.15	169.54	124.27
3.From Non-banks	102.50	27.55	139.44	160.68	172.82
4. From Non-Residents	6.40	(3.48)	4.58	1.92	2.97
Change in Credit from banks (From 30th June 2016)	(47.65)	244.31	76.05	147.17	97.92
Change in Credit from non-banks(From 30th June 2016)	102.50	27.55	139.44	160.68	172.82
Change in Credit from non-residents(From 30th June 2016)	6.40	(3.48)	4.58	1.92	2.97
5.Total Change in Dom. Credit (From 30th June 2017)	61.25	268.37	220.06	**309.76**	273.71

NB. Treasury Bills are reflected at Cost

Source: Central Bank of Kenya

Outlook for FY 2018/19

In the budget estimates for the FY 2018/19 total revenue is projected at KSh 1,949.2 billion (20.0 per cent of GDP) while external grants are projected at KSh 48.5 billion. Government expenditure is projected at KSh 2,556.6 billion (26.3 per cent of GDP), of which KSh 1,550.0 billion will be for recurrent expenses, KSh 376.4 billion for transfers to county governments, and KSh 625.1 billion for development expenses.

The overall budget deficit including grants on commitment basis is, therefore, projected at KSh 558.9 billion (5.7 per cent of GDP) in 2018/19, to be financed through net external borrowing of KSh 287.0 billion and net domestic borrowing of KSh 271.9 billion.

2.0 DOMESTIC ECONOMY

2.5 Public Debt

Kenya's public and publicly guaranteed debt increased by 14.3 percent during the FY 2017/18, with both domestic and external debt increasing at 17.4 percent and 11.6 percent, respectively. Public debt portfolio comprised of 49.2 percent and 50.8 percent domestic and external debt, respectively, by the end of the FY 2017/18. The ratio of public debt to GDP declined marginally to 57.0 percent as the projected rate of economic expansion surpassed the rate of buildup in public debt **(Table 2.16).**

Table 2.16: Public Debt

	June 2014		June 2015		June 2016		June 2017		June 2018**	
	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT										
Securitised debt	**1,242.4**	**96.7**	**1,381.2**	**97.2**	**1,765.1**	**97.2**	**2,100.5**	**99.4**	**2,413.8**	**97.4**
Treasury Bills	327.7	25.5	345.5	24.3	613.0	33.8	768.5	36.4	901.9	36.4
Of which Repo Treasury bills	28.3	2.2	26.6	1.9	25.0	1.4	24.4	1.2	23.3	0.9
Treasury Bonds	914.8	71.2	1,035.7	72.9	1,152.0	63.5	1,332.0	63.1	1,511.9	61.0
Non Securitised debt	**41.9**	**3.3**	**39.2**	**2.8**	**50.1**	**2.8**	**11.1**	**0.5**	**65.0**	**2.6**
Overdraft at CBK	37.2	2.9	36.5	2.6	44.2	2.4	0.0	0.0	56.8	2.3
others	4.6	0.4	2.7	0.2	5.9	0.3	11.1	0.5	8.1	0.3
TOTAL DOMESTIC DEBT	**1,284.3**	**100.0**	**1,420.4**	**100.0**	**1,815.1**	**100.0**	**2,112.3**	**100.0**	**2,478.8**	**100.0**
(as a % of GDP)*	25.3		24.4		27.0		27.4		28.0	
(as a % of Total Debt)	54.2		50.2		50.2		47.9		49.2	
EXTERNAL DEBT**										
Bilateral	289.9	26.7	445.1	30.6	548.4	30.5	724.8	31.6	816.1	35.6
Multilateral	597.3	55.0	684.6	48.6	798.8	44.5	841.9	36.7	821.0	35.8
Comm. Banks	182.2	16.8	276.9	19.7	432.4	24.1	712.1	31.0	906.4	39.5
Export Credit	16.5	1.5	16.6	1.2	16.6	0.9	15.9	0.7	16.7	0.7
TOTAL EXTERNAL DEBT	**1,085.9**	**100.0**	**1,423.3**	**100.0**	**1,796.2**	**100.0**	**2,294.7**	**100.0**	**2,560.2**	**100.0**
(as a % of GDP)*	21.4		24.4		26.8		29.8		28.9	
(as a % of Total Debt)	45.8		49.8		49.8		52.1		50.8	
TOTAL PUBLIC DEBT	**2,370.3**		**2,843.7**		**3,611.3**		**4,407.0**		**5,039.0**	
(as a % of GDP)*	46.7		48.8		53.8		57.3		57.0	

* Estimates
** Provisional

Source: National Treasury and Central Bank of Kenya

Public Domestic Debt

Total domestic debt increased by 17.4 percent during the FY 2017/18. The key driver of the increase is the uptake of Treasury bills (by 17.4 percent) due to uncertainties associated with the long electioneering period in the first half of the FY 2017/18. Treasury bonds increased at a slower pace of 13.5 percent . Nevertheless, interest rates remained stable characterised by a normalized yield throughout the FY 2017/18.

Consequently, the proportion of Treasury bonds in total domestic debt decreased while that of Treasury bills increased **(Chart 2.13).** The Government made significant progress in issuing and re-opening long-dated instruments during the fiscal year 2017/18 **(Chart 2.14).** The 364 days Treasury bill and 15 years Treasury bond accounted for the largest proportional increase of outstanding Government securities during the period, increasing by 29.6 percent and 23.5 percent, respectively, by June 2018.

Chart 2.13: Composition of Government Domestic Debt\[1]

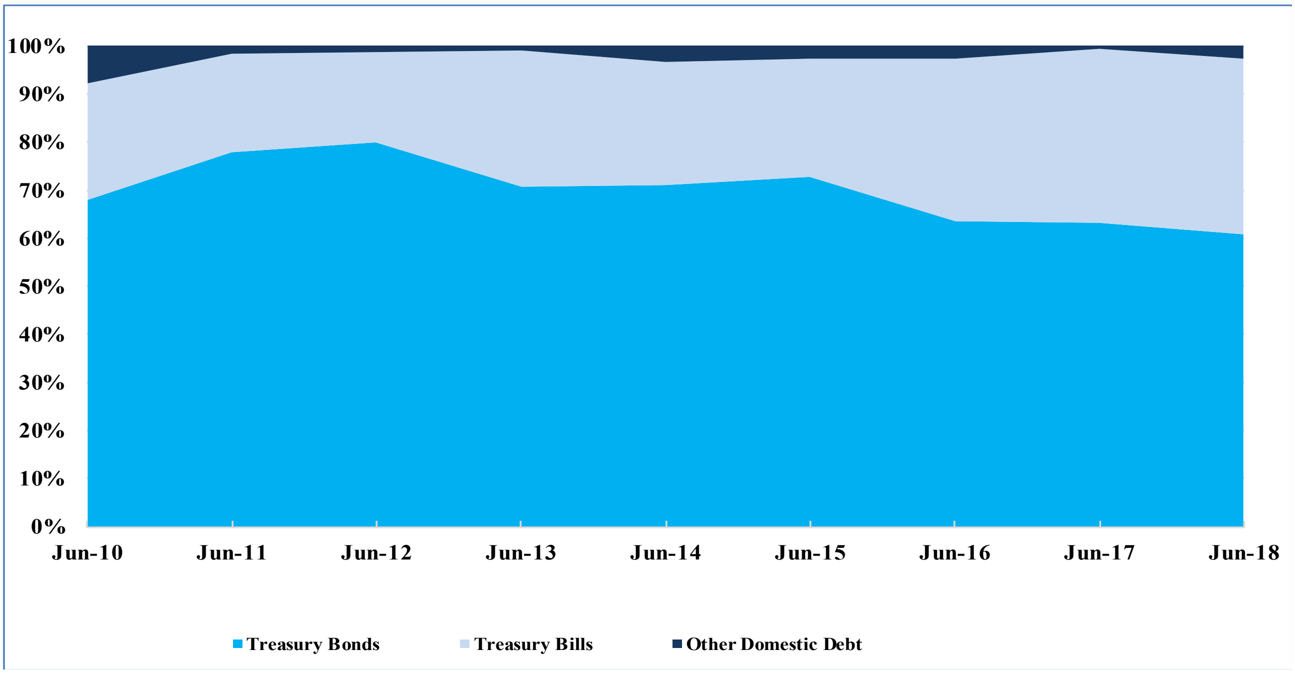
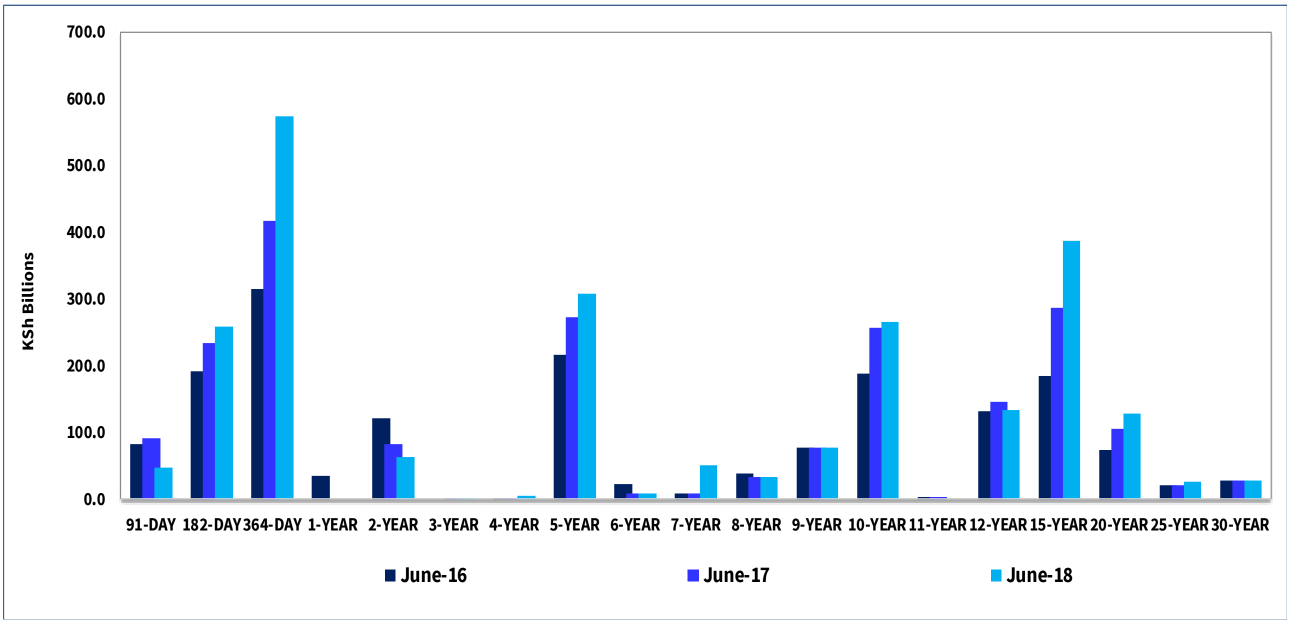


Chart 2.14: Outstanding Treasury bills and Bonds by Tenor



Source: National Treasury and Central Bank of Kenya

\[1] *Other domestic debt include government overdraft, pre-1997 overdraft, uncleared effects and tax reserve certificates*

2.0 DOMESTIC ECONOMY

Table 2.17: Outstanding Stock of Treasury Bills by Holder (KSh Billion)

Holders		Jun-14		Jun-15		Jun-16		Jun-17		Jun-18	
	%	Ksh	%	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	68.0	204.7	62.5	244.4	70.7	386.8	63.1	457.1	59.5	502.6	55.7
Central Bank*	6.2	28.3	8.6	26.7	7.7	45.5	7.4	20.6	2.7	20.6	2.3
Comm. Banks	61.9	176.4	53.8	217.7	63.0	341.3	55.7	436.5	56.8	482.0	53.4
Insurance Companies	5.0	19.9	6.1	20.8	6.0	18.4	3.0	13.7	1.8	21.2	2.3
Parastatals	1.9	4.2	1.3	15.0	4.3	53.8	8.8	89.0	11.6	136.9	15.2
Pension Funds	14.5	67.8	20.7	40.9	11.8	117.9	19.2	179.5	23.3	180.1	20.0
Others	10.6	31.1	9.5	24.4	7.1	36.1	5.9	29.2	3.8	61.1	6.8
Total	**100.0**	**327.7**	**100.0**	**345.5**	**100.0**	**613.0**	**100.0**	**768.5**	**100.0**	**901.9**	**100.0**

* Includes Repo Treasury bills

Source: National Treasury and Central Bank of Kenya

Table 2.18: Outstanding Stock of Treasury Bonds by Holder (KSh Billion)

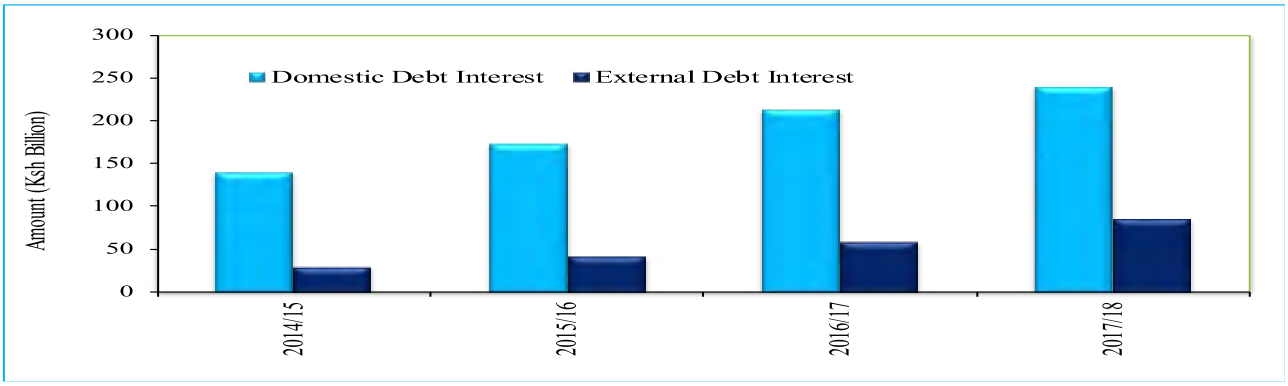
Holders	Jun-14		Jun-15		Jun-16		Jun-17		Jun-18	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	436.4	47.7	510.3	49.3	569.8	49.5	715.1	53.7	786.4	52.0
Central Bank	0.0	0.0	0.0	0.0	9.4	0.8	9.4	0.7	9.4	0.6
Comm. Banks	436.3	47.7	510.2	49.3	560.4	48.6	705.7	53.0	776.9	51.4
Insurance Companies	101.2	11.1	107.0	10.3	107.0	9.3	114.7	8.6	133.3	8.8
Parastatals	34.4	3.8	33.6	3.2	33.6	2.9	39.4	3.0	37.7	2.5
of which NSSF	16.2	1.8	13.6	1.3	13.6	1.2	-11.2	-0.8	0.0	0.0
Pension Funds	272.9	29.8	311.8	30.1	351.0	30.5	400.1	30.0	491.4	32.5
Others	69.9	7.6	73.0	7.0	90.6	7.9	62.7	4.7	63.1	4.2
Total	**914.8**	**100.0**	**1035.7**	**100.0**	**1152.0**	**100.0**	**1332.0**	**100.0**	**1511.9**	**100.0**

Source: National Treasury and Central Bank of Kenya

Interest Payments on Public Debt

Cumulative interest and other charges on domestic and external debt for the FY 2017/18 increased by 12.5 percent and 44.6 percent, respectively. This increase was mainly driven by the increased uptake of external debt in the recent past and increased domestic financing during the financial year **(Chart 2.15).**

Chart 2.15: Domestic and External Debt Interest Payments



Source: National Treasury and Central Bank of Kenya

2.0 DOMESTIC ECONOMY

Public and Publicly Guaranteed External Debt

Kenya's public and publicly guaranteed external debt increased by 11.6 percent to KSh 2,560.2 billion **(Table 2.19).** The growth in external debt during this period was attributed to disbursements from the March 2018 Eurobond, Chinese government proceeds of commercial loans from Trade and Development Bank.

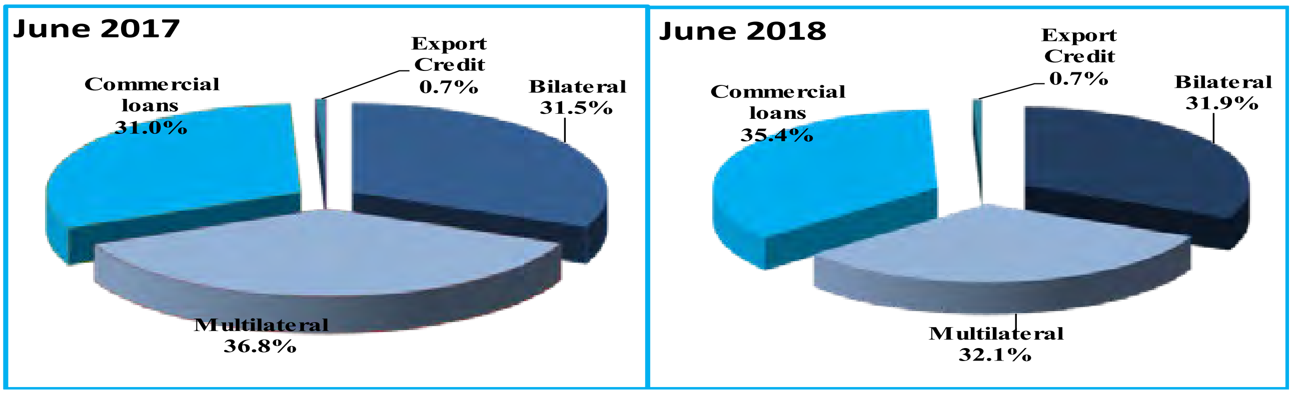
The proportion of debt owed to multilateral lenders declined by 4.7 percent while that held by commercial Banks and bilateral lenders increased by 4.4 percent and 0.4 percent, respectively. The increase in commercial debt was mainly on account of disbursements from March 2018 Eurobond **(Chart 2.16).**

Table 2.19: Distribution of External Public Debt (KSh Billion)

	Jun-15	%	Jun-16	%	Jun-17	%	Jun-18	%
Bilateral	445.1	30.6	548.4	30.5	722.6	31.5	816.1	31.9
Multilateral	684.6	48.6	798.8	44.5	844.4	36.8	821.0	32.1
Commercial loans	276.9	19.7	432.4	24.1	712.1	31.0	906.4	35.4
Export Credit	16.6	1.2	16.6	0.9	15.3	0.7	16.7	0.7
Total	**1423.3**	**100.0**	**1796.2**	**100.0**	**2294.4**	**100.0**	**2560.2**	**100.0**

Source: National Treasury

Chart 2.16: Composition of External Public Debt

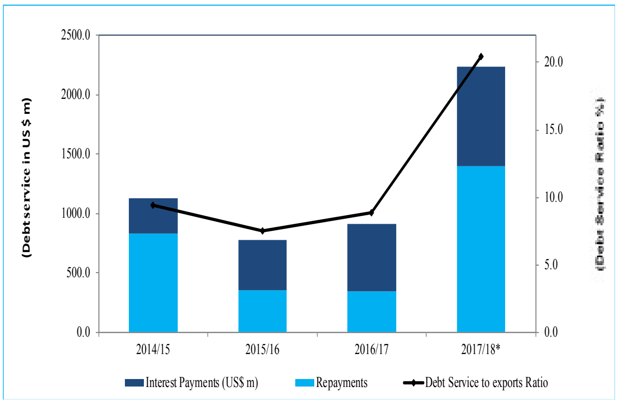


Source: National Treasury

External Debt Service

Total external debt service increased from KSh 94.3 billion in June 2017 to KSh 225.9 billion in June 2018. Liquidity indicators of indebtedness, that is debt service to revenues and exports increased from 6.6 percent and 8.8 percent to 14.7 percent and 20.4 percent, respectively **(Chart 2.17).**

Chart 2.17: External Debt Service



Source: National Treasury

3.0 REGIONAL INTEGRATION DEVELOPMENTS

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Background

Regional integration has many economic, social, and political benefits among the collaborating countries. Besides fostering good neighbourliness, regional integration enables creation of a single market anchored on economic freedom and strong institutions. It minimises or eliminates trade barriers and thus generates greater mobility of factors of production, goods and services thereby enhancing investment, economic growth, consumption and employment.

The EAC Monetary Cooperation Programme

The East African Community (EAC) comprises six countries including Burundi, Kenya, Rwanda, South Sudan, Tanzania and Uganda. Burundi and Rwanda joined the Community in July 2007 and South Sudan in April 2016. Article 5 of the Treaty for the Establishment of the East Africa Community sets the objectives of the Community to include development of 'policies and programmes aimed at widening and deepening co-operation among the Partner States in political, economic, social and cultural fields, research and technology, defense, security and legal and judicial affairs, for their mutual benefit'. The Treaty encapsulates the integration process of the EAC, commencing with a Customs Union, progressing to a Common Market, Monetary Union and eventually Political Federation characterised by common foreign and security policies. The EAC Custom Union which came into force in 2005 calls for, among other things, elimination of internal tariffs and non-tariff barriers and establishment of a common external tariff.

The EAC Common Market

The Common Market is the second stage of EAC integration process and calls for free movement of labour, goods, services, capital and the right of establishment. The Common Market came into force in 2010. Table 3.1 summarises Kenya's achievements towards implementation of the EAC Common Market.

The East African Monetary Union

The East African Monetary Union (EAMU) is the third stage in the process of the EAC regional integration and advocates for the harmonisation of monetary and fiscal policies and removal of all obstacles to movement of factors of production. Its main objective is to promote and maintain monetary and financial stability aimed at facilitating economic integration of the Community. The protocol on the establishment of the EAMU was signed on November 30, 2013 and lays the groundwork for a monetary union within 10 years. The requirements of the Protocol apply to activities undertaken by Partner States, co-operating in monetary and financial matters.

In accordance with the roadmap for implementation of the EAMU Protocol, East African Community Monetary Institute (EAMI) which is responsible for preparatory work for the Monetary Union, should have been established by 2015. The Bill was enacted by the East African Legislative Assembly (EALA) in April 2018 and awaits assent by the Summit. Other processes of establishing the EAMI, including the identification of the host Partner State, will commence after assent to the Act.

The East African Community Surveillance, Compliance and Enforcement Commission (EASCEC), the East African Community Statistics Bureau (EASB) and East African Community Financial Services Commission (EAFSC) – the other institutions of EAMU – should have been established by 2018. The legal instruments for establishing these institutions are at different stages of development but are behind schedule. The bill for the establishment of the EAC Bureau of Statistics (EACBS) is before the EALA for consideration whereas the draft Bill for the establishment of EAFSC has been developed and negotiated by the Task Force on EAMU institutions.

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Table 3.1: Progress in Kenya's achievement in implementation of the EAC Common Market during FY 2017/18

Freedom/Right	Achievement
Free Movement of Goods	Operalisation of a centralised platform for intra cargo traffic commenced in October 2017 to accelerate monitoring of single customs territory cargo processing.
	Full roll out of all products under the Single Customs Territory on December 1, 2017 by KRA thereby eliminating transit traffic to Partner States
Free Movement of Persons	Kenya launched the issuance of the EAC 'e' Passport on September 1, 2017
	Kenya fully automated the processing of travel documents, temporary passes by uploading application forms for Visa/temporary passes
	Presidential directive allowing EAC Partner State members to use their national IDs to travel into the country
	Launch of the revised immigration border procedure manual in conjuction with the International Organisation for migration to facilitate capacity building
	Piloting on the Namanga One Stop Border Post (OSBP) began on October 2, 2017 and Busia OSBP commissioned on February 28, 2018
Free Movement of Workers	Continued with gratis processing of work permits, student and dependant passes for EAC members
	Full automation of processing of work permits
	Presidential directive allowing EAC Partner State members to use their national IDs to work in the country
Free Movement of Capital	Introduction of Capital Markets online foreign exchange trading regulations 2017, in August 2017
	Introduction of Capital Markets regulations 2017 on securities, lending, borrowing and short selling in December 2017
	Introduction of a policy guidance note on Global Depository Receipts (GDRs) and Global Depository Notes (GDNs) in July 2017
Right of Residence	Presidential directive allowing EAC Partner State members to use their national IDs to do business, own property and marry (November 28, 2017)
	Full automation of the processing of resident permits

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Table 3.2: Kenya's Macroeconomic Progress under the EAC Monetary Cooperation Programme

EAC Macroeconomic Convergence Criteria under the EAMU Protocol			
Performance convergence criteria	**2015-16**	**2016-17**	**2017-18**
8% ceiling on headline inflation \1	6.48	8.13	5.20
Ceiling on fiscal deficit, including grants of 3% of GDP\2	-8.44	-9.25	-7.06
Ceiling on gross public debt of 50 percent of GDP in Net Present Value terms\3	55.5	57.5	57.0
Reserve cover of 4.5 months of imports\4	5.35	5.68	5.92
Indicative convergence criteria			
5% ceiling on core inflation\5	5.01	4.24	3.58
A ceiling on fiscal deficit, excluding grants of 6% of GDP\2	-8.44	-9.25	-7.06
Tax to GDP ratio of 25%\6	16.42	15.92	14.23

\1 Inflation annual average: CBK inflation data
\2 On commitment basis Quarterly Economic and Budget Review, August 2018 edition (Source National Treasury)
\3 Quarterly Economic and Budget Review, August 2018 edition (Source National Treasury)
\4 Based on 36 months of imports, CBK data
\5 Excludes food and fuel, CBK data
\6 Computed using Total Tax Revenues-Quarterly Economic and Budget Review, August 2018 edition (Source National Treasury)

Realization of the Monetary Union will require EAC Partner States to attain and maintain for at least three consecutive years the following macroeconomic performance convergence criteria:

i) A ceiling on headline inflation of 8%.
ii) A ceiling on fiscal deficit, including grants of 3% of GDP.
iii) A ceiling on Gross Public Debt of 50% of GDP in Net Present Value terms.
iv) A foreign exchange reserves cover of 4.5 months of imports.

Kenya is on track to meeting the EAC Macroeconomic Convergence Criteria under the EAMU Protocol **(Table 3.2).** However, challenges remain in attaining the criteria on the fiscal deficit and gross public debt.

The COMESA Monetary Cooperation Programme

Heads of State and Government of the Common market for Eastern and Southern Africa (COMESA) member countries adopted in 1992 the COMESA Monetary Cooperation Programme towards the establishment of a Monetary Union by the year 2025.

The primary objective of the COMESA Monetary Cooperation Programme is to create a common area of monetary and financial system stability which will facilitate integration of the financial markets and achieve economic integration and economic growth. The achievement of monetary and financial system stability entails attainment of economic convergence by removing all macroeconomic impediments which exist among member states as a result of pursuit of divergent macroeconomic policies.

The revised COMESA convergence criteria are categorized into primary (preconditions for convergence) and secondary (reinforcement conditions) criteria, to be implemented in three phases:

- Stage 1 (2005-2010),
- Stage 2 (2011-15) and;
- Stage 3 (2016-18).

During the review period, COMESA Committee of Central Bank Governors held the 23rd meeting on March 29, 2018 in Djibouti. The meeting of Governors was preceded by the symposium of Governors on 'Review of experiences on Central Bank role in Promoting Economic Growth; on March 28, 2018.

The meeting of Governors noted that only nine (9) central banks were live on the Regional Electronic Payments and Settlement System (REPSS) namely: DR Congo, Egypt, Kenya, Malawi, Mauritius, Rwanda, Swaziland, Uganda and Zambia. In addition, it was noted that over the two-year period until February 2018, the value of transactions

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Table 3.3: Kenya's Progress in Implementation of COMESA Monetary Programme

Indicators	Actual 2015	Actual 2016	Actual 2017	MEC Target
Primary Indicators				
Inflation (annual rate - %) Urban	6.2	6.2	7.9	**<5**
Consumer price, 12-month period average - Headline (December)	6.6	6.3	8.0	
Consumer prices end-of-period – Month-on-Month (December)	8.0	6.4	4.5	
Fiscal deficit (excluding grants)/GDP (%)	9.2	8.2	9.3	**<4**
Overall deficit (including grants)/GDP (%)	8.4	7.4	9.1	
Central Bank financing of budget deficit (Ksh mn.) End June	Ksh. 36,494	Ksh. 44,204	Ksh. 0	**0**
External reserves (import cover, months) End June	4.5	5.4	5.7	**=/>5**
Secondary Indicators				
Real GDP growth (%) End Year	5.7	5.8	4.9	**>7.0**
Real Effective Exchange Rate (2005=100) % change (Dec)	0.5	-6.5	2.3	**Achieve and maintain stable REER**
Real Interest rates (annual average deposit rate)	0.4	0.8	-0.5	**Achieve and maintain positive rate**
Nominal Interest rate (annual average deposit rate)	6.9	7.1	7.5	
Total debt stock (% GDP)	48.8	53.8	57.5	**Sustainable level**
Total government external debt stock/GDP	24.4	26.8	30.0	
Total domestic revenue (% GDP) excl. grants	18.8	18.4	18.7	**>20**
Current a/c deficit (excluding grants) as % of GDP (End of June)	10.0	4.4	6.5	Sustainable level
Domestic investment rate (%) (End June)	25.7	27.2	29.4	**>20**

processed through REPSS had reached nearly US$ 35 million and € 1 million, with the Central Bank of Kenya accounting for 91 percent of the total value of USD transactions while the Bank of Uganda accounted for 81 percent of the value of Euro transactions.

Governors' further noted the weak performance made on the Macroeconomic Convergence Criteria under the stage one (2005-2010), with majority of the countries having not met both the primary and secondary criteria. Kenya made progress towards achieving the set primary targets in 2017 compared to 2016. The overall month-on-month inflation converged to 4.5 percent in December 2017 against the COMESA target of 5 percent, however, overall annual average inflation was at 8 percent; Central Bank financing to government was 0; and Reserve to months of import was 5.7 months as at end June 2017 against the COMESA target of 5 months. However, the overall deficit (excluding grants) widened to 9.3 percent of GDP in FY 2016/17 from 8.2 percent of GDP in FY 2015/16, which is higher compared to the COMESA target of 4.0 percent.

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Under the secondary criterion, Kenya met the criterion on allocating a minimum 20 percent of fiscal receipts for government capital investments; stability in real effective exchange rate; and sustainable external balance and debt levels. However, under-performance was recorded on the criterion on mobilizing a minimum 20 percent domestic fiscal receipt to GDP and maintaining positive real interest rates.

The Association of African Central Banks

The Association of African Central Banks (AACB) was established at the Summit Conference of African Heads of State and Government in May 25, 1963 in Addis Ababa, Ethiopia. The AACB was charged to: promote co-operation in the monetary, banking and financial spheres in the African region and strengthen efforts aimed at bringing about and maintaining price and financial stability in the African region. Membership of the AACB is open to all African central banks.

The Association adopted in 2000 an African Monetary Cooperation Programme (AMCP) whose aim is to establish a harmonized monetary system with a view to setting up a common organ to work towards the creation of a single monetary zone by 2021. The AMCP spells out a hierarchy of primary and secondary criteria, with their relative target values and deadlines for compliance.

In the review period, the Assembly of AACB Governors held the 41st Ordinary Meeting on August 9, 2018, in Egypt. The meeting was preceded by the Symposium of Governors on the theme 'Declining Correspondence Banking Relationships and Illicit Capital Flows: Risks and Policy Challenges for Africa, on August 8, 2018.

The meeting reviewed the status of implementation of the decisions of the 40th Ordinary meeting of the Assembly of Governors. Key issues considered included the progress report on the implementation of the African Monetary Co-operation Program (AMCP), under which performance of member countries were assessed based on the revised criteria.

The assessment of the 2017 AMCP was based on revised targets and indicators. Overall, eighteen (18) out of the fifty-two (52) countries met all the primary convergence criteria in 2017. Improved performance was mainly in external reserves/imports of goods and services of more than or equal to three (3) and inflation target of less than or equal to seven (7) percent.

Kenya met the criteria on central bank credit to government and that of reserves/imports of goods and services. However, that of inflation and budget deficit was below the target, mainly attributed to adverse weather condition and a one off increase in drought and election related expenditure during 2017.

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Table 3.4: Kenya's Macroeconomic performance against Convergence Criteria under the AMCP

	Previous Criteria			Revised Criteria
Primary criteria				
	2014	**2015**	**2016**	**2017***
Annual Average Inflation	**<5%**			**≤ 7%**
	6.9	6.6	6.3	8.0
Overall Budget deficit/GDP**	**<3%**			**≤ 5%**
	9.2	8.2	9.3	7.2
Central Bank Credit to Government**	**0**			**≤ 5% of previous year's tax revenue**
	0.7	0.6	0.7	0.0
External Reserves/Imports of Goods and Services	**≥ 6 months**			**≥ 3 months**
	5.0	4.8	5.0	4.9
Secondary Criteria				
General Government Debt/ GDP ratio** (new)				**<65%**
	42.1	48.8	53.8	57.5
Total Tax Revenue/ GDP**	**≥ 20%**			**≥ 20%**
	19.7	23.3	18.4	19.6
Nominal Exchange Rate	**Maintenance of Real Exchange Rate stability**			**Variability ±10% (Target ±5%)**
	-3.6	0.5	-6.5	2.3
Government Capital Investment/Tax Revenue**	**≥ 20%**			**≥ 30%**
	19.7	24.1	24.2	27.1

* Fiscal numbers are for year ending June 2018
** Numbers are in fiscal year

4.0
CENTRAL BANK OPERATIONS

4.0 CENTRAL BANK OPERATIONS

4.1 Monetary Operations

Monetary Policy

The monetary policy stance of the Central Bank during financial year 2017/18 was aimed at maintaining inflation within the Government target of 5±2.5 percent. This was achieved as inflation remained within the upper bound of the target of 7.5 percent during financial year, except in August 2017 when it stood at 8.0 percent, due to a spike in food prices following transport difficulties immediately after the general elections. Non-food-non-fuel (NFNF) inflation remained below 5 percent during the financial year, indicating muted demand pressures.

The Monetary Policy Committee (MPC) held six bi-monthly meetings during the financial year: July, September, November, January, March and May. In its first four meetings, the MPC retained the Central Bank Rate (CBR) at 10.0 percent in order to continue anchoring inflation expectations. In the March 2018 meeting, while noting the risk of perverse outcomes due to interest rate capping, the MPC lowered the CBR by 50 basis points to 9.5 percent as there was room for easing of monetary policy stance to support economic activity as inflation expectations were well anchored within the Government's target range, there was increased optimism for growth prospects in the economy and the economic output was below its potential level. In its May 2018 meeting, the MPC retained the CBR at 9.5 percent noting that the impact of March 2018 reduction in the CBR was yet to be fully transmitted to the economy, and it was too early to discern any perverse outcomes.

On March 12, 2018, the Executive Board of the International Monetary Fund (IMF) approved a 6-month extension of Kenya's Stand-By Arrangement (SBA) to allow additional time to complete outstanding programme reviews. The precautionary arrangement with the IMF provided additional buffers against exogenous shocks.

Money Supply

Annual growth in broad money supply (M3) accelerated to 10.5 percent in June 2018 from 6.0 percent in June 2017. The increase was largely on account of an increase in net credit to government and a recovery of credit to the private sector in the last of quarter of FY 2017/18 **(Table 4.1).**

Consistent with the recovery in M3 growth was the growth in deposits which accelerated from 5.4 percent in June 2017 to 11.2 percent in June 2018. This growth in deposits was largely reflected in the household sector whose growth in deposits accelerated to 16.3 percent in June 2018 from 3.6 percent in June 2017, reflecting increases in both local and foreign currency deposits. The growth in foreign currency deposits of the household sector was more pronounced; grew by 76.3 percent in June 2018 compared to 16.3 percent in June 2017, partly reflecting improved diaspora remittances mainly supported by new partnerships between commercial banks and international money remittance providers **(Table 4.2).**

4.0 CENTRAL BANK OPERATIONS

Table 4.1: Monetary Aggregates

	End Month Level (KSh Billions)				Annual Growth Rate				Annual Absolute Change (KSh Billions)			
	Jun-15	Jun-16	Jun-17	Jun-18	Jun-15	Jun-16	Jun-17	Jun-18	Jun-15	Jun-16	Jun-17	Jun-18
COMPONENTS OF M3												
1. Money supply, M1 (1.1+1.2+1.3)	1,001.9	1,135.9	1,391.3	1,436.9	9.6	13.4	22.5	3.3	87.5	134.0	255.4	45.6
1.1 Currency outside banks	175.3	187.9	206.7	217.9	10.8	7.2	10.0	5.4	17.1	12.6	18.8	11.2
1.2 Demand deposits	776.2	881.1	1,102.9	1,137.3	13.0	13.5	25.2	3.1	89.3	104.8	221.9	34.4
1.3 Other deposits at CBK 1/	50.2	66.7	81.2	81.2	-27.4	32.8	21.8	0.0	-19.0	16.5	14.6	0.0
2. Money supply, M2 (1+2.1)	2,154.5	2,353.4	2,480.5	2,668.3	16.4	9.2	5.4	7.6	303.9	198.9	127.1	187.7
2.1 Time and saving deposits	1,152.6	1,218.0	1,092.3	1,231.4	22.8	5.6	-10.3	12.7	214.2	64.9	-125.7	139.1
3. Money supply, M3 (2+3.1)	2,560.4	2,769.0	2,936.1	3,242.9	18.4	8.1	6.0	10.5	397.4	208.6	167.1	306.8
3.1 Foreign Currency Deposits	405.9	415.6	455.6	574.7	29.9	2.4	9.6	26.1	93.5	9.7	40.0	119.1
SOURCES OF M3												
1. Net foreign assets 2/	435.5	562.5	644.1	758.5	-17.7	29.2	14.5	17.8	-93.9	127.0	81.6	114.3
Central Bank	565.2	694.6	738.3	783.6	-8.2	22.9	6.3	6.1	-50.3	129.4	43.8	45.3
Banking Institutions	-129.6	-132.0	-94.2	-25.2	50.7	1.9	-28.6	-73.3	-43.6	-2.4	37.8	69.1
2. Net domestic assets (2.1+2.2)	2,124.9	2,206.5	2,292.0	2,484.5	30.1	3.8	3.9	8.4	491.3	81.6	85.5	192.5
2.1 Domestic credit	2,638.8	2,855.1	3,002.2	3,203.0	29.2	8.2	5.2	6.7	596.0	216.2	147.2	200.8
2.1.1 Government (net)	521.8	560.4	646.2	745.1	84.3	7.4	15.3	15.3	238.7	38.6	85.8	98.8
2.1.2 Private sector	2,035.1	2,216.1	2,249.1	2,346.1	18.3	8.9	1.5	4.3	315.2	181.0	33.1	96.9
2.1.3 Other public sector	82.0	78.6	106.9	111.9	105.0	-4.1	36.0	4.7	42.0	-3.4	28.3	5.0
2.2 Other assets net	-513.9	-648.6	-710.3	-718.5	25.6	26.2	9.5	1.2	-104.7	-134.7	-61.7	-8.3
MEMORANDUM ITEMS												
Memorandum items												
2. Reserve money	372.0	390.2	399.6	429.2	14.9	4.9	2.4	7.4	0.8	1.7	9.4	29.6
4. Overall liquidity, L (3+4.1)	3,204.3	3,605.1	3,935.0	4,414.5	17.4	12.5	9.1	12.2	475.0	400.8	329.8	479.5
4.1 Non-bank holdings of government securities	643.9	836.1	998.9	1,171.6	13.7	29.9	19.5	17.3	77.7	192.3	162.7	172.7

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

1/ Includes county deposits and special projects deposit

2/ Net Foreign Assets at current exchange rate to the US dollar.

Source: Central Bank of Kenya

Net Foreign Assets

Growth of net foreign assets (NFA) of the banking system increased to 17.8 percent in the financial year 2017/18 from 14.5 percent in the financial year 2016/17, largely supported by government external borrowing and increase in commercial banks foreign assets mostly in form of deposits and securities purchased. The NFA of the Central Bank increased by KSh 45.3 billion in the period under review compared to KSh 43.8 billion in the previous financial year while the NFA of commercial banks increased by KSh 69.1 billion compared to KSh 37.8 billion in the previous financial year **(Table 4.1).**

Net Domestic Assets

The net domestic assets (NDA) of the banking system grew by 8.4 percent in the FY 2017/18 compared to 3.9 percent in the FY 2016/17, largely reflecting net credit to government and a recovery in growth of credit to the private sector. The recovery in private sector credit growth contributed to improved M3 growth in the financial year 2017/2018 **(Table 4.1).**

4.0 CENTRAL BANK OPERATIONS

Table 4.2: Deposit Holdings of Corporates and Household Sectors

	End Month Level (KSh Billions)				Annual Growth Rates				Annual Absolute Change(KSh BIllions)			
	Jun-15	Jun-16	Jun-17	Jun-18	Jun-15	Jun-16	Jun-17	Jun-18	Jun-15	Jun-16	Jun-17	Jun-18
Total Deposits	**2,354**	**2,557**	**2,694**	**2,996**	**19.4**	**8.6**	**5.4**	**11.2**	**382**	**203**	**138**	**302**
Household Sector 1/	1,082	1,222	1,265	1,471	20.7	12.9	3.6	16.3	185	140	43	206
1.1 Local Currency Deposits	974	1,103	1,127	1,227	20.8	13.2	2.2	8.9	168	129	24	**100**
1.2 Foreign Currency Deposits	108	119	139	244	19.0	10.2	16.3	76.3	17	11	19	106
Corporate Sector	**1,242**	**1,280**	**1,373**	**1,455**	**20.4**	**3.1**	**7.3**	**6.0**	**210**	**38**	**93**	**82**
2.1 Local Currency Deposits	944	984	1,056	1,125	16.5	4.1	7.4	6.5	134	39	73	69
2.2 Foreign Currency Deposits	**297**	**296**	**317**	**330**	**34.5**	**-0.4**	**6.9**	**4.2**	**76**	**-1**	**20**	**13**

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

1/ Includes deposits of individuals, unincorporated enterprises and Non-profit organizations serving households

Source: Central Bank of Kenya

Domestic Credit

Net domestic credit increased by KSh 200.8 billion (6.7 percent) in the FY 2017/18 up from KSh 147.2 billion (5.2 percent) in the previous financial year, largely reflected in a recovery in bank lending to private sector and net lending to the government. Growth in banks' credit to the private sector improved from 1.5 percent in June 2017 to 4.3 percent in June 2018, while net credit to government grew from 7.4 percent to 15.3 percent. Over a similar period, growth in credit to 'other public sector' declined to 4.7 percent from a growth of 36.0 percent in the FY 2016/17, largely reflecting reduced borrowing by Parastatals **(Table 4.3).**

Table 4.3: Banking Sector Net Domestic Credit

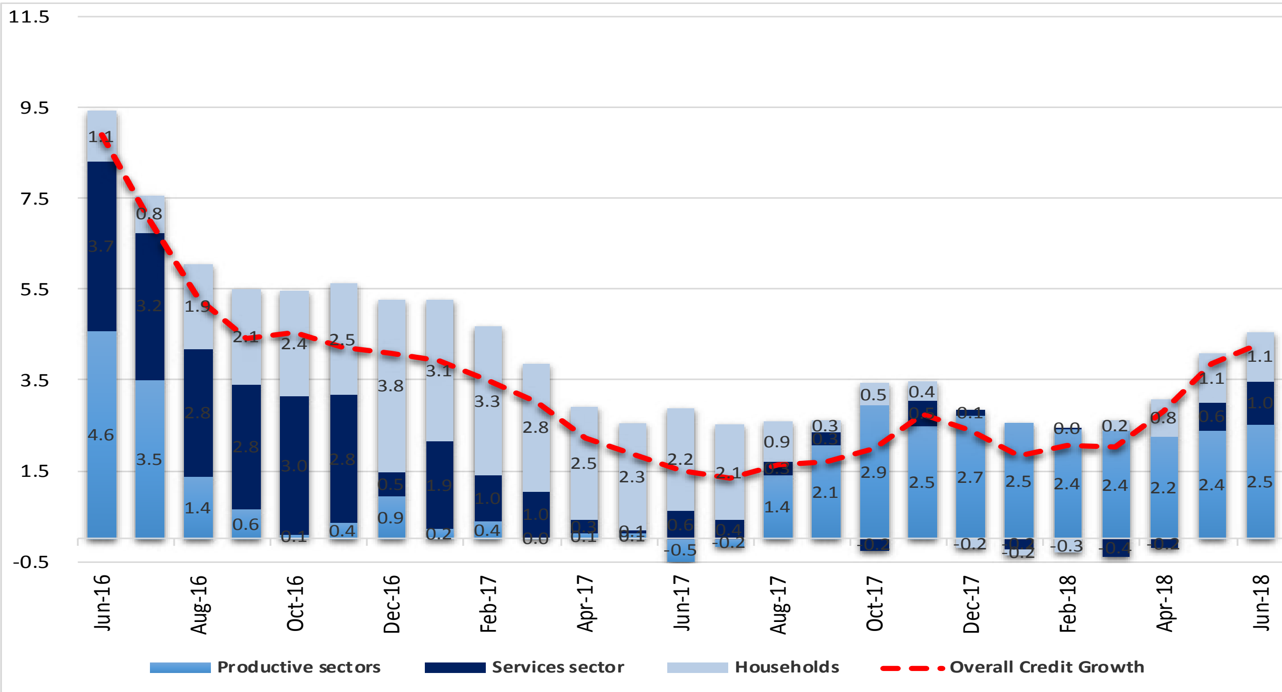
	End Month Level (KSh Billions)				Annual Growth Rate				Annual Changes (KSh Billions)			
	Jun-15	Jun-16	Jun-17	Jun-18	Jun-15	Jun-16	Jun-17	Jun-18	Jun-15	Jun-16	Jun-17	Jun-18
1. Credit to Government	**521.8**	**560.4**	**646.2**	**745.1**	**84.3**	**7.4**	**15.3**	**15.3**	**238.7**	**38.6**	**85.8**	**98.8**
Central Bank	-23.1	-156.1	-178.9	-204.4	-86.9	576.1	14.6	14.3	153.0	-133.0	-22.8	-25.5
Commercial Banks & NBFIs	544.9	716.6	825.1	949.5	18.7	31.5	15.2	15.1	85.8	171.7	108.6	124.4
2. Credit to other public sector	**82.0**	**78.6**	**106.9**	**111.9**	**105.0**	**-4.1**	**36.0**	**4.7**	**42.0**	**-3.4**	**28.3**	**5.0**
Local government	0.4	3.6	3.9	4.4	-86.6	767.0	8.8	11.9	-2.7	3.2	0.3	0.5
Parastatals	81.6	75.0	103.0	107.5	120.9	-8.0	37.3	4.4	44.6	-6.6	28.0	4.5
3. Credit to private sector	**2,035.1**	**2,216.1**	**2,249.1**	**2,346.1**	**18.3**	**8.9**	**1.5**	**4.3**	**315.2**	**181.0**	**33.1**	**96.9**
Agriculture	85.7	97.5	85.5	81.3	31.4	13.7	-12.3	-4.9	20.5	11.7	-12.0	-4.2
Manufacturing	268.8	304.5	282.8	317.6	21.6	13.3	-7.1	12.3	47.7	35.8	-21.8	34.8
Trade	312.3	350.6	388.2	421.5	10.2	12.3	10.7	8.6	28.8	38.3	37.6	33.3
Building and construction	89.6	101.5	100.8	114.4	18.3	13.2	-0.7	13.5	13.9	11.9	-0.7	13.6
Transport & communications	157.5	179.6	185.5	161.3	41.3	14.1	3.2	-13.0	46.1	22.1	5.8	-24.2
Finance & insurance	81.4	88.8	84.9	88.1	109.3	9.1	-4.4	3.8	42.5	7.4	-3.9	3.2
Real estate	288.9	323.2	355.7	369.4	28.3	11.9	10.1	3.8	63.8	34.3	32.6	13.7
Mining and quarrying	24.0	23.6	14.7	13.3	-15.7	-1.6	-37.8	-9.5	-4.5	-0.4	-8.9	-1.4
Private households	329.8	348.7	386.7	397.9	23.9	5.7	10.9	2.9	63.6	18.9	38.0	11.2
Consumer durables	152.7	156.5	168.2	181.3	48.2	2.5	7.5	7.8	49.7	3.8	11.8	13.1
Business services	154.4	162.2	136.7	146.0	-4.9	5.1	-15.8	6.9	-7.9	7.8	-25.6	9.4
Other activities	89.9	79.3	59.5	53.9	-35.2	-11.8	-25.0	-9.4	-48.8	-10.6	-19.8	-5.6
4. TOTAL (1+2+3)	**2,638.8**	**2,855.1**	**3,002.2**	**3,203.0**	**29.2**	**8.2**	**5.2**	**6.7**	**596.0**	**216.2**	**147.2**	**200.8**

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

The improved growth in private sector credit in the 12 months to June 2018 arose from strong growth in credit to manufacturing, building and construction, and trade sectors. Credit to manufacturing, building and construction, and trade sectors, grew by 12.3 percent, 13.5 percent, and 8.6 percent, respectively. Credit growth to other sectors was positive except for transport and communication, agriculture, and mining and quarrying. As a result, the contribution of productive sectors to overall credit growth increased significantly during the financial year compared with the FY 2016/17. Meanwhile, the contribution by services and household sectors to overall credit growth picked up in the last quarter of the FY 2017/18 **(Chart 4.1).** The recovery in private sector credit growth partly reflected increased optimism about the growth prospects of the Kenyan economy as well as improved business environment.

Chart 4.1: Contributions to Overall Credit Growth by Activity Group in Percent



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Reserve Money

Reserve money increased by KSh 29.6 billion (7.4 percent) in the FY 2017/18 from KSh 9.4 billion (2.4 percent) in the previous financial year. The increase was largely reflected in bank reserves which increased by KSh 18.4 billion compared with a reduction of KSh 9.4 billion in the previous financial year, partly reflecting increased customer deposits **(Table 4.4).** Meanwhile, the currency outside banks decreased in the period under review.

The primary source of reserve money expansion in the FY 2017/18 was an increase in NFA of the Central Bank, largely boosted by proceeds from government external borrowing. Meanwhile, the NDA of the Central Bank declined largely due to increased level of government deposits coupled with slowdown in net credit to commercial banks, partly reflecting improved liquidity conditions **(Table 4.4).**

Table 4.4: Reserve Money and Its Components

	End Month Level			Annual Growth Rate			Annual Changes (KSh Billions)			
	Jun-15	Jun-16	Jun-17	2014/15	2016/17	2017/18	2014/15	2015/16	2016/17	2017/18
1. Net Foreign Assets	**565.2**	**694.6**	**745.0**	**22.9**	**6.3**	**6.1**	**-50.3**	**129.4**	**50.4**	**45.3**
2. Net Domestic Assets	**-193.2**	**-304.4**	**-343.8**	**57.6**	**11.3**	**4.6**	**98.5**	**-111.2**	**-39.4**	**-15.7**
2.1 Government Borrowing (net)	-23.1	-156.1	-176.1	576.1	14.6	14.3	153.0	-133.0	-19.9	-25.5
2.2 Commercial banks (net)	-29.7	3.0	22.2	-110.0	24.0	36.0	-29.7	32.7	19.2	5.1
2.3 Other Domestic Assets (net)	-143.9	-154.7	-193.3	7.5	20.8	-2.6	-24.6	-10.8	-38.6	4.8
3. Reserve Money	**372.0**	**390.2**	**401.2**	**4.9**	**2.4**	**7.4**	**48.3**	**18.2**	**11.0**	**29.6**
3.1 Currency outside banks	175.3	187.9	206.7	7.2	10.0	5.4	17.1	12.6	18.8	11.2
3.2 Bank reserves	196.7	202.3	194.5	2.8	-4.7	9.5	31.2	5.6	-7.8	18.4
3.2.1 Required Reserves	128.1	131.8	143.9	2.9	9.2	9.1	20.8	3.7	12.1	13.0
3.2.2 Cash in Till	46.9	46.9	47.1	-0.1	0.4	-5.3	5.1	-0.1	0.2	-2.5
3.2.3 Excess Reserves	21.7	23.7	3.5	9.1	-92.0	412.4	5.3	2.0	-20.1	7.9

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

4.2 Interest Rates

Central Bank Rate

The MPC lowered the CBR to 9.5 percent in March 2018 from 10 percent since September 2016 as there was room for easing monetary policy stance to support economic activity given that inflation expectations were well anchored within the Government target range, there was increased optimism for economic growth prospects and economic output was below its potential level. The CBR was retained at 9.5 percent in May 2018 to allow the impact of the previous decision of lowering the CBR by 50 basis points to filter through the economy.

Short Term Rates

Short term interest rates, except the interbank rate, remained fairly stable during the financial year with a general declining trend in the second half of the period **(Table 4.5).** The average interbank interest rate increased to an average of 6.33 percent in the FY 2017/18 percent compared with 5.28 percent in FY 2016/17, partly reflecting tight liquidity conditions in the first half of FY 2017/2018 largely due to low government spending during the prolonged electioneering period. In the second half of the FY 2017/18, the average interbank rate generally declined due to improved liquidity conditions in the interbank market. However, the interbank rate largely remained below the CBR during the year. The volatility in the interbank rate partly reflected the impact of market segmentation along bank tiers.

The interest rates for government securities were generally stable in the FY 2017/18, indicating that the implementation of government domestic borrowing program supported market stability. The average 91-day Treasury bill rate declined slightly to 8.05 percent in the review period compared with 8.35 percent in the FY2016\17, while the average 182-day Treasury bill rate decreased to 10.42 percent from 10.90 percent in FY 2016/2017.

Commercial bank rates

Commercial banks' average interest rates remained stable and compliant with the interest rate capping law that was effected in September 2016. The average commercial bank lending rate declined to 13.22 percent in June 2018 compared to 13.66 percent in June 2017. Average commercial banks' deposit rate increased from 7.61 percent in June 2017 to 8.26 percent in January 2018, but declined thereafter to 8.04 percent in June 2018, also driven by the interest rate capping law and liquidity conditions. Interest rates declined in the fourth quarter of the financial year due to a reduction in the CBR to 9.5 percent from 10 percent. Consequently, the interest spread declined from 6.06 percent in June 2017 to 5.18 percent in June 2018.

Table 4.5: Interest Rates (%)

	2017							2018					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
91-day Treasury bill rate	8.42	8.22	8.17	8.13	8.09	8.01	8.01	8.04	8.03	8.02	8.00	7.96	7.87
182-day Treasury bill rate	10.38	10.32	10.32	10.32	10.33	10.47	10.53	10.64	10.42	10.39	10.30	10.26	9.99
Interbank rate	3.99	6.99	8.10	5.52	7.85	8.86	7.27	6.21	5.12	4.90	5.38	4.70	5.03
Repo rate	4.13	8.29	8.90	7.24	0.00	9.21	7.75	8.75	7.63	0.00	6.75	7.44	6.16
Reverse Repo rate	10.05	10.25	10.29	10.12	10.11	10.10	10.10	10.02	10.05	9.95	9.64	9.60	9.56
Central Bank Rate (CBR)	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	9.50	9.50	9.50	9.50
Average lending rate (1)	**13.66**	**13.70**	**13.65**	**13.69**	**13.71**	**13.68**	**13.64**	**13.65**	**13.68**	**13.49**	**13.24**	**13.25**	**13.22**
Overdraft rate	13.38	13.65	13.66	13.65	13.68	13.60	13.54	13.61	13.75	13.40	13.28	13.30	13.23
1-5years	13.80	13.78	13.86	13.87	13.88	13.86	13.83	13.84	13.83	13.67	13.38	13.40	13.39
Over 5years	13.64	13.62	13.39	13.51	13.51	13.51	13.46	13.45	13.45	13.31	13.03	13.03	13.00
Average deposit rate (2)	**7.61**	**7.72**	**7.67**	**7.66**	**8.01**	**8.07**	**8.22**	**8.26**	**8.25**	**8.16**	**8.17**	**8.08**	**8.04**
0-3months	7.76	7.83	7.80	7.71	8.17	8.19	8.43	8.52	8.50	8.48	8.46	8.53	8.39
Over 3 months deposit	8.04	8.05	8.13	8.02	8.17	8.35	8.39	8.35	8.39	8.26	8.34	8.01	8.14
Savings deposits	5.63	6.40	5.94	6.43	6.92	6.93	6.91	6.97	7.01	6.85	6.72	6.64	6.60
Spread (1-2)	**6.06**	**5.98**	**5.98**	**6.04**	**5.70**	**5.61**	**5.42**	**5.39**	**5.42**	**5.33**	**5.07**	**5.17**	**5.18**

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

4.3 Foreign Exchange Operations and Reserves Management

Exchange Rates

Kenya's foreign exchange market remained relatively stable during FY 2017/18 **(Table 4.6 and Chart 4.2)** mainly supported by higher foreign exchange receipts from agriculture exports and tourism, resilient inflows from remittances; and an adequate reserve buffer.

Relative to internationally traded currencies, the Kenya Shilling strengthened against the US Dollar and the Japanese Yen but weakened against the Pound Sterling and the Euro during the FY 2017/18.

The strengthening of the Kenya Shilling against the US Dollar over the FY 2017/18 was largely supported by strong foreign exchange inflows into the domestic market as well as investors seeking to participate in the securities market.

The weakening of the Kenya Shilling against the Pound Sterling and the Euro was occasioned by the strengthening of the two currencies against the US Dollar during the first three quarters of FY 2017/18. The US Dollar weakened steadily through late 2017 and into early 2018 amid uncertainties with regard to US economic policies and a growing appreciation among investors for the improving fundamental prospects outside of the USA. During the fourth quarter of FY 2017/18, however, the Kenya Shilling strengthened against the Pound Sterling and the Euro reflecting weakening of the two currencies against the US Dollar. This was on account of a stronger US Dollar in international markets, partly reflecting uncertainties with post-Brexit resolution, monetary policy normalisation in advanced economies and ongoing trade discussions between the US and its major trading partners.

Meanwhile, the Kenya Shilling strengthened against all EAC currencies based on economic fundamentals but weakened against the South African Rand during the FY 2017/18.

Table 4.6: Kenya Shilling Exchange Rates

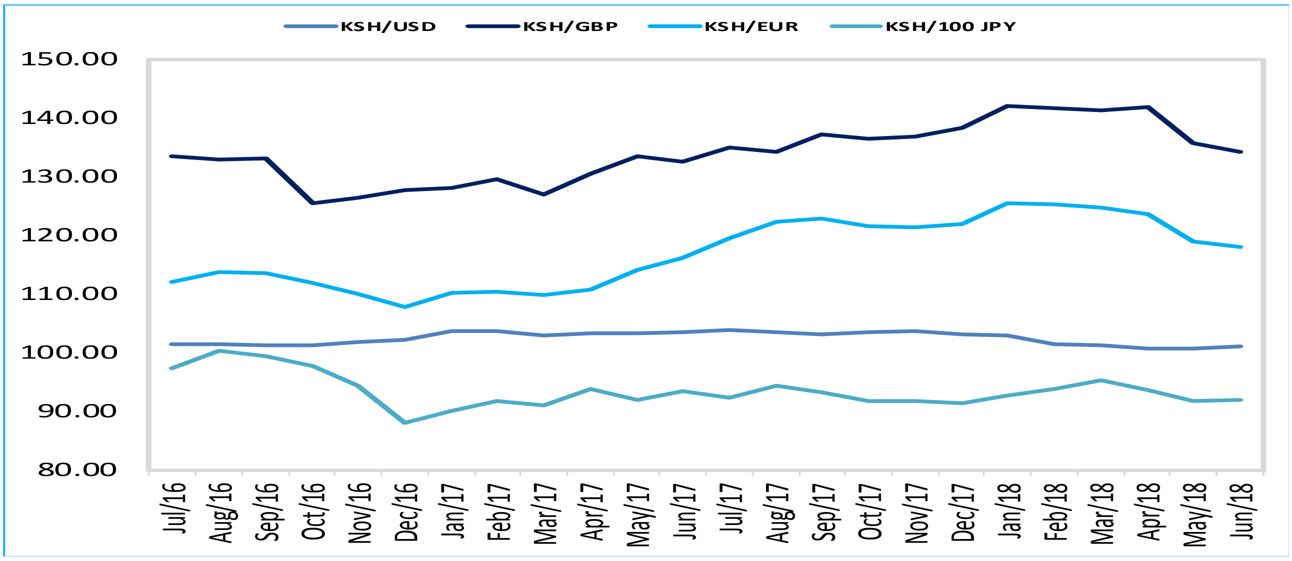
			2017_18				Average	% change
	2015/16	2016/17	Q1 Jul-Sep	Q2 Oct-Dec	Q3 Jan-Mar	Q4 Apr-Jun	2017/18	2017/18_2016/17
US Dollar	102.08	102.45	103.52	103.36	101.86	100.75	102.37	-0.1
Pound Sterling	151.59	129.97	135.38	137.12	141.64	137.26	137.86	6.1
Euro	113.28	111.71	121.51	121.65	125.11	120.19	122.14	9.3
100 Japanese Yen	87.59	94.13	93.29	91.61	93.96	92.38	92.84	-1.4
South Africa Rand	7.10	7.55	7.86	7.57	8.51	8.00	7.99	5.9
Uganda Shilling*	33.72	34.42	34.80	35.15	35.79	37.24	35.74	3.8
Tanzania Shilling*	21.24	21.55	21.64	21.70	22.10	22.60	22.01	2.1
Rwanda Franc*	7.31	7.86	8.02	8.16	8.39	8.62	8.29	5.6
Burundi Franc*	15.32	16.46	16.79	16.99	17.32	17.50	17.15	4.2

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Chart 4.2: Kenya Shilling Exchange Rate



Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system’s total foreign exchange holdings increased by 10.2 percent during FY 2017/18. Official reserves held by the Central Bank constituted 74 percent of gross reserves and stood at USD 8,954 million, equivalent to 5.9 months of import cover **(Table 4.7).**

Outlook for the Kenya Shilling

Foreign exchange earnings from key commodities such as tea and horticulture and inflows from diaspora remittances are expected to remain resilient. Consequently, these developments are expected to put less pressure on the current account deficit. In addition, increased receipts from tourism are anticipated on account of improved security in the country; continued marketing of Kenya by the Government as a tourist destination; increased hotel bookings in line with the tourism peak season (July-October and December-February); and gains from Kenya Airways’ network expansion which includes new partnerships with airlines and daily non-stop flights to the US starting October 2018. Meanwhile, international reserves at USD 8,954 million, equivalent to 5.9 months of import cover are above the statutory requirement of 4 months import cover and thus remain adequate to safeguard against exogenous shocks.

Table 4.7: Foreign exchange reserves and residents’ foreign currency deposits (End of period, USD million)

	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
1. Gross Reserves	**10,984**	**10,550**	**10,378**	**10,332**	**9,931**	**9,749**	**9,652**	**9,676**	**9,758**	**11,859**	**12,027**	**11,926**	**12,102**
of which:													
Official	8,580	8,135	7,910	7,899	7,574	7,467	7,338	7,510	7,532	9,362	9,460	9,291	8,954
*import cover**	*5.7*	*5.5*	*5.3*	*5.4*	*5.1*	*5.1*	*5.0*	*5.1*	*5.1*	*6.3*	*6.3*	*6.2*	*5.9*
Commercial Banks	2,405	2,415	2,468	2,433	2,357	2,283	2,314	2,166	2,226	2,497	2,566	2,636	3,148
2. Residents' foreign currency depos	**4,733**	**4,871**	**4,896**	**5,021**	**4,870**	**5,112**	**4,949**	**5,147**	**4,867**	**4,988**	**4,994**	**5,390**	**5,986**

*Based on 36 month average of imports of goods and non-factor services

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

4.4 Banking Sector

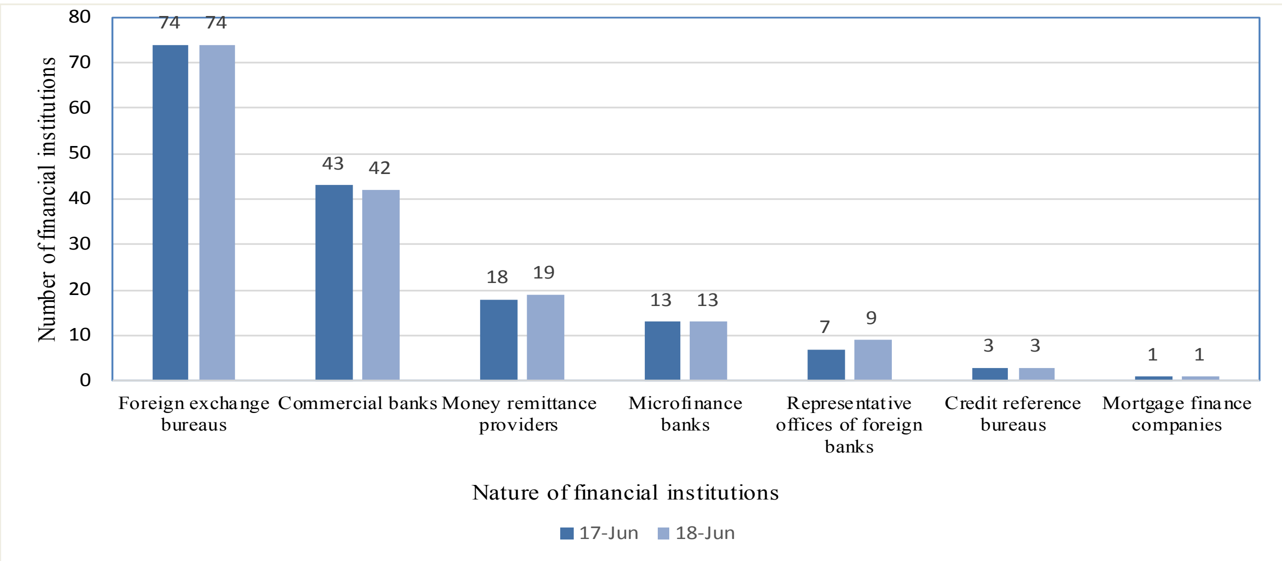
Structure of the Kenyan Banking Sector

During the fiscal year ended June 30, 2018, the Kenyan banking sector comprised 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 74 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus **(Chart 4.3).**

The notable changes in the structure include: -

- Licensing of one money remittance provider, Airtel Money Transfer Limited, in July 2017.
- Acquisition of Habib Bank (K) Ltd by Diamond Trust Bank Kenya Ltd in August 2017.
- Authorisation Société Générale-Kenya Representative Office of France in August 2017.
- Closure of one forex bureau, Crater Forex Bureau Ltd, in November 2017.
- Licensing of one forex bureau, Southend Forex Bureau Limited, in February 2018.
- Authorisation of BAHL-Representative Office of Pakistan in April 2018.

Chart 4.3: Structure of the Kenyan Banking Sector



Source: Central Bank of Kenya

Financial Position and Performance of the Kenyan Banking Sector

Overview

The banking sector registered improved financial performance in the year ended June 30, 2018:

- Net assets increased by KSh 0.32 trillion (8 percent) to KSh 4.27 trillion as at June 30, 2018 from KSh 3.95 trillion in June 30, 2017. The increase was caused by a KSh 131.6 billion increase in investment in government securities and KSh 46.3 billion increase in placements.
- Net loans and advances grew by KSh 0.06 trillion (2.7 percent) to KSh 2.3 trillion in June 30, 2018 compared to KSh 2.24 trillion as at June 30, 2017. The marginal increase reflects the banks' risk aversion to lending during the electioneering period and existing interest rate capping.
- The deposit base expanded by KSh 0.3 trillion (10.5 percent) to KSh 3.16 trillion in June 30, 2018, an increase from KSh 2.86 trillion reported in June 30, 2017. The increase was as a result of aggressive deposit mobilisation strategies by the banks.

4.0 CENTRAL BANK OPERATIONS

- Profit before tax increased by KSh 6.7 billion (9.8 percent) to KSh 76.2 billion in the period to June 30, 2018 from KSh 69.4 billion reported in the period ended June 30, 2017. The increase was attributed to KSh 9.2 billion increase in interest from government securities as well as KSh4 billion decrease in bad debts charge due to aggressive loan recovery strategies by the banks.

Structure of the Balance Sheet

The banking sector balance sheet expanded by 8.1 percent from KSh 3.95 trillion in June 2017 to KSh 4.27 trillion in June 2018. The main components of the balance sheet on the asset side were loans and advances and government securities, which accounted for 53.8 percent and 26.8 percent of total assets, respectively. Customer deposits were the main component on the liabilities side accounting for 74.1 percent of the total liabilities **(Table 4.8).**

During the period to June 2018, there was an increase in the balances at CBK (19.1 percent), placements (25.5 percent), government securities (13 percent), other investments (44.8 percent) and other assets (10.2 percent). The increase is attributed to banks preferring alternative investment options to lending during the electioneering period. This is evident from the marginal increase in lending of 2.7 percent during the same period.

Table 4.8: Extracts of the Statement of the Financial Position of the Kenya Banking Sector (KSh Million)

	Jun-17	Jun-18	Percent Change
Cash	56,177	57,899	3.1
Balances at CBK	151,737	180,674	19.1
Placements	181,835	228,165	25.5
Government Securities	1,009,780	1,141,359	13.0
Other Investments	49,463	71,619	44.8
Loans & Advances (Net)	2,238,564	2,295,984	2.6
Other Assets	264,049	290,977	10.2
Total Assets	**3,951,605**	**4,266,677**	**8.0**
Customer Deposits	2,858,197	3,161,454	10.5
Other Liabilities	469,777	463,192	-1.4
Capital & Reserves	623,631	642,030	3.0
Total Liabilities and Shareholder's Funds	**3,951,605**	**4,266,677**	**8.0**

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Sectoral Gross Loans and Advances

The banking sector gross loans and advances rose from KSh2.36 trillion in June 2017 to KSh 2.49 trillion in June 2018 translating to a growth of 5 percent. The growth in loans and advances was recorded in 9 economic sectors as shown in **Table 4.9.**

- Building and construction sector recorded the highest increase in credit with an increase of KSh 14.9 billion (14.4 percent). The increase in loans to this sector arose from increased construction of roads and other infrastructure.
- Financial services sector recorded a growth of KSh 11billion (13.46 percent), with the growth reflecting increased lending by banks to microfinance banks and savings and credit cooperative societies (SACCOs) to fund their activities in the year to June 2018.
- Transport and communication sector recorded the highest decrease in gross loans by KSh 24 billion (12.47 percent) due to significant repayments by some major corporates in this sector.

Table 4.9: Sectoral Distribution of Gross Loans (KSh Billion)

	Jun-17	Jun-18	Percent Change
Personal/Household	605.5	635.2	4.91
Trade	449.7	476.4	5.94
Real Estate	375.5	392.7	4.58
Manufacturing	288.2	320.4	11.17
Transport and Communication	192.5	168.5	-12.47
Energy and Water	110.1	121.5	10.28
Building and Construction	103.3	118.1	14.40
Financial Services	81.9	92.9	13.46
Agriculture	88.7	91.8	3.47
Tourism, Restaurant and Hotels	60.4	65.0	7.71
Mining and Quarrying	10.4	10.2	-2.08
Gross Loans	**2,366.13**	**2,492.69**	**5.35**

Source: Central Bank of Kenya

Deposit Liabilities

Customer deposits were the main source of funding for the banking sector, accounting for 74.1 percent of total liabilities as at end of June 2018, which was higher than the 72.3 percent recorded as at end of June 2017. The deposit base increased by 10.5 percent from KSh2.86 trillion in June 2017 to KSh 3.16 trillion in June 2018.

Customer deposits growth within the period was supported by:-

- Use of technological innovations for deposit mobilization - The number of commercial banks deposit accounts increased by 4.5 million (10.1 percent) from 44.4 million in June 2017 to 48.9 million in June 2018. The new accounts were largely opened through the mobile phone platforms.
- Agency banking model - The number of transactions through bank agents increased by 103 million transactions from KSh 517.4 billion in the period ended June 2017 to KSh 620.6 billion in the year ended June 2018.
- Aggressive deposit mobilization strategies by several banks to increase their deposit levels.

4.0 CENTRAL BANK OPERATIONS

Capital Adequacy

The Central Bank of Kenya prudential guideline on capital adequacy requires banks to adhere to the prescribed minimum ratios of core capital and total capital to total risk weighted assets of 10.5 percent and 14.5 percent, respectively.

- The ratio of core capital to total risk weighted assets decreased slightly from 16.8 percent in June 2017 to 16.5 percent in June 2018. This was attributable to 5.2 percent growth in total risk weighted assets that outpaced the 3.5 percent increase in core capital.
- Total capital to total risk weighted assets (TRWA) dropped by 1.61 percent to 17.97 percent between June 2017 and June 2018 as shown in **Table 4.10.** The decrease was occasioned by a 5.2 percent increase in TRWA and a 3.5 percent decrease in total capital.

Banks are also required to maintain a core capital to total deposits ratio of not less than 8 percent. This ratio decreased to 17.2 percent from 18.4 percent registered at the end of June 2017. The drop was as a result of a higher growth in customer deposits of 10.5 percent as compared to a 3.5 percent growth in core capital.

Table 4.10: Capital Adequacy Ratios

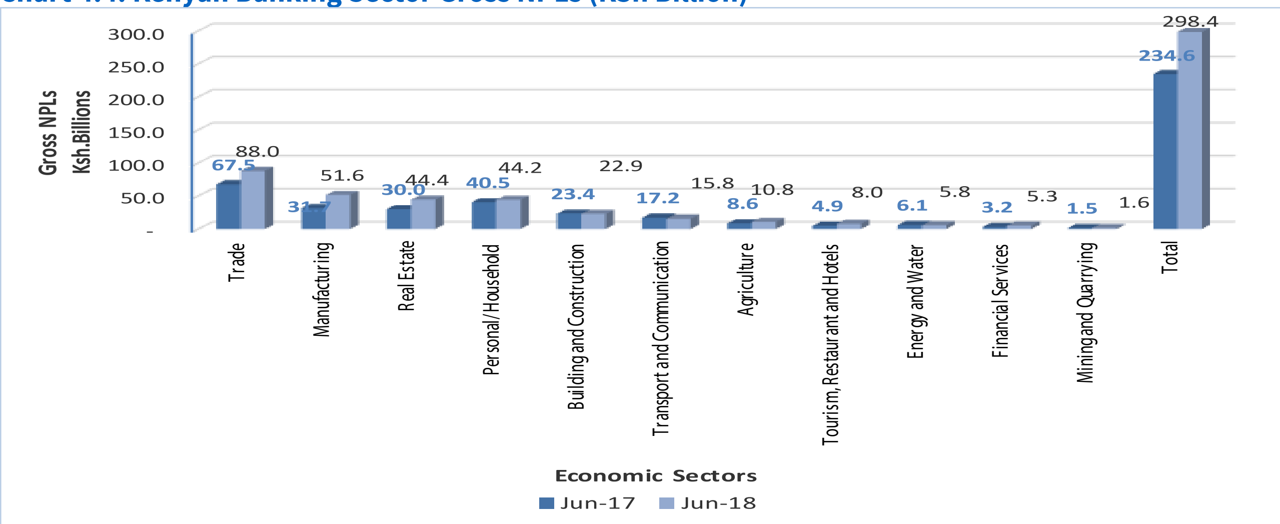
	Jun-17	Jun-18	Minimum Capital Adequacy Ratios
Core Capital/TRWA*	16.81%	16.55%	14.5%
Total Capital/TRWA*	19.58%	17.97%	10.5%
Core Capital/Total Deposits	18.42%	17.23%	8.0%
***Total Risk Weighted Assets**			

Source: Central Bank of Kenya

Asset Quality

Gross non-performing loans (NPLs) increased by KSh 63.8 billion (27.2 percent) from KSh 234.6 billion in June 2017 to KSh 298.4 billion in June 2018. During the period under review, 8 out of the 11 economic sectors registered increased NPLs as shown in **Chart 4.4.**

Chart 4.4: Kenyan Banking Sector Gross NPLs (KSh Billion)



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

The increase in NPLs was mainly caused by:

(i) delayed payments by government agencies and private sector,
(ii) business stagnation during the prolonged electioneering period, and
(iii) slow uptake of developed houses in the real estate sector.

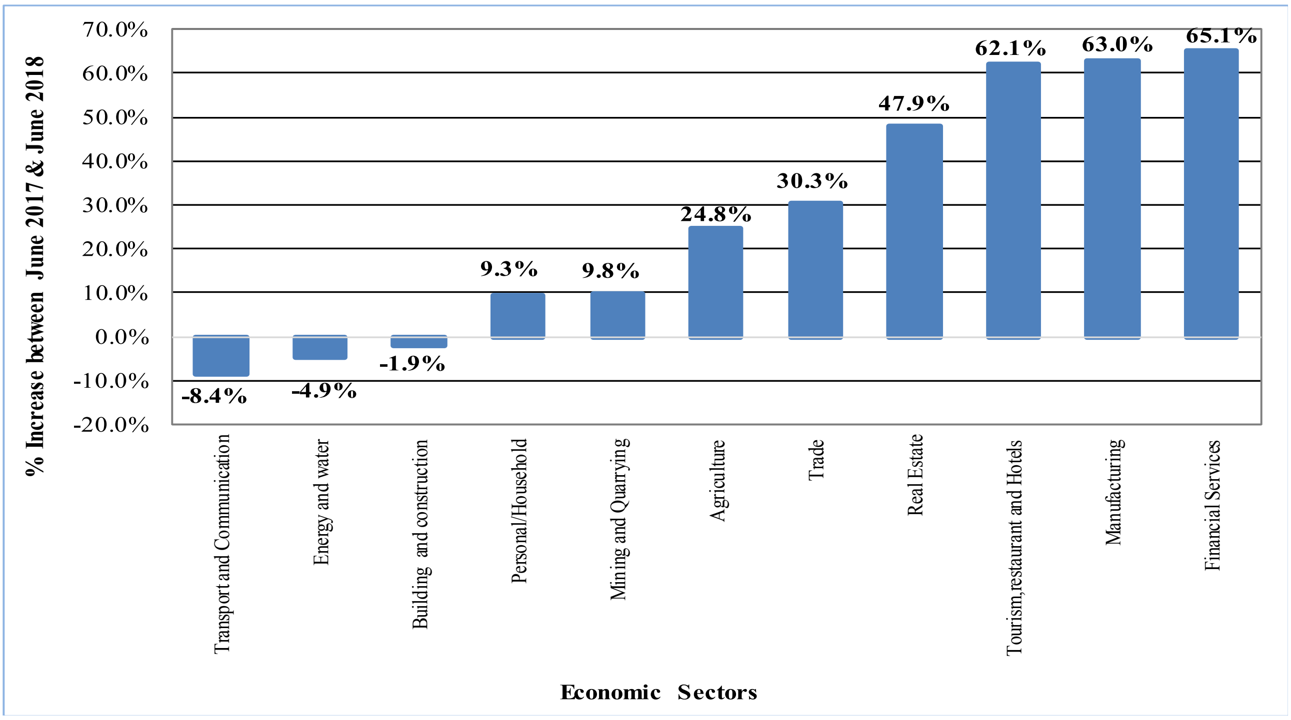
The above reasons led to downgrading of loan accounts by banks, which impacted negatively on the quality of assets.

The top three sectors with highest NPLs increases were: -

- The trade sector, which recorded increased NPLs of KSh 20.5 billion (30.3 percent) between June 2017 and June 2018 due to business slowdown during the 2017 general elections, leading to lower loan repayments.
- The manufacturing sector, whose NPLs increased by KSh19.9 billion (62.7 percent) due to business slowdown in 2017.
- The real estate sector, whose NPLs increased by KSh14.4 billion (48 percent) as a result of slow uptake of developed housing units, and delay in subdivision of land.

Based on the movements of NPLs highlighted above, the gross NPLs to gross loans ratio increased from 9.9 percent in June 2017 to 11.97 percent in June 2018. **Chart 4.5** highlights the percentage movements in sectoral gross NPLs between June 2017 and June 2018.

Chart 4.5: Sectoral Increase in Gross NPLs between June 2017 and June 2018



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Table 4.11: Extracts of Statement of Comprehensive Income (KSh Billion)

Item	Jun-17	Jun-18	Change
Total income	234.6	246.9	5.2%
Expenses before provisions	149.1	158.7	6.4%
Profit before provisions	85.5	88.2	3.2%
Provisions for bad debts	16.0	12.0	-25.2%
Profit before tax	69.4	76.2	9.8%
Return on Assets	2.8%	2.8%	0.0%
Return on Shareholders' Funds	**22.3%**	**23.7%**	**6.3%**

Source: Central Bank of Kenya

Profitability

The banking sector registered KSh 76.2 billion pre-tax profits during the period ended June 30, 2018, which represented an increase of 9.8 percent from KSh 69.4 billion for the period ended June 2017 as shown in **Table 4.11.** The KSh 6.8 billion increase in profitability is attributed to KSh 12.3 billion increase in income that exceeded the KSh 9.6 billion growth in expenses.

- Total income increased by KSh 12.3 billion to KSh 246.9 billion for the period ended June 2018 from KSh 234.6 billion registered in the previous year. Increased income was attributed to KSh 9.2 billion increase in earnings from government securities, KSh 1.7 billion increase in interest on advances and KSh 1.3 billion increase in foreign exchange gain. Commercial banks' investment in government securities increased by 13.0 percent between June 2017 and June 2018. Interest on loans and advances of KSh 129.4 billion constituted 55.1 percent of total income in the period ended June 2018.

- Total expenses increased by 6.4 percent from KSh 149.1 billion in June 2017 to KSh 158.7 billion in June 2018. Increase in expenses was caused by increase in interest on deposits, which occurred due to increased customer deposits by 10.5 percent during the period to June 2018. Interest on deposits, staff costs and other expenses were the key components of expenditure, accounting for 33.8 percent, 25.3 percent and 23.7 percent of total expenses, respectively.

- Provisions for bad debts reduced by KSh 4 billion (25.5 percent) from KSh 16 billion in the period ending June 2017 to KSh12 billion in the period ending June 2018. The decrease was caused by aggressive loan recovery mechanisms employed by the banks.

Liquidity

Liquidity held by commercial banks underscore their ability to fund increases in assets and meet obligations as they fall due. Liquidity is one of the important financial stability indicators. Liquidity shortfall in one bank can cause systemic crisis in the banking sector due to interconnected operations.

The banking sector's overall liquidity ratio in June 2018 was 48.3 percent as compared to 45.0 percent recorded in June 2017. The liquid assets increased more than short term liabilities. The banking sector liquidity ratio was well above the minimum statutory level of 20 percent.

Performance of Microfinance Banks

Microfinance banks (MFBs) registered 447 percent increase in reported loss of KSh 935.1 million in the period to June 2018 compared to loss of KSh 171.4 million in the period ended June 2018 **(Table 4.12).** The decline in profitability is underscored by increased borrowing expenses due to tight liquidity experienced by microfinance banks. This is evident from the increased interest expense on borrowings by KSh 0.7 billion (50 percent) from KSh 1.4 billion for the period ended June 2017 to KSh 2.1 billion for the period ended June 2018.

4.0 CENTRAL BANK OPERATIONS

Table 4.12: Performance of MFBs (KSh Million)

Parameter	Jun-17	Jun-18	% Change
Pre-Tax Profits	-171	-935	447%
Customer Deposits	40,698	38,563	-5%
Loan Portfolio (Net)	46,783	46,142	-1%
Core Capital/Total Risk Weighted Assets	20%	18%	-2%
Total Capital/Total Risk Weighted Assets	23%	19%	-4%

Source: Central Bank of Kenya

- Customer deposits decreased by KSh 2.1 billion (5 percent) from KSh 40.6 billion to KSh 38.5 billion between June 2017 and June 2018 as MFBs competed to attract deposits to fund their lending activities.
- The MFBs' core capital to risk weighted assets ratio decreased from 20 percent in June 2017 to 18 percent in June 2018, which was above the minimum requirement of 10 percent. Similarly, the ratio of total capital to total risk weighted assets decreased from 23 percent as at June 2017 to 19 percent in June 2018 against the minimum statutory requirement of 12 percent. The decrease in the two capital ratios was as a result of decrease in core capital as well as total capital by 8.5 percent and 12.4 percent respectively as a result of 447 percent increase in losses, which eroded the capital base.

Agency Banking

The use of the agency banking model by banks and microfinance banks has continued to improve access to banking services since its launch in 2010.

- As at June 2018, there were 18 commercial banks that had contracted 64,345 active agents and 3 microfinance banks with 1,974 agents as compared to 17 commercial banks with 57,901 agents and 3 microfinance banks with 2,184 agents as at June 2017.
- Commercial banks have continued to expand agents base as a strategy to provide services at locations closer to their customers and at reduced costs.
- The decrease in number of microfinance agents was caused by closure of 228 agents during the period to June 2018 due to inability to mobilise financial resources and relocation of businesses.
- The number of banking transactions undertaken through agents increased from 62.6 million in the year ended June 2017 to 80.6 million transactions in the year ended June 2018. Similarly, the value of banking transactions undertaken through agents increased from KSh 517.4 billion in the year ended June 2017 to KSh 620.6 billion in the year ended June 2018. The increases in number and value of transactions are attributed to 10 percent increase in number of banking agents as well as increased customer awareness of agent banking.

4.0 CENTRAL BANK OPERATIONS

Table 4.13: Credit Report Requests

	Jun-17	Jun-18	Change	% Change
Credit reports requests - Commercial Banks only	2,421,048	4,576,593	2,155,545	89%
Credit reports requests - MFBs only	110,594	195,623	85,029	77%
Credit reports requests - Customers	76,124	138,026	61,902	81%
Total	**2,607,766**	**4,910,242**	**2,302,476**	**88%**

Source: Central Bank of Kenya

Credit Information Sharing Mechanism

The credit information sharing mechanism remained a key input in the decision making process of credit providers in Kenya as they seek to mitigate risks associated with information asymmetry. The credit reports requested in the period to June 2018 by banks, microfinance banks and customers increased by 89 percent, 77 percent and 81 percent, respectively **(Table 4.13).**

- The 89 percent and 77 percent increase in credit report requests by banks and microfinance banks respectively is a reflection of increased demand in credit as well as the desire of banks and microfinance banks to strengthen their credit standards.
- The 81 percent increased uptake of credit reports by customers is an indication of increased requirement for credit reports including in the vetting of public officers and private sector hiring.

Banking Sector 2018 Outlook

Credit risk, which is currently elevated, is expected to decrease going forward as the business environment improves. Liquidity risk has eased off based on improved distribution of deposits in the banking sector. With the positive domestic economic outlook, the Kenyan banking sector is expected to register improved performance in 2018 compared to 2017.

4.0 CENTRAL BANK OPERATIONS

4.5 Currency Operations

Currency in Circulation

Currency in circulation increased by 3.4 per cent during FY 2017/18 on the basis of national demand. The currency was issued through the Central Bank of Kenya offices in Nairobi, Mombasa, Kisumu, Eldoret, Nyeri, Nakuru and Meru. Banknotes accounted for 97 per cent and coins 3 per cent of currency in circulation **(Table 4.14).**

Banknotes quantities in circulation decreased by 3.6 per cent from 531 million pieces in the year to June 30, 2017 to 512 million pieces in the year to June 30, 2018. Coins in circulation increased by 4.8 per cent over the same period with notable increases in usage of the KSh 10 and KSh 20 coins **(Table 4.15)**

Cash Inflows and Outflows

Banknote deposits by banks (i.e. cash inflows) declined by 2.2 percent to KSh 501.8 billion by June 2018. Likewise, banknote withdrawals (i.e. cash outflows) decreased from KSh 531.4 billion to KSh 509.8 billion in the same period. The net currency outflow was KSh 8.7 billion, down from the previous year's outflow of KSh 18.9 billion **(Table 4.16).**

Table 4.14: Currency in Circulation (KSh Millions)

	Jun-17		Jun-18	
	Ksh bn.	%	Ksh bn.	%
Total Currency in Circulation	253.68	100%	262.44	100%
Banknotes	245.48	97%	253.55	97%
Coins	8.19	3%	8.89	3%

Source: Central Bank of Kenya

Table 4.15: Currency in Circulation (KSh Millions)

	Banknotes				Coins		
	2016/2017 Pieces (m)	2017/2018 Pieces (m)	% Change		2016/2017 Pieces (m)	2017/2018 Pieces (m)	% Change
1000/=	201.13	210.37	4.59%	40/=	9.49	9.58	0.95%
500/=	33.47	32.62	-2.54%	20/=	144.62	159.48	10.28%
200/=	48.95	54.86	12.07%	10/=	256.77	284.59	10.83%
100/=	124.17	117.12	-5.68%	5/=	286.46	305.59	6.68%
50/=	101.82	75.63	-25.72%	1/=	779.91	801.94	2.82%
20/=	9.93	9.91	-0.20%	=/50	274.56	274.34	-0.08%
10/=	11.89	11.87	-0.17%	=/10	0	0	0.00%
5/=	0	0	0.00%	=/05	0	0	0.00%
	531.36	**512.38**	**-3.57%**		**1751.81**	**1835.52**	**4.78%**

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Table 4.16: Value of Currency Inflows and Outflows (KSh Million)

Inflow by banks	2016/2017	2017/2018
Bank Notes	513,159	501,808
Coins	103	95
Total	**513,262**	**501,903**
Outflows to banks		
Bank Notes	531,402	509,793
Coins	777	792
Total	**532,179**	**510,585**
Net Outflows	**-18,917**	**-8,682**

Source: Central Bank of Kenya

Currency Centres

The three Currency Centres i.e. Nyeri, Nakuru and Meru account for a total of 15 percent of all Currency activities in the Country. The Centres serve a total of 219 commercial bank branches.

Combating Counterfeiting

The Central Bank of Kenya continued to create and enhance public awareness on security features of banknotes as a way of minimizing counterfeiting. The awareness and other anti-counterfeiting strategies are carried out in collaboration with commercial banks, security agencies, other educational institutions and currency dispensing machine vendors. Members of the public are encouraged to visit the CBK website to learn more on the various security features on our currency.

Regional Currency Convertibility

The Central Bank of Kenya in partnership with other East African Community (EAC) central banks continued to facilitate the acceptance of the EAC domestic currencies as a way of enhancing regional trade and lowering transaction costs. The EAC Central Banks have arrangements for repatriating excess partner state central bank currencies, back to the issuing central bank.

4.0 CENTRAL BANK OPERATIONS

4.6 Banking Services and National Payments

Introduction

The developments in the payments system have culminated in a more accessible, effective and efficient Kenyan payments system. From cash transactions to digital finance ecosystems, the most notable of these developments have taken place over the last two decades. The vast, fast-paced world of Fintech – the intersection of two dynamic industries – has irrevocably redefined, transformed, and reshaped the sphere of business. This has given rise to a new era of investment, customer service and digital innovation.

The dynamic nature of emerging financial technologies (Fintech) has not only created challenges but also opened up opportunities for innovation and growth. The main issue now revolves around harnessing the opportunities provided by Fintech to enhance financial inclusion and to raise productivity and economic performance.

The Central Bank of Kenya has continued to support the modernization of the National Payment System. This has led to lower transaction costs and improved efficiency and effectiveness of the payment, clearing and settlement systems.

Performance of the National Payments System and Infrastructure Developments

During the FY 2017/2018, the payment systems operated smoothly and recorded improved performance as indicated in the tables and charts below.

Real Time Gross Settlement (RTGS) System

This is the most significant component of the national payments system due to its potential to generate and transmit disturbances of a systemic nature to the financial sector.

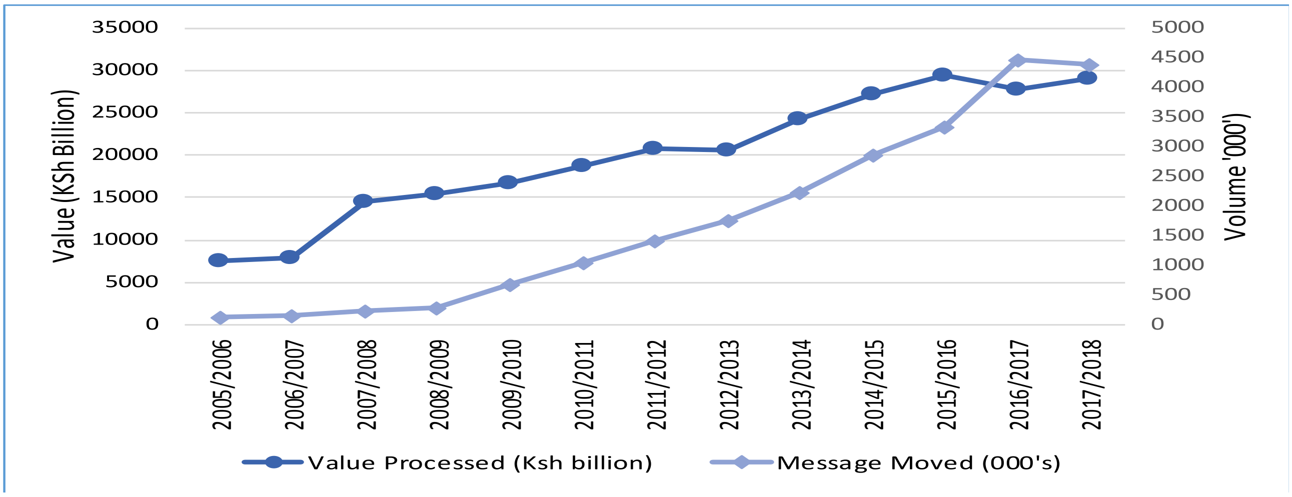
Kenya Electronic Payment and Settlement System (KEPSS)

KEPSS, over the years has continued to register remarkable growth in both volume and value of transactions as depicted in the **Chart 4.6.**

During the year, KEPSS recorded a volume of 4.39 million transactions worth KSh 29,112 billion compared to a volume of 4.46 million transactions worth KSh 27,742 billion in FY 2016/2017. This reflects an increase of 4.9 percent in value but a decrease of 1.6 percent in volume. The increase in the value of transactions recorded is an indication of the confidence and significance of the RTGS in the economy's financial infrastructure.

Direct settlements through KEPSS by commercial banks continues to account for an average of 99.0 percent of the total activity through KEPSS while the Net Settlement Instruction (NSI) or activity through the ACH to KEPSS accounted for an average 1.0 percent of the total activity.

Chart 4.6: Value and Volumes through KEPSS



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Table 4.17: KEPSS System Flows

Financial Year	Amount Transferred		Messages moved	
	(KSh Billion)	% increase	Number (000's)	% increase
2005/2006	7,461.197		120.249	
2006/2007	7,929.003	6.27	155.46	29.28
2007/2008	14,506.951	82.96	232.516	49.57
2008/2009	15,441.446	6.44	277.445	19.32
2009/2010	16,806.252	8.84	673.368	142.70
2010/2011	18,792.538	11.82	1,048.206	55.67
2011/2012	20,866.83	11.04	1,418.202	35.30
2012/2013	20,686.221	(0.87)	1,765.054	24.46
2013/2014	24,311.16	17.52	2,230.049	26.34
2014/2015	27,125.848	11.58	2,868.752	28.64
2015/2016	29,456.832	8.59	3,345.775	16.63
2016/2017	27,742.582	(5.82)	4,461.27	33.34
2017/2018	29,117.148	4.95	4,385.544	(1.70)

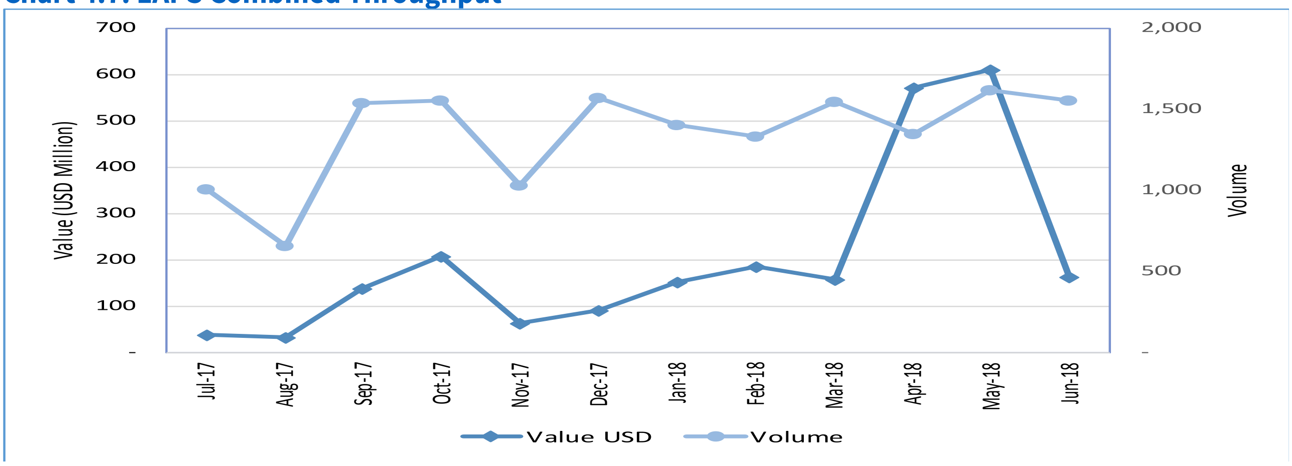
Source: Central Bank of Kenya

The East Africa Payment System (EAPS)

The East Africa Payment System (EAPS) is increasingly being use by traders and commercial banks to settle transactions in the East African Community (EAC). The system works in the same way as the central banks' RTGS, which allows for the movement of cash between different banks and branches and is increasingly being used in the region in place of cheques.

During the period under review, 16,161 messages were sent worth about USD 2.413 billion. Kenya was leading in the EAPS utilisation with 8,053 messages worth USD 2.377 Billion which represents 98.4 percent value utilisation and 49.8 percent volume utilisation.

Chart 4.7: EAPS Combined Throughput



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

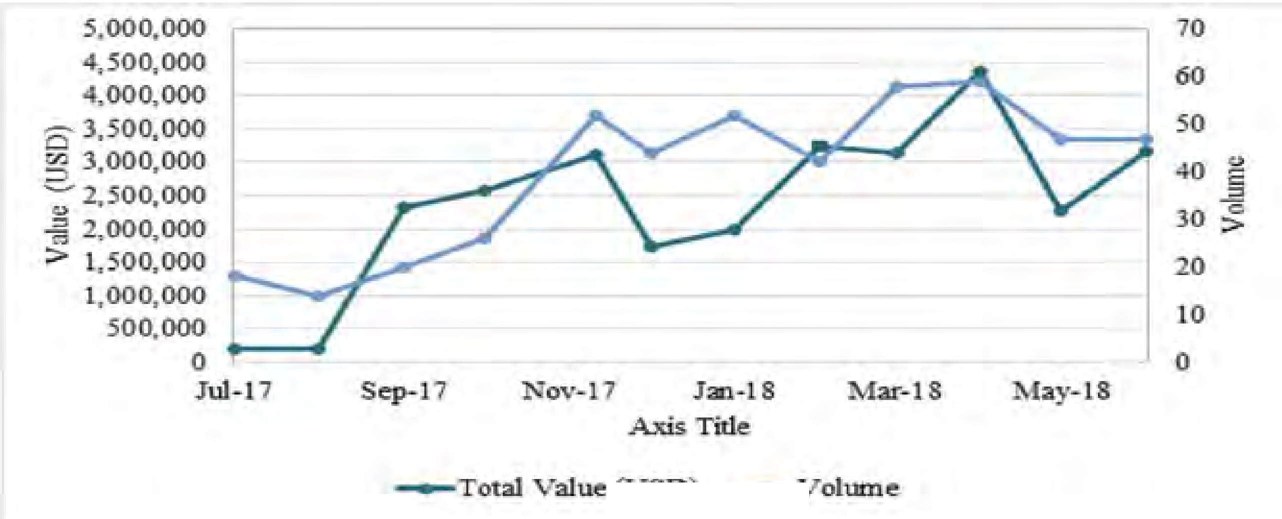
Regional Payment and Settlement System (REPSS)

The REPSS is a system used to effect payments within COMESA countries. The facility was conceived to enable commercial banks and traders in COMESA member states to transfer and receive funds safely and at lower cost.

During the year, the REPSS system effected a combined throughput of 479 messages worth about USD 28.301 billion. The US dollar transactions represented 99 percent of the total in both value and volume. The Central Bank of Kenya led the region in both value and volume utilisation, followed by Bank of Uganda, Central Bank of Egypt and finally Bank of Mauritius. Other participating central banks did not utilise the system in the period under review.

There has been a general increase in the uptake of REPSS since inception, reflecting increasing acceptance and confidence in the REPSS system.

Chart 4.8: Total REPSS Throughput



Source: Central Bank of Kenya

The Automated Clearing House (ACH)

During the Financial Year 2017/2018, the ACH processed 31.1 million transactions valued at KSh 3.1 trillion. Compared to FY 2016/2017, the volume and value of cheques and EFTs cleared decreased by 1.3 percent and 2.3 percent respectively **(Table 4.19 and Chart 4.9).**

Table 4.18: REPSS Flows

Financial Year	Amount Transferred		Messages moved	
	(USD millions)	Percent increase	Number	Percent increase
2014/2015	2.12	-	78	-
2015/2016	11.90	462 %	325	317 %
2016/2017	7.79	-35 %	193	-41 %
2017/2018	28.30	263 %	479	148 %

Source: Central Bank of Kenya

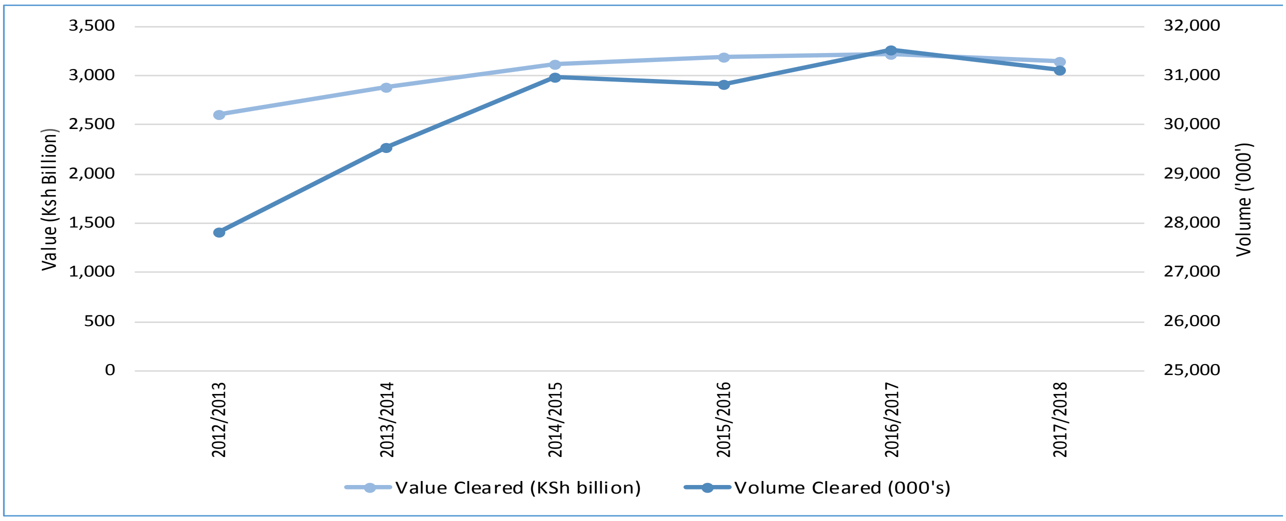
4.0 CENTRAL BANK OPERATIONS

Table 4.19: ACH Performance

Financial Year	Volume cleared (000's)	Value cleared (KSh billion)
2012/2013	27,821	2,607
2013/2014	29,548	2,890
2014/2015	30,974	3,117
2015/2016	30,811	3,193
2016/2017	31,531	3,215
2017/2018	31,123	3,141
	Percentage changes	
	Volume	Value
2016/17 - 2017/ 18	(1.3)	(2.3)

Source: Central Bank of Kenya

Chart 4.9: Clearing House Throughput



Source: Central Bank of Kenya

Cards Transactions

During the period under review, the Payment Card Industry recorded 17.1 million active cards with 217.6 million transactions valued at KSh 1.4 trillion. This was a marginal increase of 1.2 percent and 1.4 percent in value and volume processed respectively. The number of active cards increased from 15.6 million to 17.1 million in June 2017 and 2018 respectively.

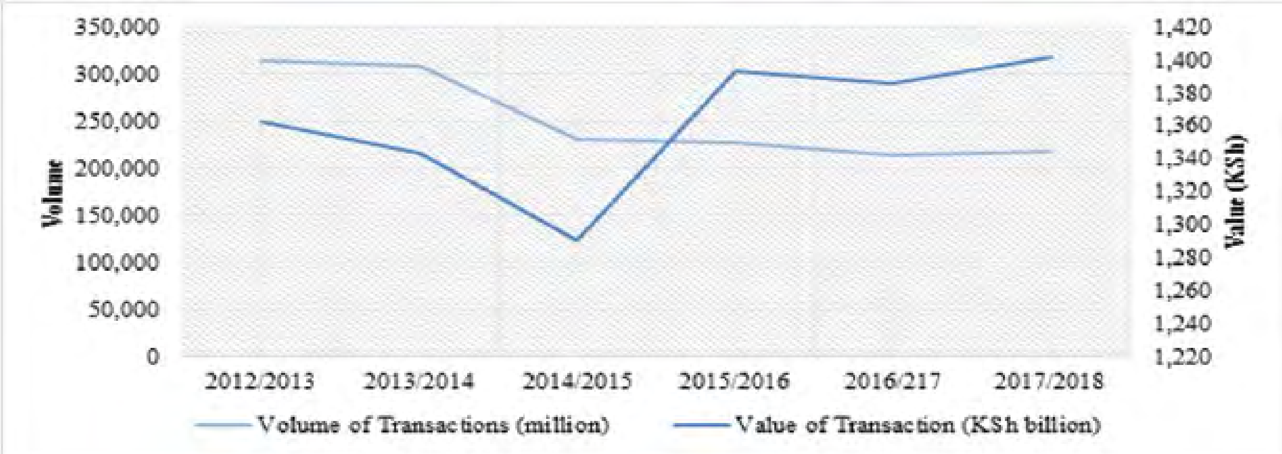
4.0 CENTRAL BANK OPERATIONS

Table 4.20: Payment Cards Developments

FY	No. of Cards (million)	No. of ATMs	No. of POS Terminals	Volume of Transactions (Million)	Value of Transactions (KSh billion)
2012/2013	10.9	2,439	19,204	314,828	1,363
2013/2014	11.6	2,618	17,395	309,306	1,343
2014/2015	14.5	2,698	19,259	231,529	1,291
2015/2016	12.9	2,682	26,742	227,513	1,393
2016/217	15.6	2,782	34,908	214,586	1,386
2017/2018	17.1	2,828	39,249	217,634	1,402
Percentage changes					
	Cards	**ATMs**	**POS Terminals**	**Volume**	**Value**
2016/17-2017/ 18	9.6	1.7	12.4	1.4	1.2

Source: Central Bank of Kenya

Chart 4.10: Payment Cards Trends



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Mobile Money Transfers

The mobile money transfer industry has grown significantly, giving opportunity to individuals and businesses that were left out of the traditional banking system to access financial services. Beside the growth in number and values of customers and transactions, there is an increased fusion and integration of payment and banking services to form a robust digital finance ecosystem. The digital ecosystem hosts varied value-added products and services, like credit and saving platforms and e-commerce intertwined through linkages between both financial and non - financial institutions.

Mobile Money Transfer Services continued to gain popularity in the period under review **(Table 4.21 and Chart 4.11).** In particular, the number of agents grew by 19.5 percent from 165,109 in June 2017 to 197,286 agents in June 2018. The number of mobile money transfer accounts increased by 24.58 percent from 34.18 million accounts to 42.58 million accounts during the same period.

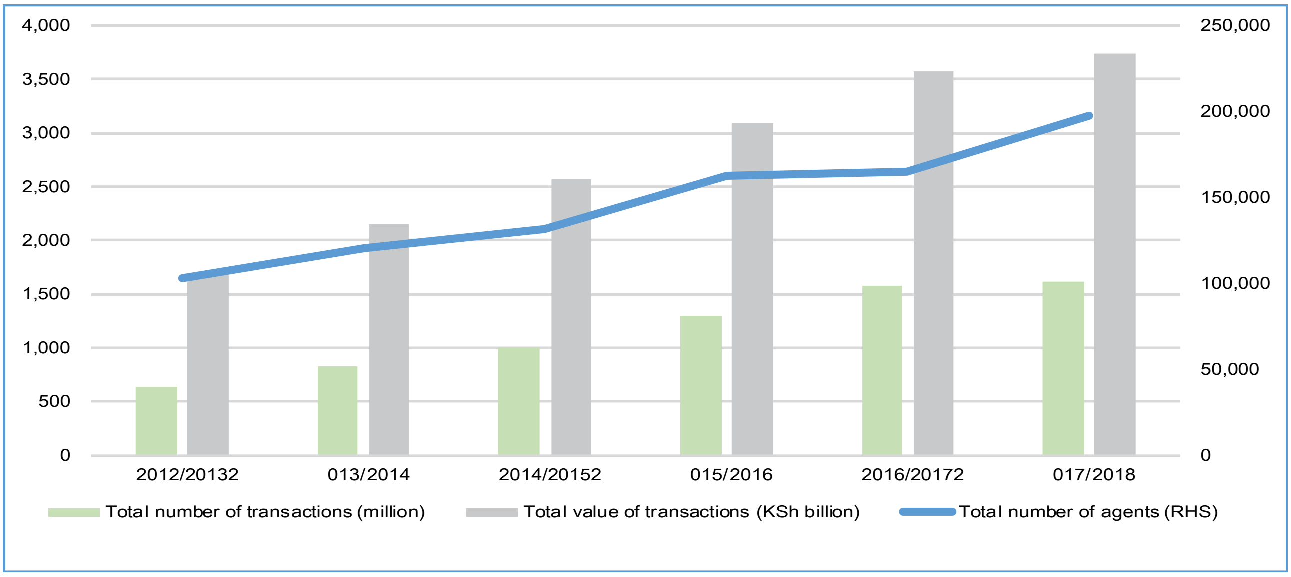
The volume and value of Mobile Phone Money Transfers increased from 1,577.68 million transactions worth KSh 3,574.43 billion in FY 2016/2017 to 1,619.97 million transactions worth KSh 3,747.33 billion in FY 2017/2018. **(Table 4.21 and Chart 4.11).** This represents an increase of 2.68 percent and 4.84 percent in volume and value, respectively.

Table 4.21: Mobile Money Transfers

	2012/2013	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Total number of agents	103,165	120,781	131,761	162,465	165,109	197,286
Total Mobile money transfer accounts (million)	23.75	25.93	26.50	31.39	34.18	42.58
Total number of transactions (million)	643.02	824.26	1,002.25	1,304.52	1,577.68	1,619.97
Total value of transactions (KSh billion)	1,689.04	2,148.14	2,575.44	3,094.92	3,574.43	3,747.33

Source: Central Bank of Kenya

Chart 4.11: Growth of Mobile Money Transfer Services



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

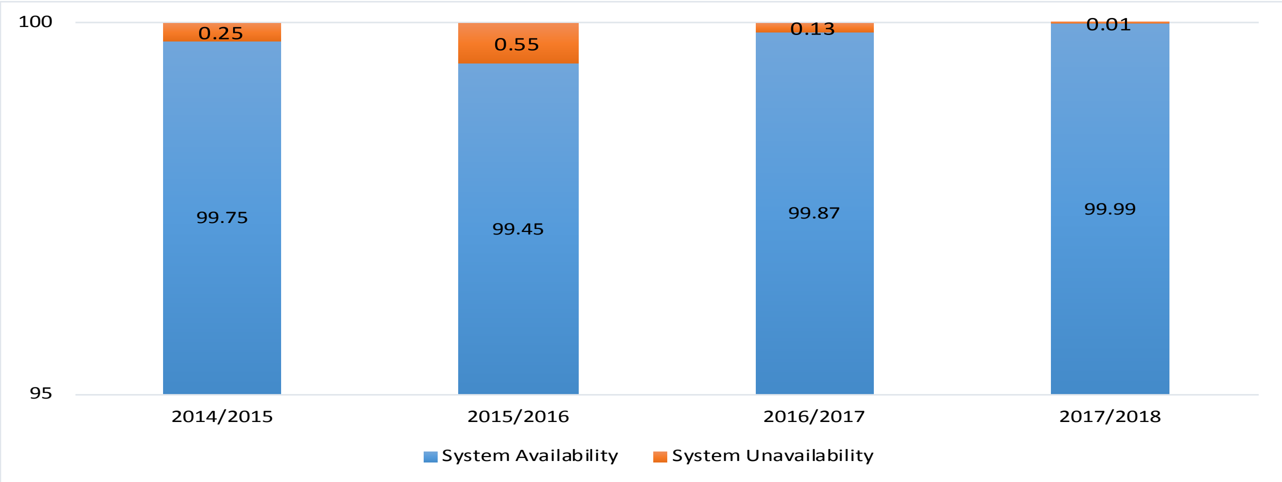
KEPSS Availability

During the FY 2017/2018, KEPSS operations were smooth with a monthly average system availability level of 99.99 percent **(Chart 4.12).**

ACH Availability

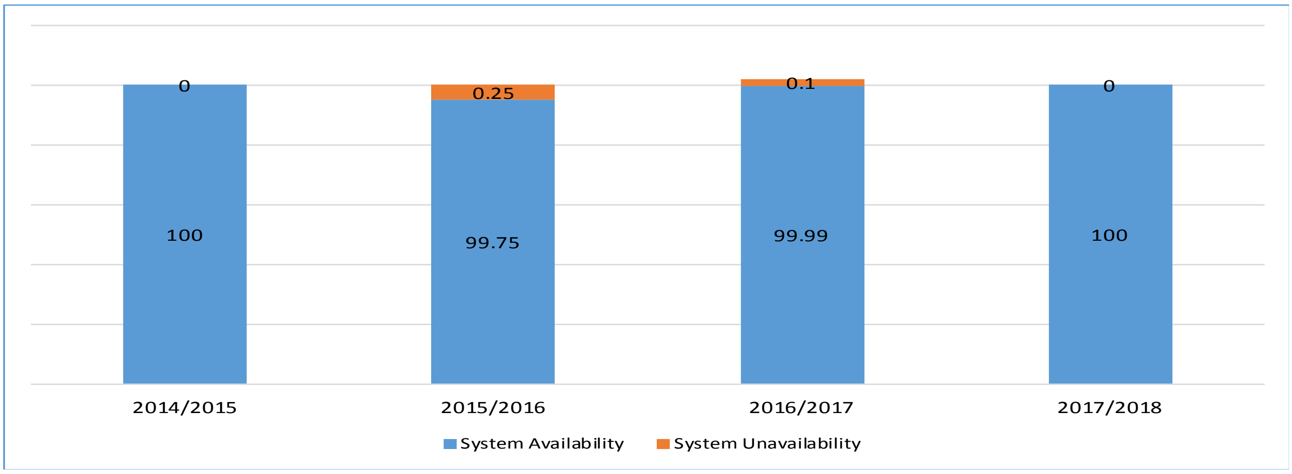
During the period under review, the ACH system continued to maintain a high level of availability. **(Chart 4.13).**

Chart 4.12: KEPSS System Uptime



Source: Central Bank of Kenya

Chart 4.13: ACH Availability



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Developments and Risk Profile in National Payment and Settlement Systems

Cybercrime and cyber-attacks are risks inherent due to increased use of emerging technologies and connectivity of customer channels. In order to mitigate these risks, CBK issued a Guidance Note on Cyber security in August 2017 outlining the minimum standards that institutions should adopt to develop effective cyber security governance and risk management frameworks.

Regulation of Fintech firms, if not done well, poses a strategic threat of potentially disrupting the financial sector and services, in areas such as lending, payments, wealth management and property.

Current Developments and Outlook

Fintechs are transforming how consumers and financial service providers interact and communicate. The wide-spread use of Fintech has also opened new markets in Kenya, giving opportunity to individuals and businesses that were previously left out of the traditional banking system to gain greater access to formal financial services.

Entrepreneurs will continue to invest in technological innovations such as artificial intelligence (AI)/machine learning (ML), blockchain technologies, cloud computing, big data and analytics, Internet of Things. These technologies are at different stages of infancy/maturity, and some have the potential to significantly change the industry in the coming years.

4.7 Domestic Debt Operations

Background

Public borrowing in Kenya is governed by the public finance management act (PFMA), which also provides for the formulation of the management of public debt, the Medium Term Debt Strategy (MTDS). It also guides the other public debt management activities such as debt sustainability analysis, which takes into consideration the domestic debt operations.

Central Depository Securities (CDS) Accounts

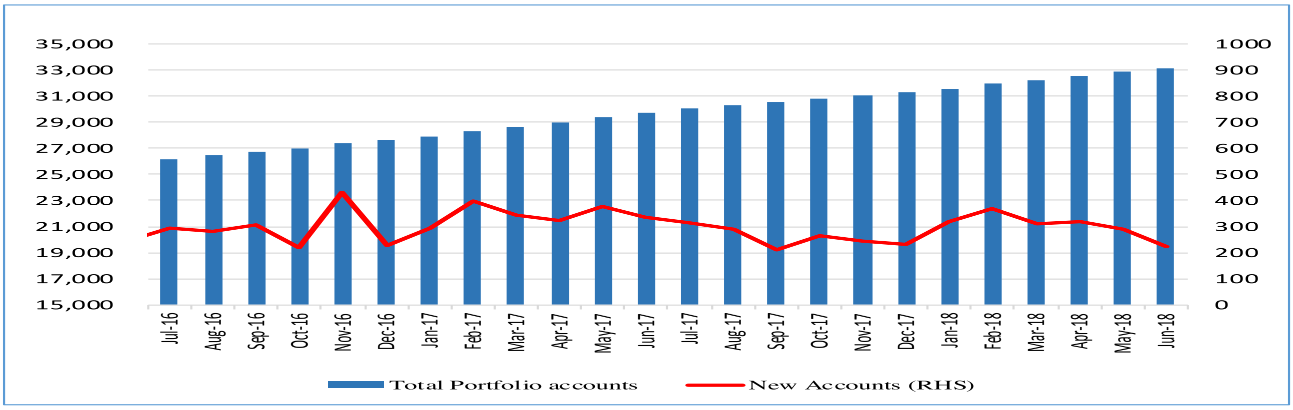
The number of CDS accounts has continued to grow steadily. However, the number of new CDS accounts opened during the year declined slightly to 3,382 compared to 3,839 accounts opened in the previous year. As at end June 2018, the total number of CDS accounts was 33,092 **(Chart 4.14).**

Net Domestic Borrowing

During the FY-2017/18, the Bank raised net cumulative borrowing of KSh 300.1 billion compared to a revised target of KSh 268.7 billion through issuance of Treasury bills and bonds **(Chart 4.15).** During the year, a total of 8 Treasury bonds were reopened and 8 new Treasury bonds were issued with the bulk of the issuances being on the medium long term maturity spectrum. Two new Infrastructure bond were issued during the period **(Chart 4.16).**

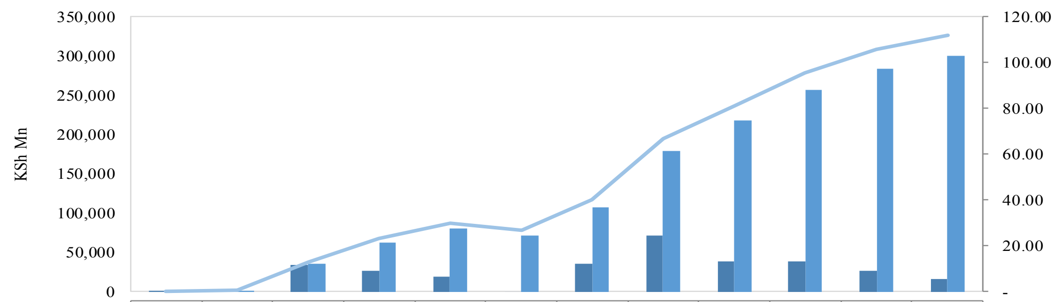
4.0 CENTRAL BANK OPERATIONS

Chart 4.14: Number of CDS Accounts



Source: Central Bank of Kenya

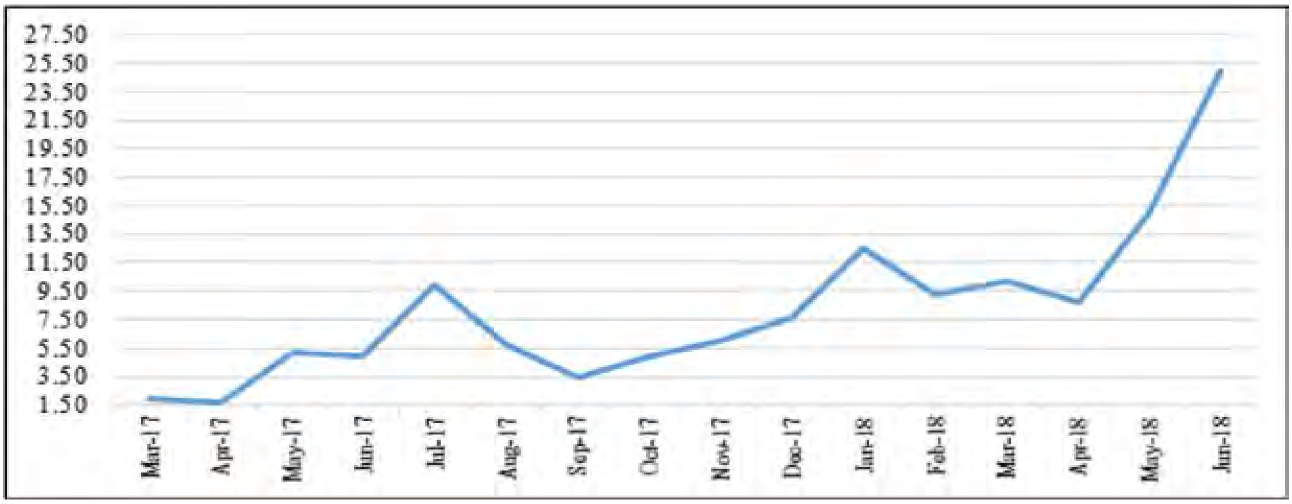
Chart 4.15: Domestic Borrowing Programme Performance in FY 2017/18



	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
Net Borrowing	728.00	730.00	33,776.0	27,007.0	18,902.0	-9,274.00	35,968.0	72,118.0	38,861.0	38,197.2	27,336.0	15,737.3
Net Cum. Borrowing	728.00	1,458.00	35,234.0	62,240.0	81,143.0	71,868.0	107,836.	179,954.	218,835.	257,032.	284,433.	300,105.
Borrowing Perfomance (%)	0.27	0.54	13.11	23.16	30.20	26.75	40.13	66.97	81.44	95.66	105.86	111.69

Source: Central Bank of Kenya

Chart 4.16: Bond Tenors Issued in FY 2017/18



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

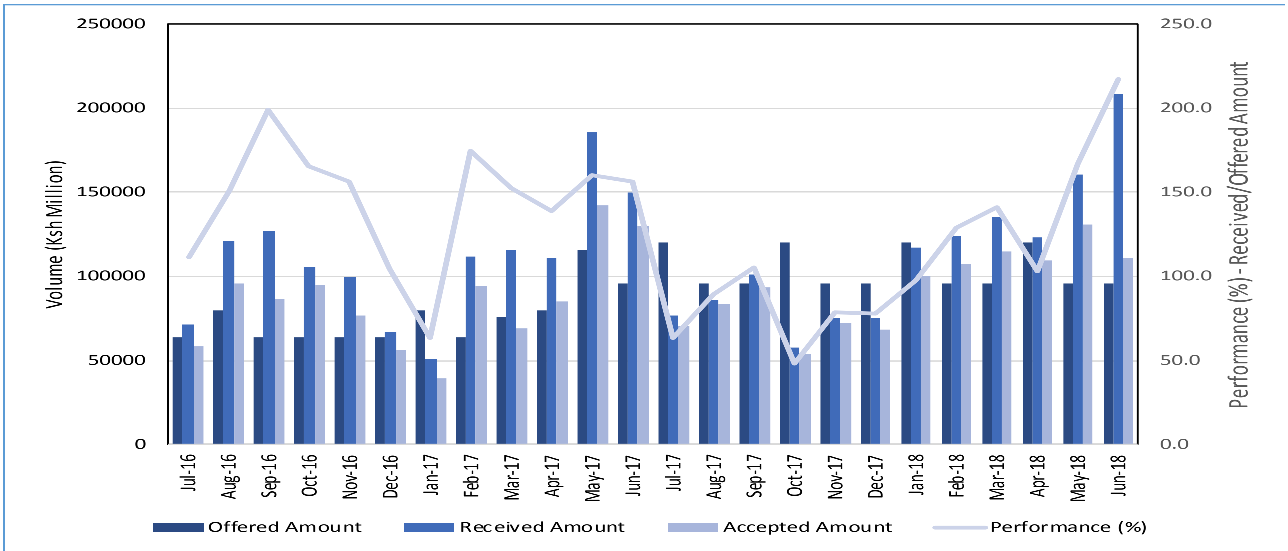
Government Securities Auctions

Treasury Bills Auctions

Treasury bills auctions were oversubscribed in the second half of the financial year recording an average performance of 142.6 percent **(Chart 4.17).**

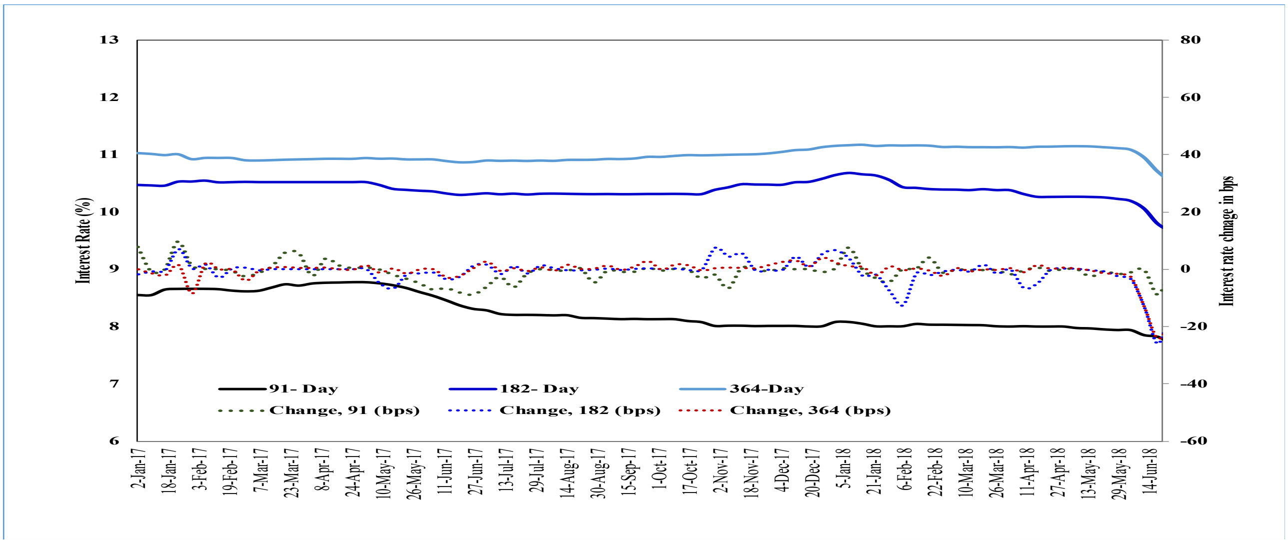
Average interest rates for the 91 days Treasury bills declined steadily during the year. By end June 2018, the 91-day Treasury bill average rate was 7.725 percent, 182-day at 9.666 percent and 364-day at 10.537 percent compared to 8.310 percent, 10.314 percent and 10.868 percent by end June 2017 respectively **(Chart 4.18).**

Chart 4.17: Monthly Uptake of Treasury Bills at Primary Market



Source: Central Bank of Kenya

Chart 4.18: Treasury Bills Interest Rates



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

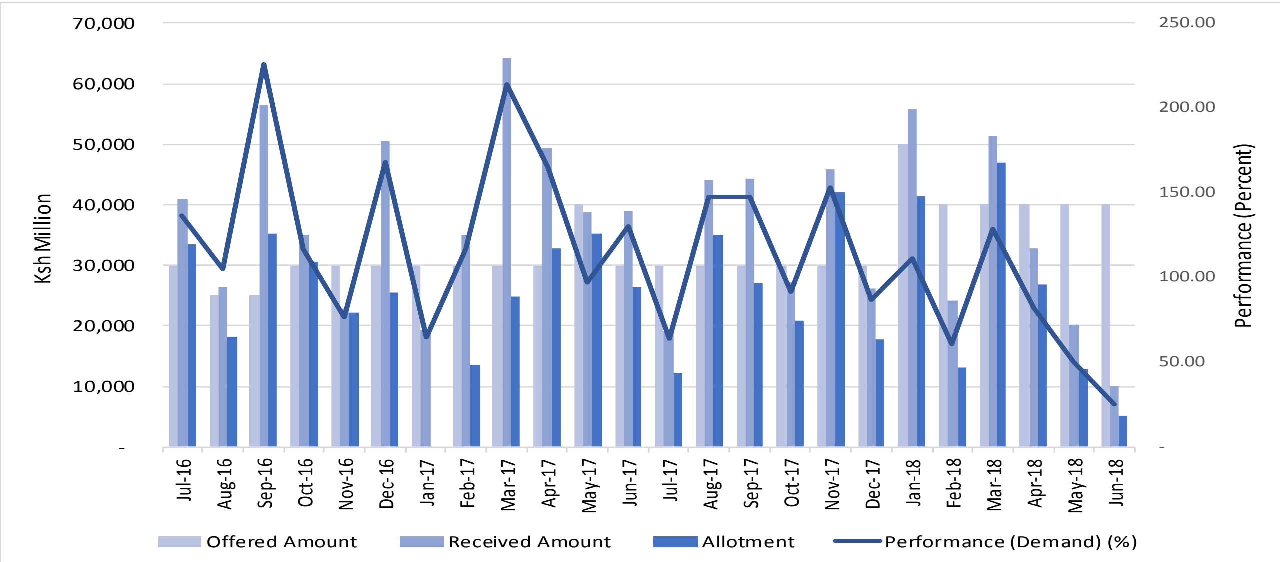
Treasury Bonds Auctions

Treasury bonds auctions were generally under-subscribed in the second half of the financial year compared to the first half largely due to issuance of long dated bonds during the second half of the year **(Chart 4.19).**

Debt Maturity Profile

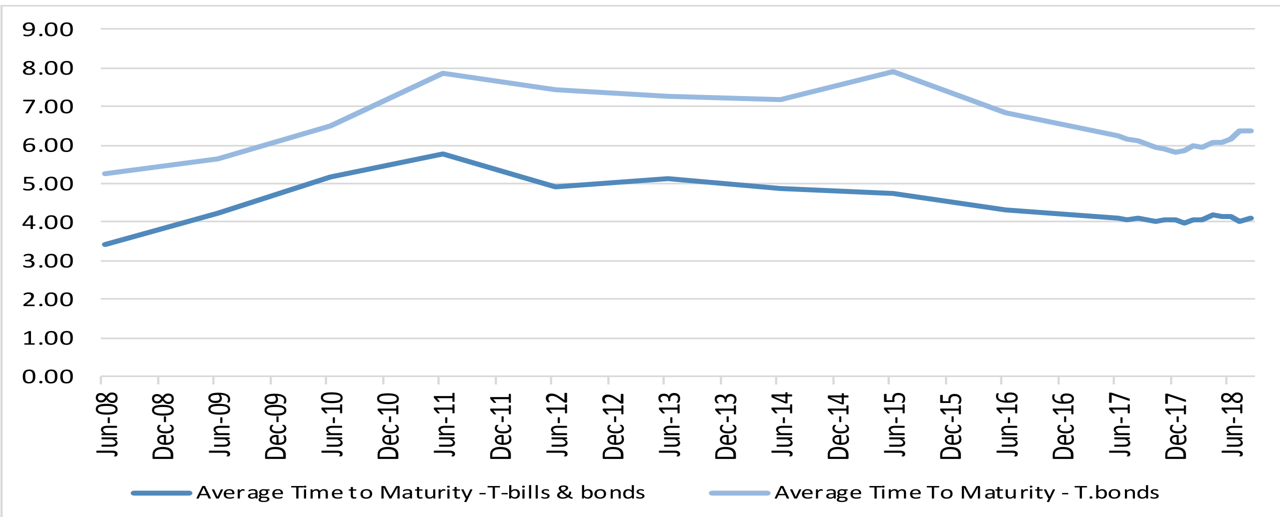
The domestic debt maturity profile for all securities improved, albeit slightly, from 4.10 years in June 2017 to 4.13 years in June 2018. The Bank working together with the National Treasury is committed to further lengthening the maturity profile to mitigate refinancing risk **(Chart 4.20).** By June 2018, ratio of T-bills to bonds was 37:63 compared to 36: 64 by June 2017.

Chart 4.19: Monthly Uptake of Treasury Bonds at Primary Market



Source: Central Bank of Kenya

Chart 4.20: Average Maturity (Years) of Government Securities)



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

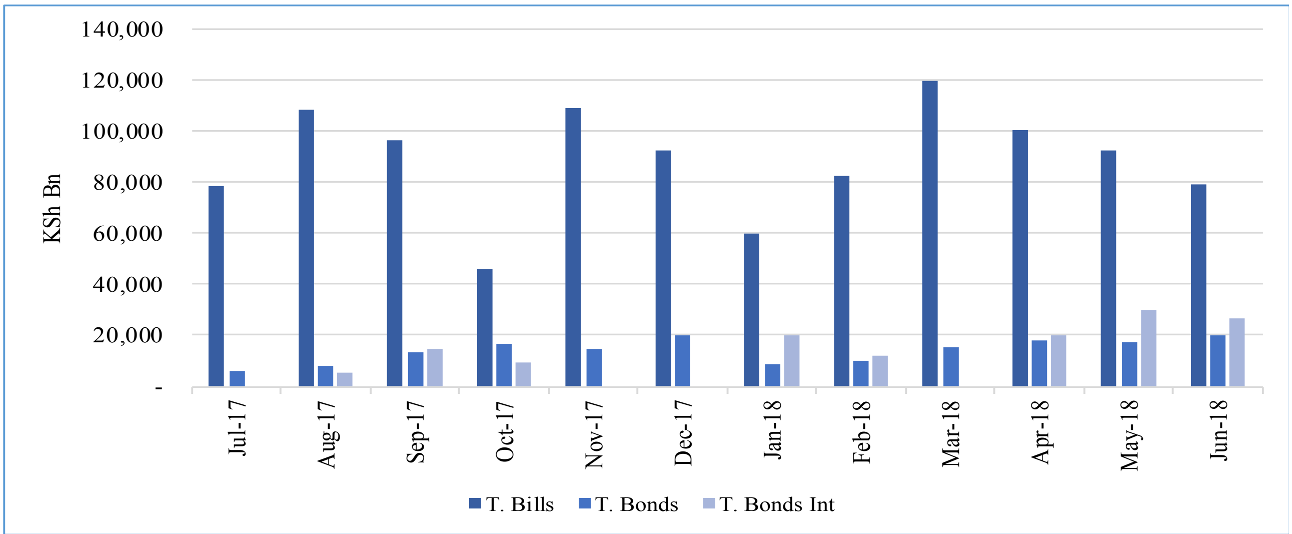
Debt redemptions and interest payments

During the financial year, KSh 1,234.3 billion was paid out in Treasury bills and bonds maturities while interest payments were KSh 138.04 billion **(Chart 4.21).**

Secondary Market for Government Securities

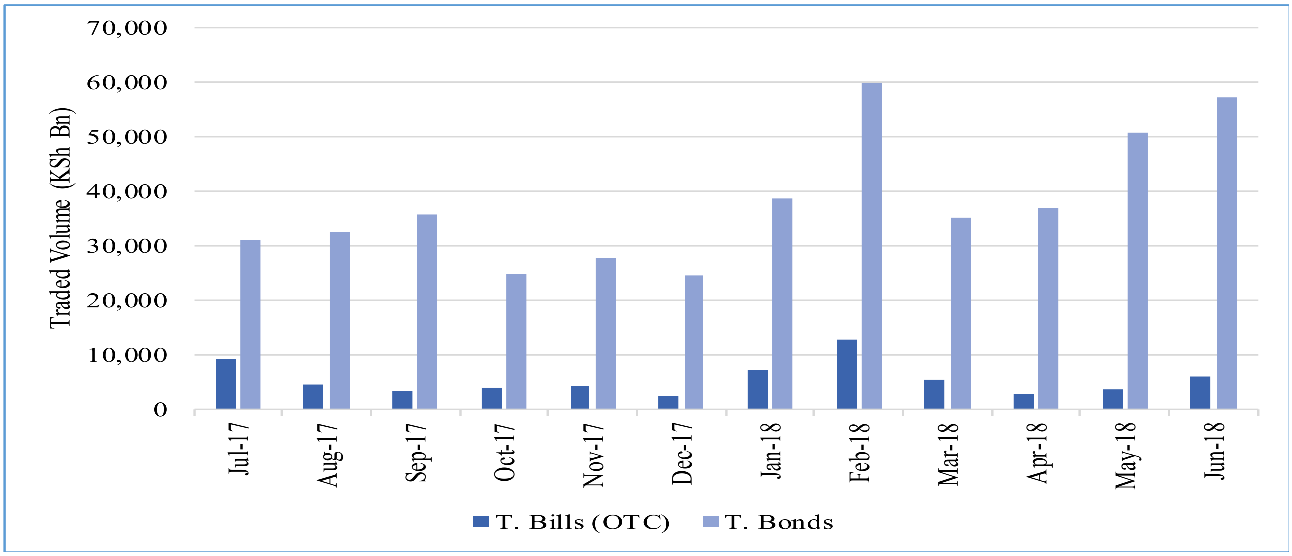
Treasury bonds secondary trading turnover amounted to KSh 455. 2billion in 2017/18 compared to KSh 366.9 billion in 2016/17. Over The Counter (OTC) trading for Treasury bills during the financial year amounted to KSh 66.21 billion. The bulk of trading took place in February 2018 with Treasury bill trades amounting to KSh 12.9 billion, while bonds traded KSh 59.9billion **(Chart 4.22).**

Chart 4.21: Maturities and Interest Payments



Source: Central Bank of Kenya

Chart 4.22: Trading of Government Securities



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Kenya Government Securities Yield Curve

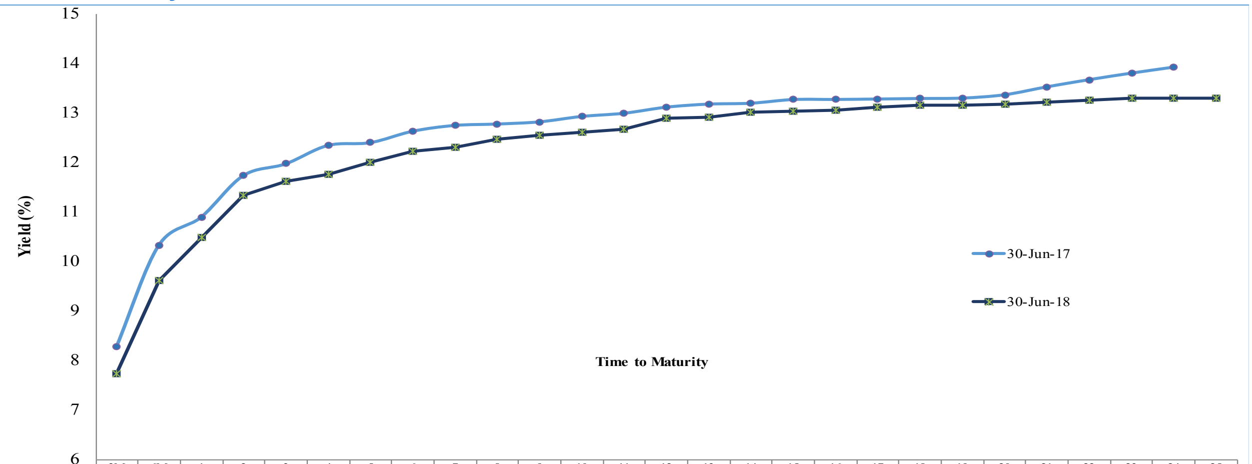
The Government securities yield curve was stable during the year, shifting downwards by June 2018 compared to level in June 2017, indicating reduced cost of borrowing. The Yield curve is expected to remain stable in 2018 supported by auction decisions at the primary market and trading at the secondary market **(Chart 4.23).**

Projects in Domestic Debt Operations

Central Securities Depository (CSD) System: This is one of the strategic initiatives of Financial Markets Department that is currently under implementation. It aims at enhancing operational efficiency in domestic debt management and promotion of market development.

Treasury Mobile Direct (TMD) and Internet Banking (IB): Treasury Mobile Direct is an initiative aimed at improving the efficiency of issuance operations of domestic debt through provision of channel for access of small denomination of Government securities through the mobile phone hence promote financial inclusion, support market development through increase of outreach to retail investors, broadening of the investor base as well as improve the national savings rate. It aims at allowing investors to open Central depository securities accounts, check status of their investments, receive information on government securities; buy and sell, pledge and transfer securities and settle investments in government securities within allowed limits on mobile money platforms. Service level agreements are being finalized with the Mobile Network Operators (MNOs). For Internet Banking, 26 (66.67 percent) commercial banks have executed the IB Agreement, 14 banks have been connected and 4 banks are awaiting connection to the IB platform while 3 Micro Finance Banks are already connected to the platform.

Chart 4.23: Kenya Government Securities Yield Curve



	3M	6M	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
30-Jun-17	8.2840	10.329	10.895	11.735	11.972	12.344	12.400	12.629	12.747	12.776	12.820	12.929	12.993	13.115	13.178	13.196	13.270	13.272	13.281	13.291	13.300	13.366	13.526	13.671	13.803	13.924	
30-Jun-18	7.7330	9.6070	10.488	11.326	11.626	11.750	12.000	12.217	12.313	12.458	12.540	12.615	12.678	12.886	12.912	13.018	13.030	13.050	13.114	13.146	13.155	13.179	13.220	13.261	13.299	13.3	13.3

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

4.8 Strategic Plan

Introduction

During the implementation of the Bank's 2015-2018 Strategic Plan, it became imperative to re-set the Bank's strategic priorities and direct special attention and resources to address risks, challenges and significant developments that emerged in the Bank's operating environment. Therefore, the Bank's strategic plan was updated in July 2017. The focus areas in the updated plan included: Bank Supervision, Information Technology, Security, People, Banking, NPS and Risk Management, Communication, Currency, Financial Markets, Procurement and Projects, Research and Legal. The overall objective for the strategic update was to build resilience and stability in order to significantly deliver the Bank's mandate. The **Updated 2015-2018 Strategic Plan was thus anchored on the theme: "Overcoming Current Challenges in Pursuit of the Vision of Becoming a World Class Modern Central Bank".** The CBK 2015-2018 Strategic Plan closed on June 30, 2018.

Strategic Milestones

The Bank recorded remarkable performance by the end of the strategy period. The following key milestones were achieved:

- The Bank promoted the stability and integrity of the financial sector through the following initiatives:
  - o Enhanced commercial banks' capability to assess and hold adequate capital levels commensurate with their respective business models and risk profiles.
  - o Enhanced commercial banks assessment and effective management of risks associated with money laundering.
  - o Improved transparency in the pricing of credit hence increased access to credit at competitive prices.
  - o Enhanced cyber security risk management in the banking sector.
- In the area of Information Communication Technology, the Bank stabilized its Core Banking System that supported efficient business operations, business continuity and excellent service delivery.
- In the area of Banking and National Payment Systems (NPS), the Bank conducted Internet Banking (IB) user training for MDAs and Counties. This enhanced efficiency in the delivery of banking services to National and County Government.
- Currency Operations were made more efficient and modernized by upgrading Banknote Processing System (BPS).
- To develop and deepen financial markets, the Bank introduced Treasury Mobile Direct (TMD). The Bank also put in place the infrastructure for Over the Counter (OTC) trading of Government Securities to enhance domestic debt management.
- The Bank completed a number of initiatives in the re-alignment of the human resources function which enhanced staff engagement and motivation.
- The communication function was revamped which made it impactful and enhanced the Bank's image.

Strategy Implementation challenges

The Bank encountered challenges during the implementation of the Strategic Plan leading to rescheduling of some initiatives and activities. These challenges are classified in the following three broad categories:

1. Prolonged consultations with Stakeholders
2. External dependencies, for instance, in receiving technical and financial support from external partners
3. Frustrated procurement processes occasioned by non-performance by suppliers, consultants, vendors and contractors as well as none-responsiveness of tenders

Strategic Initiatives for the medium term

In the medium term the Bank is aiming at: ***"Leveraging innovative technologies and systems to drive CBK's mandate"*** and will focus on the following areas:

- Modernizing monetary policy formulation and implementation
- Enhancing Banking and Financial Markets stability, growth and efficiency
- Building a cohesive Human Capital with common vision and values
- Building a robust and resilient Information Communication Technology (ICT) system
- Enhancing Risk Management and Control Environment
- Undertaking Business Process Re-engineering in every area of its operations
- Continuing to participate in the EAC Integration process

4.0 CENTRAL BANK OPERATIONS

4.9 Human Resources

Preventive Health Care Initiatives

The Bank's medical facility carried out various preventive healthcare initiatives to increase staff appreciation of the changing disease patterns that impact people of all walks of life. During the year, a system upgrade was carried out resulting in improved efficiency and effectiveness in managing health care provision in the Bank.

Enhancing the Brand of the Bank as a great place to work

Kenya Institute of Bankers games

The Bank being a leading financial institution and a key member of the Kenya Institute of Bankers (KIB) participated in the 2017 Annual Inter-Banks and Financial Institutions games. This is an important social event for the Bank as the games bring together the banking community to interact in a friendly, cordial and sporting atmosphere. The Bank emerged the overall winners for the 2nd year running.

East African Central Banks Regional games

The Bank hosted the first regional games for the central banks at the Kenya School of Monetary Studies on 30th June, 2018. This is a friendly event that brings together members of staff from Central Banks in the East Africa region to interact in a friendly environment, and enhance regional integration and cooperation.

Mt. Kilimanjaro expedition

The Bank organized an expedition to Mt. Kilimanjaro from 4th to 11th June, 2017 and 29th April to 8th May, 2018 in which a group of twenty eight (28) and thirty (30) members of staff respectively, participated in the expedition. Funds raised from the expedition were used to improve St. Kizito School for the deaf, Litein's facilities and learning environment for the pupils. During the 2nd expedition, two (2) Police Women attached to the Bank accompanied the team, became the first women Police Officers from Kenya to reach the mountain summit.

Internship Program

The Central Bank of Kenya launched Internship Program (CBKIP) on 1st July, 2016. Currently in its fourth group, CBKIP is a sixth-month programme that aims to expose talented youth to the work of central banking, improve their financial sector literacy and generate a pool of skilled graduates for the broader financial sector. During the year 2017/18, the Bank offered internships to eighteen (18) young graduates and the current group internship tenure is ending in November 2018.

Relaunch of the Karura run and the staff Gym

CBK encourages its employee to embrace wellness as a life style. Some of the activities carried out to support this initiative was the relaunch of the Karura run on 17th March 2017, an outdoor activity that takes place every Saturday in Karura. The CBK staff gym which was also refurbished with the state of the art equipment, was formally relaunched on the same day.

Recognition events

The Bank organized a recognition ceremony for its retirees dubbed "Mashujaa day" in November 2017 and long service awards on 11th May, 2018 for members of staff to recognize their contributions and service to the Bank.

5.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2018

REPUBLIC OF KENYA

OFFICE OF THE AUDITOR-GENERAL

REPORT

OF

THE AUDITOR-GENERAL

ON

THE FINANCIAL STATEMENTS OF CENTRAL BANK OF KENYA

FOR THE YEAR ENDED 30 JUNE 2018

CENTRAL BANK OF KENYA ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2018

FINANCIAL PERFORMANCE

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FINANCIAL PERFORMANCE

Board of Directors

Mr. Mohammed Nyaoga	Chairman
Dr. Patrick Njoroge	Governor
Mr. Samson Cherutich	Member
Mrs. Rachel Nzombo	Member
Mrs. Nelius W. Kariuki	Member
Mr. Ravi J. Ruparel	Member
Mrs. Charity S. Kisotu	Member
Dr. Kamau Thugge	Principal Secretary, The National Treasury

Senior Management

Dr. Patrick Njoroge	Governor
Ms. Sheila M'Mbijjewe	Deputy Governor

Heads of Department

Mr. Kennedy Abuga	Director - Governors' Office (Board Secretary)
Ms. Rose Detho	Director - Strategic Management Department
Mr. William Nyagaka	Director - Internal Audit Department-Transferred to Financial Market Department on 9 May 2018
Mr. Charles Koori	Director - Research Department
Mr. Gerald Nyaoma	Director - Bank Supervision Department
Mr. Peter Rotich	Director - Finance and IMS Department-Retired on July 9 ,2017
Mr. John Birech	Acting Director - Financial Markets Department-Retired on 10 May 2018
Ms. Terry Nganga	Acting Director - Human Resource and Administration Department
Mr. Paul Wanyagi	Acting Director - Currency Operations and Branch Administration Department
Mr. Mwenda Marete	Acting Director - Banking, National Payments and Risk Management Department
Mr. Peter Kigondu	Acting Director - Department of Procurement, Logistics and Supplies
Mr. Moses Ngotho	Acting Director - Finance and ICT Department-Appointed on July 10,2017
Mrs. Matilda Onyango	Acting Director – Internal Audit Department- Appointed May 10, 2018
Mr. Joshua Kimoro	Acting Director - Kenya School of Monetary Studies

Registered office and principal place of business

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00200 Nairobi, Kenya
Tel.(+254) (020) 2860000

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Mombasa Branch
Central Bank of Kenya Building
Nkurumah Road
P.O. Box 86372
80100 Mombasa

Kisumu Branch
Central Bank of Kenya Building
Jomo Kenyatta Highway
P.O. Box 4
40100 Kisumu

Eldoret Branch
Kiptagich House
Uganda Road
P.O. Box 2710
30100 Eldoret

FINANCIAL PERFORMANCE

Currency Centres

Nyeri Currency Centre
Kenya Commercial Bank Building
Kenyatta Street
P.O. Box 840
10100 Nyeri

Meru Currency Centre
Co-operative Bank Building
Njuri Ncheke Street
P.O. Box 2171
60200 Meru

Nakuru Currency Centre
Central Bank of Kenya Building
George Morara Street
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20100 Nakuru

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P.O. Box 40092
00100 Nairobi

On behalf of:-

The Auditor General
Kenya National Audit Office
Anniversary Towers
P.O. Box 30084
00100 Nairobi

FINANCIAL PERFORMANCE

1. Statement of Corporate Governance

The Central Bank of Kenya (the “Bank”/“CBK”) is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from Article 231 of the Constitution of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act (the “Act”) provides that the Board of Directors (the “Board”) shall be composed of a Chairperson, a Governor, Principal Secretary to The National Treasury who is a non-voting member and eight Non-Executive Directors. The law requires that the President appoints the Chairman and Governor after the conduct of a competitive process and following the approval of Parliament. Other than the Principal Secretary to The National Treasury who is an ex-officio member, all the Non-Executive Directors of the Board are also appointed by the President with the approval of Parliament. All the Board members are appointed for a term of four (4) years each and are eligible for reappointment provided that no Board member holds office for more than two (2) terms.

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.

The Board meets once every two (2) months and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to enable them provide and maintain full and effective direction and control over strategic, financial and operational issues of the Bank. The Board is not involved in the conduct of day-to-day business as this is the responsibility given to the Governor by law. It however, retains responsibility for determining the policies of the Bank.

The Members of the Board (all Kenyans) in the year ended 30th June, 2018 and their attendance and the number of meetings held in the year were as follows:

No.	Name	Position	Discipline	Date of Appointment / Retirement	Meetings Attended
1.	Mr. Mohammed Nyaoga	Chairman	Lawyer	Appointed – 19th June, 2015	11
2.	Dr. Patrick Njoroge	Governor	Economist	Appointed – 19th June 2015	11
3.	Principal Secretary/ The National Treasury	Executive Officer	Economist	Permanent	2
4.	Mrs. Nelius Kariuki	Member	Economist	Appointed – 4th November, 2016	10
5.	Mr. Ravi Ruparel	Member	Financial Sector Expert	Appointed – 4th November, 2016	11
6.	Mrs. Charity Kisotu	Member	Accountant	Appointed – 4th November, 2016	9
7.	Mr. Samson Cherutich	Member	Accountant	Appointed – 5th December, 2016	11
8.	Mrs. Rachel Dzombo	Member	Management Expert	Appointed – 5th December, 2016	10

The remuneration paid to the Directors for services rendered during the financial year 2017/2018 is disclosed in Note 27 to 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 staff loans.

FINANCIAL PERFORMANCE

1.2. Secretary to the Board

The Board Secretary provides technical and secretarial services as well as corporate governance and logistical support to the Board in order to facilitate efficient policy making interface with policy implementation. The Board Secretary also advises the Board on legal matters. In conjunction with the Chairman, the Board Secretary ensures good and timely information flow among the Board members, the Board Committees and Management. All members of the Board and Management have access to the Board Secretariat services.

1.3. Audit Committee

The members of the Audit Committee in the year ended 30th June, 2018 were Mr. Samson K. Cherutich (Chairman), Mr. Ravi J. Ruparel, Mrs. Charity S. Kisotu, Mrs. Nelius W. Kariuki and Mrs. Rachel Dzombo. The members are all Non-Executive Directors with experience in Accounting, Auditing, Financial and Management. The Committee meets once every two (2) months and as necessary. The Terms of Reference of the Audit Committee cover five (5) major areas, namely; Internal Control System, Financial Reporting and Related Reporting Practices, External and Internal Audits.

The audit committee ensures the integrity of the financial statements prior to the review and approval by the Board. This is achieved by reviewing the accounting policies, financial reporting and regulatory compliant practices of the Bank. The committee reviews report on the findings of internal and external auditors and manages corrective actions in response to the findings. The committee meets every two months and at least once per annum with the external auditors without senior staff of the Bank being present. Each year the committee reviews and approves the overall scope and plan for the internal audit activities.

The committee aligns the risk management processes and internal audit activities and ensures that the Bank has a solid risk management system in place in terms of people, systems, policies, controls and reporting. The risk responsibility is to approve risk policies that guide the risk parameters and tolerance. Thereafter to monitor the compliance with the policies limits and programs.

The Committee Members’ positions, disciplines and number of meetings attended for the year ended 30th June 2018 were as follows:

No.	Name	Position	Discipline	Meetings Attended
1.	Mr. Samson Cherutich	Chairman	Accountant	11
2.	Mr. Ravi Ruparel	Member	Financial Sector Expert	10
3.	Mrs. Charity Kisotu	Member	Accountant	10
4.	Mrs. Nelius Kariuki	Member	Economist	8
5.	*Mrs. Rachel Dzombo	Member	Management Expert	7

* Mrs. Rachel Dzombo Joined the Audit Committee of the Board on December 18, 2017.

1.4. Human Resources Committee (HRC)

The members of the HR Committee in the year ended 30th June, 2018 were Mrs Nelius Kariuki, Mr Samson Cherutich, Mrs Charity Kisotu, Mrs Rachel Dzombo and Mr Ravi Ruparel. The members are all Non-Executive Directors with experience in Accounting, Management and Business.

The Human Resources Committee of the Board approves the HR policies and reviews procedures and ensures that they are aligned to the Bank strategy. This covers succession plans, employee and compensation structures, training and development, evaluation and career management and finally discipline and grievance processes. The goal is to ensure that the staff of the Bank are adequately remunerated and recognized in order to motivate and retain staff of the highest calibre.

FINANCIAL PERFORMANCE

The members of the Human Resources Committee in the year ended 30th June, 2018 and their attendance of the meetings held in the year were as follows:

No.	Name	Position	Discipline	Meetings attended
1	Mrs Nelius Kariuki	Chairman	Economist	7
2	Mr Samson Cherutich	Member	Accountant	8
3	Mrs Charity Kisotu,	Member	Accountant	8
4	Mrs Rachel Dzombo	Member	Management Expert	8
5	*Mr. Ravi Ruparel	Member	Financial Sector Expert	3

Note* Mr. Ravi Ruparel joined Human Resource Committee of the Board on 22nd May, 2018.

The meetings also include a Special Human Resource Committee of the Board held on 28th September, 2017.

1.5. Monetary Policy Committee (MPC)

Section 4D of the Central Bank of Kenya (Amendment) Act 2008 establishes the Monetary Policy Committee (MPC). The MPC is responsible for formulating monetary policy and is required to meet at least once every two (2) months. The MPC comprises of the Governor who is the Chairman, the Deputy Governor who is the Deputy Chairperson, two (2) members appointed by the Governor from the Bank, four (4) external members appointed by the Cabinet Secretary for the National Treasury, and the Principal Secretary for the National Treasury or his Representative. External members of the MPC are appointed for an initial period of three (3) years each, and may be reappointed for another final term of three (3) years. The quorum for MPC meetings is five (5) members, one of whom must be the Chairman or Deputy Chairperson.

During the FY2017/18, the MPC formulated monetary policy aimed at achieving and maintaining overall inflation within the target range of 2.5 to 7.5 percent. The period was characterized by sustained macroeconomic stability in spite of the spillover effects of the drought conditions witnessed in the first half of 2017, uncertainties with regard to the prolonged elections period, and the impact of interest rate caps on the economy. Overall month-on-month inflation fell to 4.3 percent in June 2018 from 9.2 percent in June 2017 largely due to a decline in food prices following improved weather conditions, and the impact of Government measures to mitigate the adverse effects of the drought on the prices of key food items. The 12-month and 3-month non-food-non-fuel inflation measures remained stable below 5 percent during the period, suggesting that demand-driven inflationary pressures in the economy were muted. Stability in the foreign exchange market minimized the threat of imported inflation.

Risks to the global economy persisted during the period particularly with regard to U.S economic and trade policies, the post-Brexit resolution and the pace of normalization of monetary policy in the advanced economies. Nevertheless, the foreign exchange market remained stable in the period supported by a narrowing in the current account deficit and improved confidence in the economy. The current account deficit narrowed to 5.8 percent of Gross Domestic Product in the 12 months to June 2018 from 6.7 percent in 2017 reflecting strong growth in diaspora remittances, improved inflows from tea and horticultural exports due to favorable weather conditions, and improved receipts from tourism. Lower imports of food and SGR-related equipment during the period offset the increase in the petroleum products import bill due to higher international oil prices. CBK's foreign exchange reserves, which stood at USD 8,643.5 million (or 5.8 months of import cover) at the end of June 2018, continued to provide an adequate buffer against short-term shocks. The Precautionary arrangements with the IMF provided an additional buffer against short-term shocks during the period.

After every MPC Meeting, the Governor held meetings with Chief Executive Officers of banks to discuss the background to the MPC decisions and to obtain feedback from the market. Additionally, the Governor held press conferences with the media to brief them on the background of the MPC decisions and developments in the financial sector and the economy. The forums continued to improve the public's understanding of monetary policy decisions.

FINANCIAL PERFORMANCE

The MPC held six (6) meetings in the year ended June 30, 2018, and attendance was as follows:

No.	Name	Position	Discipline	Meetings Attended
1	Dr. Patrick Njoroge	Chairman	Economist	6
2	Ms. Sheila M'Mbijjewe	Deputy Chairperson	Finance/ Accountancy	6
3	Mr. Musa Kathanje	Representative of the Principal Secretary, The National Treasury	Economist	6
4	Mr. Charles Koori	Member (Internal)	Economist	6
5	Mr. John Birech	Member (Internal)	Economist	5
6	Mr. William Nyagaka*	Member (Internal)	Finance/ Accountancy	1

** Mr. Nyagaka replaced Mr. Birech in May 2018, following his retirement from the CBK.*

1.6. Management Structure

The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Governor and the Deputy Governor constitute the Central Bank's Senior Management and meet regularly with the Heads of the Bank's various departments indicated on page 75, to review the overall performance of the Bank.

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

1.7. 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 embedded in the *Staff Rules and Regulations* and *the Employment Act 2007* apply to the entire Bank's staff.

1.8. Internal Controls

The Management of the Bank has put in place a system 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, 2015*. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

1.9. Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of the Bank policies and procedures. There is an annual Budget approved by the Board and a Procurement Plan approved by the Senior Management before commencement of the financial year. The Board of Directors receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.

1.10. Internal Audit and Risk Management

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

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1.11. Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statements. In addition, the Bank issues policy briefs to The National Treasury on both the Monetary and Fiscal policies. On an annual basis, the Financial Statements of the Bank are published in the Kenya Gazette and are also placed in the Bank's website.

2. Financial Performance

The Bank's financial performance is affected by the Monetary Policy stance undertaken, interest rates and exchange rate changes. The Bank's financial performance is presented on page 87 of these financial statements.

During financial year ended 30 June, 2018, the Bank recorded a net deficit of Shs. 4,280m compared to a net surplus of Shs. 17,050m in financial year ended 30 June, 2017. The deficit is included as part of the General Reserve Fund.

During the Financial year ended 30th June 2018 the Bank operating surplus before unrealized gains (losses) was Shs. 16, 101m (2017: Shs. 9,917m). Interest income of Shs.20,097m (2017: Shs 14,441m) rose due to the higher interest rates on US Dollar denominated reserves instruments plus higher reserve levels. As a result of a stronger Kenya Shillings to US Dollar an unrealized foreign exchange loss of Shs. 18,690m (2017: gain Shs. 8,516m) were noted as at 30th June 2018, and a fair value loss on financial assets held for trading of Shs. 2,073m (2017: Shs. 871m).

In addition, an actuarial loss of Shs. 2,629m (2017: Shs. 512m) was also incurred. This loss was offset by a revaluation gain on land and buildings of Shs. 3,011m. This valuation is performed every 3 years in line with the Bank's Fixed assets management policy.

The Bank assets increased to Shs. 1,083,892m (2017: Shs. 975,623m) mainly attributed to the Euro Bond proceeds of USD 2 billion (Shs. 202b) moderated by repayments of syndicated loans. The Government overdraft facility closed higher of Sh. 56,849m (Shs. 2017: Nil). Following a revaluation of fixed asset, the Bank assets increased by Shs. 3,011m.

Liabilities increased to Shs. 954,129m (2017: Shs. 841,580m) as a result of an increase in deposit from banks and government largely attributed to a lower bank reserves repo holding and higher government overdraft position at the year end.

FINANCIAL PERFORMANCE

Directors' Report

The Directors submit their report together with the audited Financial Statements for the year ended 30th June 2018, which shows performance of the Bank during the period and the state of affairs of Central Bank of Kenya (the "Bank"/"CBK") as at the year end.

Incorporation

The Bank is incorporated by Article 231 of the Constitution of Kenya, 2010.

Principal Activities

The Bank is established and administered under the Constitution of Kenya, 2010 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.

Results and Surplus

The deficit for the year of Shs 4,280 million (2017: Shs.17,050 million surplus) has been included as part of the General Reserve Fund. The Directors recommend a transfer of Ksh 800m to the Consolidated Fund from the General Reserve Fund (2017: Nil).

Board of Directors

The members of the Board of Directors who served during the year and up to the date of this report are listed on page 75

Auditor

The Bank is audited by the Auditor General in accordance with *Section 12 of the Public Audit Act* and the *Central Bank of Kenya Act*.

By order of the Board

Kennedy Abuga
Board Secretary

4 September 2018

FINANCIAL PERFORMANCE

Statement of Directors' Responsibilities

The Directors are responsible for the preparation of Financial Statements for each financial year that give a true and fair view of the state of affairs of the Bank as at the end of the financial year and of the Bank's financial performance. The Directors also ensure that the Bank keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the Bank. They are also responsible for safeguarding the assets of the Bank.

The Directors accept responsibility for the preparation and fair presentation of Financial Statements that are free from material misstatements whether due to fraud or error. They also accept responsibility for:

(i) Designing, implementing and maintaining internal control necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;

(ii) Selecting and applying appropriate accounting policies; and

(iii) Making accounting estimates and judgments that are reasonable in the circumstances.

The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial position of the Bank as at 30th June 2018 and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the *Central Bank of Kenya Act*.

This financial statements were prepared on a going concern basis, taking cognizance of certain unique aspects relating to the bank's ability to create, distribute and destroy local currency, its role as a lender of last resort, its responsibilities in the areas of price and financial stability, and its relationship with the Kenyan government concerning foreign exchange transactions.

Approved by the Board of Directors and signed on its behalf by:

Chairman, Board of Directors
Mr. Mohammed Nyaoga

4 September 2018

Patrick Njoroge

Governor
Dr. Patrick Njoroge

4 September 2018

REPUBLIC OF KENYA

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NAIROBI

HARAMBEE

OFFICE OF THE AUDITOR-GENERAL

REPORT OF THE AUDITOR-GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30TH JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Central Bank of Kenya set out on pages 13 to 55, which comprise the consolidated statement of financial position as at 30 June 2018, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Delloitte and Touche, auditors appointed under Section 23 of the Public Audit Act, 2015 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Central Bank of Kenya as at 30 June 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRSs) and comply with the Central Bank of Kenya Act, Cap.491 of the Laws of Kenya.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). My responsibilities under those standards are further described in the Auditor-General's Responsibilities for the audit of financial statements section of my report. I am independent of the Bank in accordance with the International Ethics Standard Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), together with other ethical requirements that are relevant to the audit of financial statements in Kenya. I have fulfilled other ethical responsibilities in accordance with these requirements, and IESB Code. I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, are of most significance in the audit of the financial statements. There were no Key Audit Matters to report in the year under review.

Other Matters

1. Board Members

The Central Bank Act Cap 491 of 2014, Part IV - Management, Section 11(1) (d) provides that there shall be eight (8) other non-executive directors of the Board. During the year under review, the Bank had in place five (5) non-executive directors transacting business on behalf of the bank.

2. Deputy Governors

The Central bank of Kenya Act Cap 491 Section 13B (1) states that "There shall be two Deputy Governors who shall be appointed by the President through a transparent and competitive process and with the approval of Parliament". During the year under review, only one Deputy Governor was in place.

Report on Compliance with Lawfulness and Effectiveness

As required by Article 229(6) of the Constitution, I confirm that, nothing has come to my attention to cause me believe that public money has not been applied lawfully and in an effective way.

Report on Effectiveness of Internal Controls

As required by section 7(1) (a) of the Public Audit Act, 2015, I confirm that nothing has come to my attention to cause me to believe that internal controls were not operating in an effective way.

Other Information

The Directors are responsible for the other information, which comprises the statement of corporate governance, directors' report and the statement of Directors' responsibilities. The other information does not include the financial statements and my auditor's report thereon.

My opinion on the consolidated financial statements does not cover the other information and I do not express any form of assurance or conclusion thereon.

In connection with the audit of the consolidated financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or the knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work performed on the other information that was obtained prior to the date of the audit report, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

FINANCIAL PERFORMANCE

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs), and for such internal control as management determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the applicable basis of accounting unless the management either intends to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 Of the Public Audit Act, 2015.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor-General's Responsibilities for the Audit of the Financial Statements

The audit objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229 of the Constitution of Kenya. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when they exist. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISSAIs, the auditor exercises professional judgement and maintains professional skepticism throughout the audit. The auditor also:

- Identifies and assesses the risk of material misstatement of the consolidated financial statements, whether due to fraud or error, designs and performs audit procedures responsive to those risks, and obtains audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting material misstatements resulting from fraud is higher than one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentation, or the override of internal control;

- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control;

FINANCIAL PERFORMANCE

- Evaluates the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors;

- Concludes on the appropriateness of the Directors use of the going concern basis of accounting and, based on the audit evidence obtained, concludes whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify the opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern;

- Evaluates the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;

- Obtains sufficient appropriate audit evidence regarding the consolidated financial information of the entity or business activities within the Bank to express an opinion on the consolidated financial statements. The auditor is responsible for the direction, supervision and performance of the audit. I remain responsible for the audit opinion;

- Communicates with directors among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

FCPA Edward R. O. Ouko, CBS
<u>AUDITOR-GENERAL</u>

Nairobi

26 September 2018

FINANCIAL PERFORMANCE

Consolidated Statement of Comprehensive Income

	Notes	Year ended 30 June 2018 Shs' million	2017 Shs' million
Interest income	4	20,097	14,441
Interest expense	5	(881)	(1,718)
Net interest income		19,216	12,723
Increase/(decrease)/ in loan impairment	15	(35)	24
Net interest income		19,181	12,747
Fees and commission income	2(s)	3,000	3,000
Net trading income	6	4,245	4,193
Other income	7	646	1,114
Operating income		27,072	21,054
Operating expenses	8	(10,971)	(11,137)
Operating surplus before unrealised (losses)/gains		16,101	9,917
Unrealized gains and losses:			
Foreign exchange (loss)/gain		(18,690)	8,516
Fair value loss on financial assets held for trading		(2,073)	(871)
(Deficit)/surplus for the year		(4,662)	17,562
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss:			
Actuarial loss in retirement benefit asset	17	(2,629)	(512)
Land and building valuation gain	18	3,011	-
Total comprehensive (loss)/ Income for the year		(4,280)	17,050

The notes on pages 93 to 130 are an integral part of these financial statements.

FINANCIAL PERFORMANCE

Consolidated Statement of Financial Position

	Notes	30 June 2018 Shs' million	30 June 2017 Shs' million
Assets			
Balances due from banking institutions	10	522,987	735,548
Funds held with International Monetary Fund (IMF)	13(a)	2,012	1,877
Securities & advances to banks	14	38,503	34,870
Loans and advances	15	2,585	2,575
Financial assets at fair value through profit or loss	11	400,404	134,777
Investments securities – Available-for-sale	12	9	9
Other assets	16	3,302	10,568
Property and equipment	18	27,153	22,703
Intangible assets	19	165	52
Retirement benefit asset	17	6,584	8,197
Due from Government of Kenya	20	80,188	24,449
Total assets		1,083,892	975,623
Liabilities			
Currency in circulation	21	262,439	253,787
Deposits from banks and government	22	584,287	470,109
Due to International Monetary Fund (IMF)	13(b)	100,284	115,125
Other liabilities	23	7,119	2,559
Total liabilities		954,129	841,580
Equity and reserves			
Share capital	24(a)	5,000	5,000
General reserve fund	24(b)	106,162	114,253
Revaluation reserve	24(c)	17,801	14,790
Consolidated fund	24(d)	800	-
Total equity		129,763	134,043
Total equity and liabilities		1,083,892	975,623

The financial statements on pages 88 to 130 were authorised for issue by the Board of Directors on 4 September 2018 and signed on its behalf by:

Chairman of the Board
Mr. Mohammed Nyaoga

Patrick Njoroge

Governor
Dr. Patrick Njoroge

FINANCIAL PERFORMANCE

Consolidated Statement of Changes in Equity

	Notes	Share Capital Shs' million	General Reserve Fund Shs' million	Revaluation reserve Shs' million	Total Shs' million
Year ended 30 June 2017					
Balance at 1 July 2016		5,000	97,203	14,790	116,993
Surplus for the year		-	17,562	-	17,562
Actuarial loss in retirement benefit asset	17	-	(512)	-	(512)
Total comprehensive Income for the year		-	17,050	-	17,050
Balance at 30 June 2017		**5,000**	**114,253**	**14,790**	**134,043**

The notes on pages 93 to 130 are an integral part of these financial statements.

FINANCIAL PERFORMANCE

Consolidated Statement of Changes in Equity (continued)

	Notes	Share Capital Shs' million	General Reserve Fund Shs' million	Revaluation reserve Shs' million	Consolidated fund Shs' million	Total Shs' million
Year ended 30 June 2018						
Balance at 1 July 2017		5,000	114,253	14,790	-	134,043
Deficit for the year		-	(4,662)	-	-	(4,662)
Actuarial loss on retirement benefit Asset	17	-	(2,629)	-	-	(2,629)
Land and Building valuation gain	18	-	-	3,011	-	3,011
Total comprehensive (loss)/income for the year		-	(7,291)	3,011	-	(4,280)
Transactions with owners recorded directly in equity						
Transfer to consolidated fund	24(d)	-	(800)	-	800	-
Balance at 30 June 2018		**5,000**	**106,162**	**17,801**	**800**	**129,763**

The notes on pages 93 to 130 are an integral part of these financial statements.

FINANCIAL PERFORMANCE

Consolidated Statement of Cash Flow

	Notes	Year ended 30 June 2018 Shs’ million	2017 Shs’ million
Net cash generated from operating activities	25	74,117	39,820
Cash flow from investing activities			
Purchase of property and equipment	18	(2,314)	(1,273)
Purchase of intangible assets	19	(136)	(24)
Proceeds from disposal of property and equipment		8	3
Net (purchase)/sale of financial assets			
- Fair value through profit or loss		(242,204)	(10,464)
- Held to maturity		176,751	150,515
- Securities & advances to Banks		1,686	(8,508)
- Funds held with International Monetary Fund (IMF)		(135)	46
Net cash (used in)/generated from investing activities		(66,344)	130,295
Cash flows from financing activities			
Repayments to the International Monetary Fund (IMF)		(14,841)	(7,313)
Net cash used in financing activities		(14,841)	(7,313)
(Decrease)/increase in cash and cash equivalents		(7,068)	162,802
Cash and cash equivalents at start of year		584,395	421,593
Cash and cash equivalents at end of year	26	577,327	584,395

The notes on pages 93 to 130 are an integral part of these financial statements.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

1 General information

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

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these Financial Statements are set below. These policies have been consistently applied to all years presented, unless otherwise stat

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Repor Standards (IFRS)[1]. The measurement basis applied is the historical cost basis, except wh otherwise stated in the accounting policies below. The financial statements are presented in Ke Shillings (KShs), rounded to the nearest million.

Changes in accounting policy and disclosures

(b) Adoption of new and revised International Financial Reporting Standards (IFRSs) International Financial Reporting Interpretations Committee (IFRIC)

i) Relevant new standards and amendments to published standards effective for the y ended 30 June 2018

The following new and revised IFRSs were effective in the current year and had no materia impact on the amounts reported in these financial statements.

Annual Improvements to IFRSs 2014-2016 Cycle

The Bank has applied the amendments to IFRS 12 included in the Annual Improvements to IFRSs 2014-2016 Cycle for the first time in the current year. The other amendments included in this package are not yet mandatorily effective and they have not been early adopted by the Bank.

IFRS 12 states that an entity need not provide summarised financial information for interests in subsidiaries, associates or joint ventures that are classified (or included in a disposal Bank that is classified) as held for sale. The amendments clarify that this is the only concession from the disclosure requirements of IFRS 12 for such interests.
The application of these amendments has had no effect on the Bank's consolidated financial statements as none of the Bank's interests in these entities are classified, or included in a disposal Bank that is classified, as held for sale.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(b) Adoption of new and revised International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) (Continued)

ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 30 June 2018.

New and Amendments to standards	*Effective for annual periods beginning on or after*
IFRS 16 Leases	1 January 2019
IFRS 9 Financial Instruments	1 January 2018
IFRS 15 Revenue from contracts with customers	1 January 2018
Amendments to IAS 7 Disclosure Initiative	1 January 2018
IFRIC 22 Foreign Currency Transactions and Advance Consideration	1 January 2018, with earlier application permitted
Annual Improvements to IFRS Standards 2014-2016 Cycle	Effective for annual periods beginning on or after 1 January 2018

iii) Relevant new and revised IFRSs in issue but not yet effective for the year ended 30 June 2018

IFRS 16 Leases

IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

The directors of the Bank anticipate that the application of IFRS 16 in the future may have a significant impact on amounts reported in respect of the Bank's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until a detailed review has been completed by the Bank.

IFRS 9, Financial Instruments

On 29 July 2014, the IASB issued the final IFRS 9 Financial Instruments Standard, which brings together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement.

The standard is effective for annual period beginning on or after 1 January 2018 with retrospective application permitted if, and only if, it is possible without the use of hindsight. The bank will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement including impairment changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will be recognised in retained earnings and reserves as at 1 January 2018.

The new classification and measurement and impairment requirements will be applied by adjusting our Balance Sheet on 1 January 2018, the date of initial application, with no restatement of comparative period financial information. The Directors of the Bank are assessing the impact of the application of IFRS 9. It is not practical to provide a reasonable estimate of this effect until a detailed review has been completed.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(b) Adoption of new and revised International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) (Continued)

iii) Relevant new and revised IFRSs in issue but not yet effective for the year ended 30 June 2018 (Continued)

IFRS 9, Financial Instruments *(Continued)*

Classification and measurement

IFRS 9 introduces a principles-based approach to the classification of financial assets. Debt instruments, including hybrid contracts, are measured at fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) or amortized cost based on the nature of the cash flows of the assets and an entity's business model. These categories replace the existing IAS 39 classifications of FVTPL, available for sale (AFS), loans and receivables, and held-to-maturity. Equity instruments are measured at FVTPL, unless they are not held for trading purposes, in which case an irrevocable election can be made on initial recognition to measure them at FVOCI with no subsequent reclassification to profit or loss.

For financial liabilities, most of the pre-existing requirements for classification and measurement previously included in IAS 39 were carried forward unchanged into IFRS 9 other than the provisions relating to the recognition of changes in own credit risk for financial liabilities designated at fair value through profit or loss, as permitted by IFRS 9.

Impairment

Impairment Overall Comparison of the New Impairment Model and the Current Model

IFRS 9 introduces a new, single impairment model for financial assets that requires the recognition of expected credit losses (ECL) rather than incurred losses as applied under the current standard. Currently, impairment losses are recognized if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after initial recognition of the asset and that loss event has a detrimental impact on the estimated future cash flows of the asset that can be reliably estimated. If there is no objective evidence of impairment for an individual financial asset, that financial asset is included in a Bank of assets with similar credit risk characteristics and collectively assessed for impairment losses incurred but not yet identified. Under IFRS 9, ECLs will be recognized in profit or loss before a loss event has occurred, which could result in earlier recognition of credit losses compared to the current model.

Under the current standard, incurred losses are measured by incorporating reasonable and supportable information about past events and current conditions. Under IFRS 9, the ECL model, which is forward-looking, in addition requires that forecasts of future events and economic conditions be used when determining significant increases in credit risk and when measuring expected losses. Forward-looking macroeconomic factors such as unemployment rates, inflation rates, interest rates, exchange rates, domestic borrowing, credit to private sector and gross domestic product will be incorporated into the risk parameters. Estimating forward-looking information will require significant judgment and must be consistent with the forward-looking information used by the Bank for other purposes, such as forecasting and budgeting.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(b) Adoption of new and revised International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) (Continued)

iii) Relevant new and revised IFRSs in issue but not yet effective for the year ended 30 June 2018 (Continued)

Scope

Under IFRS 9, the same impairment model is applied to all financial assets, except for financial assets classified or designated as at FVTPL and equity securities designated as at FVOCI, which are not subject to impairment assessment. The scope of the IFRS 9 expected credit loss impairment model includes amortized cost financial assets, debt securities classified as at FVOCI, and off balance sheet loan commitments and financial guarantees which were previously provided for under IAS 37 Provisions, Contingent Liabilities and Contingent Assets (IAS 37). The above-mentioned reclassifications into or out of these categories under IFRS 9 and items that previously fell under the IAS 37 framework were considered in determining the scope of our application of the new expected credit loss impairment model.

Measurement of Expected Credit Losses

ECLs are measured as the probability-weighted present value of expected cash shortfalls over the remaining expected life of the financial instrument.

The measurement of ECLs will be based primarily on the product of the instrument's probability of default (PD), loss given default (LGD), and exposure at default (EAD).

The ECL model contains a three-stage approach that is based on the change in the credit quality of assets since initial recognition.

- Stage 1 - If, at the reporting date, the credit risk of non-impaired financial instruments has not increased significantly since initial recognition, these financial instruments are classified in Stage 1, and a loss allowance that is measured, at each reporting date, at an amount equal to 12-month expected credit losses is recorded.
- Stage 2 - When there is a significant increase in credit risk since initial recognition, these non-impaired financial instruments are migrated to Stage 2, and a loss allowance that is measured, at each reporting date, at an amount equal to lifetime expected credit losses is recorded. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the ECL model requires reverting to recognition of 12-month expected credit losses based on the Central Bank of Kenya and banks policy on curing of loans.
- When one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred, the financial asset is considered credit-impaired and is migrated to Stage 3, and an allowance equal to lifetime expected losses continues to be recorded or the financial asset is written off.

Interest income is calculated on the gross carrying amount of the financial assets in Stages 1 and 2 and on the net carrying amount of the financial assets in Stage 3.

Definition of Default

IFRS 9 does not define default but requires the definition to be consistent with the definition used for internal credit risk management purposes. However, IFRS 9 contains a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due. Under IFRS 9, the Bank will consider a financial asset as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred or when contractual payments are 90 days past due. The Bank's write-off policy under IAS 39 is not expected to be materially different under IFRS 9.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(b) Adoption of new and revised International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) (Continued)

iii) Relevant new and revised IFRSs in issue but not yet effective for the year ended 30 June 2018 (Continued)

Hedge Accounting

IFRS 9 introduces a new general hedge accounting model that better aligns hedge accounting with risk management activities. However, the current hedge accounting requirements under IAS 39 may continue to be applied until the IASB finalizes its macro hedge accounting project. The IFRS 9 Hedge accounting requirements will not have any significant impact on the bank as the bank does not apply hedge accounting.

The bank has estimated that on adoption of IFRS 9 on 1 January 2018, the impact of the increase in loss allowance will be approximately Kshs 1,655 million.

The directors plan to implement the new standard on 1 January 2018.

IFRS 15, Revenue from Contracts with Customers

In May 2015, IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Specifically, the Standard introduces a 5-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when ‘control’ of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

Amendments to IAS 7 Disclosure Initiative

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities including both changes arising from cash flows and non-cash changes. The amendments do not prescribe a specific format to disclose financing activities. However, an entity may fulfil the disclosure objective by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.

The amendments apply prospectively for annual periods beginning on or after 1 January 2018 with early application permitted. The directors of the Bank do not anticipate that the application of these amendments will have a material impact on the Bank’s consolidated financial statements.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(b) Adoption of new and revised International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) (Continued)

iii) Relevant new and revised IFRSs in issue but not yet effective for the year ended 30 June 2018 (Continued)

IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the ‘date of transaction’ for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The Interpretation specifies that the date of transaction is the date on which the entity initially recognises the non-monetary asset or non- monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration.

The Interpretation is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Directors of the Comapny do not anticipate that the application of these amendments will have a material impact on the financial statements. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

Annual Improvements to IFRSs 2014 – 2016 Cycle

The Annual Improvements to IFRSs 2014 – 2016 Cycle include a number of amendments to various IFRSs, which are summarised below:

The amendments to IFRS 1 deletes certain short-term exemptions because the reporting period to which the exemptions applied have already passed. As such, these exemptions are no longer applicable. The Directors of the Bank do not anticipate that the application of these amendments will have any impact on the financial statements.

The amendments to IAS 28 clarify that the option for a venture capital organisation and other similar entities to measure investments in associates and joint ventures at FVTPL is available separately for each associate or joint venture, and that election should be made at initial recognition of the associate or joint venture.

In respect of the option for an entity that is not an investment entity (IE) to retain the fair value measurement applied by its associates and joint ventures that are IEs when applying the equity method, the amendments make a similar clarification that this choice is available for each IE associate or IE joint venture.

The amendments apply retrospectively with earlier application permitted. The Directors of the Bank do not anticipate that the application of these amendments will have a material impact on the financial statements. The Directors do not intend to early apply the standard and intend to use the full retrospective method upon adoption.

iv) Early adoption of standards

The Bank did not early-adopt any new or amended standards in the period.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(c) Accounting for currency expenses

The cost of unissued bank note stocks is recognised in the statement of financial position as deferred currency costs under 'other assets'. Bank note costs are charged to profit or loss in the year in which the bank notes are issued.

Coin minting costs are charged to profit or loss when issued to the public. The cost of new currency coins not yet issued is recognised as inventory within 'other assets' consistent with the accounting for the cost of unissued bank note stocks.

(d) Consolidation

Kenya School of Monetary Studies is wholly owned by the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

The group uses the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

The excess of the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Bank's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between group entities are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

(e) Functional currency and translation of foreign currencies

i. Functional and presentation currency

Items included in the financial are measured using the currency of the primary economic environment in which the Bank operates (the “Functional Currency”). The financial statements are presented in Kenya Shillings (“Shs”) which is the Bank's Functional Currency.

ii. Transactions and balances

Foreign currency transactions are translated into the Functional Currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/(losses)'.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(f) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in investments by banks.

Securities purchased under agreements to resell ('reverse repos') are recorded as advances to banks. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

The Bank from time to time mops up money from the financial market ('repos') or injects money into the market ('reverse repos') with maturities of 4 – 7 days. The Bank engages in these transactions with commercial banks only. These have been disclosed in the financial statements as 'advances to banks' and 'investments by banks'.

(g) Financial assets and liabilities

i. Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale financial assets. The directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consist of debt host and embedded derivatives that must be separated.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as Fair value loss on financial assets held for trading '. Interest income and expense and dividend income and expenses on financial assets held for trading are included in interest income' and 'interest expense' respectively.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(f) Financial assets and liabilities

i. Financial assets and liabilities (Continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

The Bank operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The loans are granted to staff at an interest rate of 3% per annum which generally below the prevailing market interest rates. Loans issued at non market rates are initially measured at fair value (by discounting the related cash flows using market rates of interest) and subsequently carried at amortised cost. The difference between the fair value of the loans and the carrying amount at inception is treated as a long term employee benefit and is accounted for as a deferred cost. The resulting loan adjustment account is released to interest income over the loan period in line with the unwinding of the discount, while the deferred cost is expensed to staff costs as the services are rendered to the Bank over the period of the loan.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.

Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value re-measurements are included in other comprehensive income.

ii. Financial liabilities

The Bank's holding in financial liabilities represents mainly deposits from banks and government and other liabilities. Such financial liabilities are initially recognised at fair value and subsequently measured at amortised cost.

Cash Reserve Ratio are statutory deposits taken from commercial banks and non-bank financial institutions for liquidity management as part of monetary policies in accordance with the Kenyan Banking Act and are interest free.

iii. Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial instruments is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(f) Financial assets and liabilities

iii. Determination of fair value (Continued)

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

iv. De-recognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent de-recognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

v. Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2018	2017
				Shs' million	Shs' million
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank Reserve Asset Management Programme (RAMP) financial assets	30,600	31,789
			Fixed income securities	369,733	102,915
		Designated at initial recognition	Gold holdings	71	73
	Loans and receivables	Advances to banks		38,503	34,870
		Funds with IMF		2,012	1,877
		Net advances to staff and banks under liquidation		2,585	2,575
		Other assets (classified as financial assets)		5,897	12,536
		Due from Government	Government loan	23,339	24,449
			Overdraft facility to Government	56,849	-
		Balances due from banking institutions	Foreign denominated Term deposits	522,987	735,548
	Available-for-sale	Investment securities	SWIFT shares	9	9
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Cash reserve ratio and current account deposits	217,357	209,792
		Due to IMF		100,284	115,125
		Other liabilities		7,119	2,559
		Deposits from Government institutions		366,930	253,787

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(f) Financial assets and liabilities

vi. Impairment of financial assets

a. Loans and receivables

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss on loans carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount, and for a collateralised loan, after taking into account any value of the security which has been realised.

b. Available for sale financial assets

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

If any such evidence exists for available-for-sale financial assets, impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

v. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(h) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

(i) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Bank is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Land and buildings are stated at valuation less accumulated depreciation. Valuations are carried out every three years.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is de-recognised. All other repair and maintenance costs are charged to profit or loss during the financial period in which they are incurred.
Freehold land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(i) Property and equipment (Continued)

Asset classification	Useful life	Depreciation rate
Leasehold land	Over the period of the lease	
Buildings	20 years	5%
Motor vehicles	4 years	20%
Furniture and equipment	5 - 10 years	10-20%

No depreciation is charged on work in progress and assets held in clearing accounts. Depreciation of property and equipment is made from date of placement to use and it ceases when the asset is obsolete, classified as held for sale, fully depreciated or derecognized as per policy.

(j) Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

(i.) It is technically feasible to complete the software product so that it will be available for use;
(ii.) Management intends to complete the software product and use or sell it;

- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and

(iii.) The expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years. Computer software under installation and not yet place in use is held in software clearing account and not amortized until commissioned.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

(k) Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (Continued)

(l) Employee benefits

The Bank operates a defined benefit and defined contribution pension schemes. The schemes are funded through payments to trustee-administered funds on a monthly basis.

On the defined contribution scheme, the Bank pays fixed contributions to the scheme. The payments are charged to the profit or loss in the year to which they relate. The Bank has no further payment obligation once the contributions have been paid.

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on age, years of service and compensation.

The assets of the scheme are held by the Bank in an independent trustee administered fund. The asset recognised in the statement of financial position in respect of the defined benefit pension scheme is the fair value of the scheme's assets less the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of Kenya treasury bonds that have terms to maturity approximating to the terms of the related pension liability.

The asset recognised in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The Bank and all its employees contribute to the National Social Security Fund, which is a defined contribution scheme.

A defined contribution plan is a retirement benefit plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank's contributions to the defined contribution scheme are charged to the profit or loss account in the year in which they fall due.

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

(m) Income tax

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.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(n) Provisions

Provisions are recognised when: The Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation at a rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(o) Surplus funds

The *Central Bank of Kenya Act (Cap 491)* allows the Bank to retain at least 10% or any other amounts as the board, in consultation with the minister, may determine, off the net annual profit (surplus) of the bank after allowing for the expenses of operations and after provision has been made for bad and doubtful debts, depreciation in assets, contributions to staff benefit funds, and such other contingencies and accounting provisions as the Bank deems appropriate.

(p) Share capital

Ordinary shares are classified as 'share capital' in equity.

(q) Leases

Bank as lessee

The leases entered into by the Bank are primarily operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Bank as lessor

The group leases certain property, plant and equipment where it does not transfer substantially all the risks and benefits of ownership of the assets. The operating leases generate rental income which is recorded in the income statement on a straight-line basis over the period of the lease.

(r) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(s) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided.

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

(t) Commitments on behalf of the Kenya Government and National Treasury

The Bank issues Treasury bills and bonds on behalf of the National Treasury. Commitments arising on such transactions on behalf of Kenya Government and the National Treasury are not included in these financial statements as the Bank is involved in such transactions only as agent.

(u) Currency in circulation

Notes and coins in circulation are measured at fair value. Currency in circulation represents the nominal value of all bank notes and coins held by the public and commercial banks.

(v) Inventories

The Bank's inventory is comprised of new currency notes issued. Inventories are stated at the sum of the production costs. Cost is determined using the first-in, first-out (FIFO) method.

Bank notes printing expenses and coin minting costs for each denomination which include ordering, printing, minting, 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. The deferred amount is recognised as prepayment and represents un-issued bank notes and coins stock.

(w) Loan due from the Government of Kenya

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 Shs 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 amortised cost.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(x) Funds held at/ 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.

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

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and en cashable 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.

(y) Comparatives

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

3 Critical accounting estimates and judgements in applying accounting policies

(i) Critical estimates in applying the entity's accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a. *Post-retirement benefits*

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 17 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

b. *Loans and advances*

Critical estimates are made by the management in determining the recoverable amount of impaired loans and receivables.

c. *Fair value of financial assets*

The fair value of financial instruments that are not traded in an active market and off market loans are determined by using valuation techniques.

d. *Property and equipment*

Land and buildings are carried at fair value; representing open market value determined periodically by internal professional valuers.

(ii) Critical judgements in applying the entity's accounting policies

In the process of applying the Bank's accounting policies, management has made judgements in determining:

- the classification of financial assets and leases
- whether assets are impaired.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

4 Interest income

	2018 Shs’ million	2017 Shs’ million
Financial assets - held to maturity	8,284	7,070
Loans and advances	7,875	6,040
Financial assets at fair value through profit or loss	3,938	1,331
	20,097	14,441

Interest income from loans and advances comprises:

Due from Government of Kenya – loan	725	759
Due from Government of Kenya - overdraft	2,494	1,270
Staff loans and advances	191	150
Advances to banks	3,055	3,411
Local commercial banks overnight loans	-	8
Other interest income	1,410	442
	7,875	6,040

5 Interest expense

Interest on monetary policy issues – investments by banks	452	1,445
Interest paid to IMF	429	273
	881	1,718

6 Net trading income

Net gain on sale of foreign exchange currencies	4,547	4,298
Net loss on held for trading financial assets	(302)	(105)
	4,245	4,193

7 Other income

Licence fees from commercial banks and foreign exchange bureau	271	292
Penalties from commercial banks and foreign exchange bureau	21	30
Rent income from Thomas De La Rue Kenya Limited	2	2
Kenya School of Monetary Studies operating income - hospitality services and tuition fee	330	379
Gain on disposal of property and equipment	6	1
Miscellaneous income	16	410
	646	1,114

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

8 Operating expenses

	2018 Shs’ million	2017 Shs’ million
Employee benefits (Note 9)	3,429	3,468
Currency production expenses	2,028	2,352
Property maintenance and utility expenses	1,361	1,135
Depreciation (Note 18)	873	1,016
Amortisation (Note 19)	23	116
Provision for impairment loss on other assets (Note 16)	15	18
Auditor's remuneration	11	10
Transport and travelling	146	168
Office expenses	274	313
Postal service expense	190	165
Legal and professional fees	437	374
Other administrative expenses including KSMS	2,184	2,002
	10,971	11,137

9 Employee benefits

	2018	2017
Wages and salaries	3,769	3,663
Medical expenses	285	286
Other staff costs	223	300
Directors’ emoluments (Note 27(ii))	69	51
Net income relating to the retirement benefit asset (Note 17)	(917)	(832)
	3,429	3,468

10 Balances due from banking institutions

	2018	2017
Current accounts	29,877	25,184
Foreign currency denominated term deposits(cash & cash equivalents)	450,641	489,877
Accrued interest on term deposits	1,148	1,561
Special project accounts	17,328	21,180
Domestic foreign currency cheque clearing	23,831	20,827
Repos clearing and regional central banks	162	168
Cash and cash equivalents (note 26)	522,987	558,797
Foreign currency denominated term deposits (Long term)	-	176,751
	522,987	735,548

Special project accounts relate to amounts received by the Government of Kenya (or its ministries) for specific projects or purposes. An equal and corresponding liability is recorded and disclosed under “Deposits from banks and government (note 22)”. The movement in the year is mainly attributable to the proceeds from sponsors of various government projects. This has corresponding effect on the growth of foreign reserves during the year.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

11 Financial assets at fair value through profit or loss

	2018 Shs' million	2017 Shs' million
a. Designated at initial recognition		
Gold holdings	71	73

Movements in gold holdings are due to mark to market movements.

	2018 Shs' million	2017 Shs' million
b. Held for trading		
Fixed income securities	369,733	102,915
Fixed income securities under World Bank RAMP	30,600	31,789
	400,333	134,704
	400,404	134,777

12 Investments securities – Available-for-sale

	2018 Shs' million	2017 Shs' million
Unlisted equity securities	9	9
At start of year	9	9
Additions	-	-
At end of year	9	9

"Unlisted equity securities" relate to the Bank's investment in shares of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) which member is owned co-operative with its headquarters in Belgium. The Bank held 24 (2017: 24) SWIFT shares at 30 June 2018.

13 Funds held at/ due to International Monetary Fund (IMF)

	2018 SDR million	2018 Shs' million	2017 SDR million	2017 Shs' million
(a) Assets				
IMF balances (SDR asset account)	15	2,012	13	1,877
(b) Liabilities				
International Monetary Fund Account No. 1	20	2,841	20	2,786
International Monetary Fund Account No. 2	-	13	-	12
International Monetary Fund – PRGF Account	427	60,605	520	74,916
IMF - SDR Allocation account	260	36,825	260	37,411
	707	100,284	800	115,125

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

13 Funds held at/ due to International Monetary Fund (IMF) (Continued)

The National Treasury is the Government of Kenya's Fiscal Agent. Commitments arising on transactions between IMF, Kenya Government and the National Treasury are not included in these financial statements as the Bank is not the Government's fiscal agent.

Kenya's quota in IMF of SDR 542.8 million (2017: SDR 271.4 million) are not included in the financial statements of the Bank as these are booked in the National Treasury with the Government of Kenya's Fiscal Agent and allocations of SDR 260 million (2017: 260 million) are included in the financial statements of the Bank as custodian.

14 Securities and advances to banks

	2018 Shs' million	2017 Shs' million
Treasury bonds discounted	9,470	10,918
Treasury bills discounted	28	36
Accrued interest bonds discounted	277	316
Repo treasury bills(Injection)	19,400	14,641
Accrued interest repo	43	22
Liquidity support framework	7,765	7,530
Due from Commercial banks	1,520	1,407
	38,503	34,870

As at 30 June 2018

Advances to banks analysis	1-3 months Shs' million	Maturity period 3-12 months Shs' million	Over 1 year Shs' million	Total Shs' million
Treasury bills discounted	15	6	7	28
Treasury bonds discounted	176	941	8,353	9,470
Accrued interest bonds discounted	-	277	-	277
Repo treasury bills & bonds (Injection)	19,400	-	-	19,400
Accrued interest repo	43	-	-	43
Due from commercial banks	1,520	-	-	1,520
Liquidity support framework	7,765	-		7,765
	28,919	**1,224**	**8,360**	**38,503**

At 30 June 2017

Treasury bills discounted	-	36	-	36
Treasury bonds discounted	-	1,560	9,358	10,918
Accrued interest bonds discounted	-	316	-	316
Repo treasury bills & bonds (Injection)	14,641	-	-	14,641
Accrued interest repo	22	-	-	22
Due from commercial banks	1,407	-	-	1,407
Liquidity support framework	7,530	-	-	7,530
	23,600	**1,912**	**9,358**	**34,870**

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

15 Loans and advances

	2018 Shs' million	2017 Shs' million
Due from banks under liquidation	3,400	3,400
Advances to employees	2,688	2,643
	6,088	6,043
Allowance for impairment	(3,503)	(3,468)
Net advances	2,585	2,575
Movement in the loan impairment allowance is as follows:		
At start of year	3,468	3,747
Increase/(decrease) in impairment allowance	35	(24)
Recoveries collected in the year	-	(255)
At end of year	3,503	3,468

16 Other assets

	2018 Shs' million	2017 Shs' million
Prepayments	12	319
Impersonal accounts	-	6,598
Deferred currency expenses	1,799	2,401
Sundry debtors-including KSMS debtors	5,897	5,938
Items in the course of collection	498	181
Uncleared effects	25	43
	8,231	15,480
Provision for impairment	(4,929)	(4,914)
	3,302	10,566

All other assets balances are recoverable within one year.

	2018 Shs' million	2017 Shs' million
Movement in the impairment allowance is as follows:		
At start of year	4,914	4,896
Increase in impairment allowance	15	18
At end of year	4,929	4,914

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

17 Retirement benefit asset

	2018 Shs' million	2017 Shs' million
Present value of funded obligations	14,551	13,440
Fair value of plan assets	(30,279)	(28,464)
Net overfunding in funded plan	(15,728)	(15,024)
Limit on defined benefit asset	9,144	6,827
Asset in the statement of financial position	(6,584)	(8,197)

Movements in the net defined benefit asset recognised are as follows:

	2018	2017
At start of year	8,197	7,776
Net income recognised in the income statement	917	832
Net expense recognized in other comprehensive income (OCI)	(2,629)	(512)
Employer contributions	99	101
At end of year	6,584	8,197

Movements in the plan assets are as follows:

	2018	2017
At start of year	28,464	27,161
Expected return on scheme assets	3,886	3,544
Actuarial (loss)/gain	-	-
Employer contributions	99	101
Employee contributions	50	51
Benefits expenses paid	(1,165)	(983)
Adjustment for previous year values	(1,055)	(1,410)
At end of year	30,279	28,464

Movements in the plan benefit obligation are as follows:

	2018	2017
At start of year	13,440	17,623
Current service cost net of employees' contributions	215	193
Interest cost	1,805	2,286
Employee contributions	50	50
Actuarial loss due to experience	(559)	(3,078)
Actuarial loss due to change in assumptions	765	(2,651)
Benefits paid	(1,165)	(983)
At end of year	14,551	13,440

The principal actuarial assumptions at the reporting date were:	2018	2017
Discount rate (p.a.)	13.3%	13.9%
Salary increase (p.a.)	7.0%	7.0%
Expected return on plan assets (p.a.)	-	12.9%
Future pension increases	3.0%	3.0%

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

17 Retirement benefit asset (Continued)

Five year summary	2018 Shs' million	2017 Shs' million	2016 Shs' million	2015 Shs' million	2014 Shs' million
Fair value of plan assets	30,279	28,464	27,161	27,156	24,665
Present value of funded obligations	(14,551)	(13,440)	(17,623)	(17,820)	(17,006)
Adjustment to retirement benefit	(9,144)	(6,827)	(1,762)	(4,668)	-
Net retirement benefit asset	6,584	8,197	7,776	4,668	7,659

Plan assets are distributed as follows:

	2018 Shs' million	2018 %	2017 Shs' million	2017 %
Quoted shares	8,529	28.2%	7,977	28%
Investment properties	6,552	21.6%	6,336	22.3%
Government of Kenya treasury bills and bonds	11,488	37.9%	9,963	35.0%
Commercial paper and corporate bonds	1,226	4.1%	1,608	5.6%
Offshore investments	1,100	3.6%	208	0.7%
Fixed and term deposits	748	2.5%	2,055	7.2%
Net current assets	634	2.1%	317	1.1%
Fixed assets	2	0%	-	-
	30,279	100%	28,464	100%

Sensitivity of principal actuarial assumptions:

If the discount rate is 1% higher (lower), the present value of funded obligations would decrease by Shs 15,955 million (increase by Shs 1,438 million). This sensitivity analysis has been determined based on reasonably possible changes of the assumption occurring at the end of 30 June 2018, while holding all other assumptions constant.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

18 Property and equipment

	Freehold land and Buildings Shs' million	Leasehold land and buildings Shs' million	Work in progress Shs' million	Motor vehicles Shs' million	Furniture and equipment Shs' million	Total Shs' million
Year ended 30 June 2017						
Opening net amount	12,070	2,157	6,331	57	1,770	22,385
Additions	-	-	1,044	-	229	1,273
Transfer	-	-	(86)	-	86	-
Reclassification-cost	-	-	-	-	64	64
Reclassification-depreciation	-	-	-	-	(1)	(1)
Disposals-NBV	-	-	-	-	(2)	(2)
Charge for the year	(480)	(50)	-	(18)	(468)	(1,016)
At end of year	11,590	2,107	7,289	39	1,678	22,703
At 30 June 2017						
Cost of valuation	12,492	2,203	7,289	388	4,794	27,166
Accumulated depreciation	(902)	(96)	-	(349)	(3,116)	(4,463)
Net book amount	11,590	2,107	7,289	39	1,678	22,703
Year ended 30 June 2018						
Opening net amount	11,590	2,107	7,289	39	1,678	22,703
Additions	-	-	1,175	116	1,023	2,314
Revaluation	1,073	1,938	-	-	-	3,011
Capitalization of WIP	-	-	(237)	-	237	0
Disposals-NBV	-	-	-	(1)	(1)	(2)
Charge for the year	(389)	(54)	-	(44)	(386)	(873)
At end of year	12,274	3,991	8,227	110	2,551	27,153
At 30 June 2018						
Cost	12,337	4,006	8,227	498	6,039	31,107
Accumulated depreciation	(63)	(15)	-	(388)	(3,488)	(3,954)
Net book amount	12,274	3,991	8,227	110	2,551	27,153

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

18 Property and equipment (continued)

Land and buildings were revalued by external professional valuers in 2018 on an open market basis and the revaluation has been included in the revaluation reserve. Land and buildings are included in the level 2 of the fair valuation hierarchy (that is, the fair value is based on inputs other than quoted prices that are observable).

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 comparable 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 Bank is in possession of all titles deeds and occupies all the properties.
The additions for the year includes Ksh 970m relating to Work-In Progress at the KSMS.

19 Intangible assets

	Software Shs' Million	Total Shs' Million
Year ended 30 June 2017		
Cost		
At start of year	1,721	1,721
Additions	24	24
Reclassification	(64)	(64)
At end of year	1,681	1,681
Accumulated amortisation		
At start of year	1,514	1,514
Reclassification	(1)	(1)
Amortisation for the year	116	116
At end of year	1,629	1,629
Net carrying value	52	52
Year ended June 30 2018		
Cost		
At start of year	1,681	1,681
Additions	136	136
At end of year	1,817	1,817
Accumulated amortisation		
At start of year	1,629	1,629
Amortisation for the year	23	23
At end of year	1,652	1,652
Net carrying value	165	165

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

20 Due from Government of Kenya

	2018 Shs' million	2017 Shs' million
Overdraft	56,849	-
Government loan	23,339	24,449
	80,188	24,449

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 for the year ending 30 June 2018 is Shs. 57,579 million (2017: Shs. 52,102 million) based on the gross recurrent revenue for the year ended 30 June 2016, which are the latest audited financial statements at the date of approval of these financial statements. Interest is charged at the Central Bank Rate currently at 10%.

The Bank converted the Government of Kenya overdraft facility that exceeded statutory limit in 1997 into a loan at 3% interest repayable by 2039 and is guaranteed by a deed executed by the Minister of Finance. Principal repayments of Shs.555 million plus interest accruing are paid half yearly. The movement in the balance in the current year includes the year repayment of principal of Shs.1,110 million which was received by 30 June, 2018.

21 Currency in circulation

	2018 Shs' million	2017 Shs' million
Kenya bank notes	253,550	245,595
Kenya coins	8,889	8,192
	262,439	253,787
Movement in the account was as follows:		
At start of year	253,787	234,751
Deposits by commercial banks	(501,903)	(513,252)
Withdrawals by commercial banks	510,585	532,179
(Deposits)/withdrawals by CBK	(30)	109
At end of year	262,439	253,787

22 Deposits from banks and government

	2018	2017
Local commercial banks clearing accounts and cash ratio reserve	166,772	145,815
Local banks foreign exchange settlement accounts	21,753	28,526
External banks foreign exchange settlement accounts	134	179
Other public entities and project accounts	28,698	35,272
Government of Kenya	366,930	260,317
	584,287	470,109

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

23	Other liabilities	2018 Shs' million	2017 Shs' million
	Impersonal accounts	3,743	-
	Sundry creditors-Including KSMS creditors	2,934	2,106
	Refundable deposits	231	243
	Leave accrual	156	156
	Gratuity to staff members	55	54
		7,119	2,559

Impersonal accounts holds amounts due to ministries and departments of Government of Kenya.

24(a)	Share capital	Authorised share capital Shs' million	Authorised share capital Shs' million
	Balance at 1 July 2016, 30 June 2017 and 30 June 2018	5,000	5,000

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

24(b) General reserve fund

The general reserve fund represents accumulated surpluses comprising surplus arising from normal operations of the Bank and unrealized gains on exchange rates fluctuations. The distribution of this amounts is subject to the Bank retaining at least 10% of annual surplus for the year or any other amount as the Board in consultation with the Minister may determine.

24(c) Revaluation reserve

The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.

24(d) Consolidated fund

The Consolidated Fund represents amounts proposed for distribution to the Government of Kenya from the General Reserve Fund.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

25 Cash generated from operations

	2018 Shs’ million	2017 Shs’ million
Reconciliation of net surplus to cash flows from operations:		
(Deficit)/surplus for the year	(4,662)	17,562
Adjustments for:		
Depreciation (Note 18)	873	1,016
Amortisation (Note 19)	23	116
Gain on disposal of property and equipment (Note 7)	(6)	(1)
Net credit relating to the retirement benefit asset (Note 17)	(917)	(832)
Employer contributions on defined benefits scheme	(99)	(101)
Changes in working capital:		
Loans and advances	(10)	(9)
Other assets	7,264	(6,281)
Due from Government of Kenya	(55,739)	45,313
Currency in circulation	8,652	19,036
Deposits	114,178	(25,935)
Other liabilities	4,560	(2,221)
Investments by banks	-	(7,843)
Net cash generated from operations	74,117	39,820

26 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include:

	2018 Shs’ million	2017 Shs’ million
Balances due from banking institutions (Note 10)	522,987	558,797
Financial assets - FVPL (Note 28 ii)	25,421	1,998
Securities discounted by banks and other advances (Note 14)	28,919	23,600
	577,327	584,395

27 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 Kenya Deposit Insurance Corporation (formerly, the Deposit Protection Fund Board) which is established by law as a deposit insurance scheme to provide cover for depositors and act as a liquidator of failed member institution. It is managed by a Board including the Governor of the Central Bank of Kenya.

The main transactions are ordinary banking facilities to government ministries included in Note 22 and lending to the Government of Kenya included in Note 20.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

27 Related party transactions (continued)

(i) Loans

The Bank extends loan facilities to the key management staff of the Central Bank. The advances are at preferential rates of interest determined by the Bank.

	2018 Shs' million	2017 Shs' million
Loans to key management staff		
At start of the year	44	52
Loans advanced during the year	53	16
Loan repayments	(22)	(24)
At end of the year	75	44

	2018 Shs' million	2017 Shs' million
(ii) Directors' emoluments:		
Fees to non-executive directors	22	13
Directors travelling expenses	14	4
Other remuneration to executive director	33	34
	69	51
(iii) Remuneration to senior management	185	165
(iv) Post–employment pension to senior management	4	4

(v) Government of Kenya

	2018 Shs' million	2017 Shs' million
Due from Government of Kenya (Note 20)	80,188	24,449
Government of Kenya Deposits (Note 22)	366,930	260,317
Interest earned from Government of Kenya –Loan (Note 4)	725	759
Interest earned from Government of Kenya-Overdraft (Note 4)	2,494	1,270
Loans Principal repayment	1,110	1,110

Transactions entered into with the Government include:

i. Banking services;
ii. Management of issue and redemption of securities at a commission and;
iii. Foreign currency denominated debt settlement and other remittances at a fee.

(vi) Kenya Deposit Insurance Corporation (KDIC)

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

The balance outstanding from the KDIC has been included in sundry debtors (note 16) as at year end was Shs.26 million (2017: Shs. 20.5 million).

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

27 Related party transactions (continued)

(vi) Kenya Deposit Insurance Corporation (KDIC) (Continued)

The deposits relating to KDIC has been included in deposits from banks and Government as at year end was Shs. 19 million (2017: Shs. 27 million)

The staffs of the Corporation are contractually employees of Central Bank but seconded to the Corporation. Salaries of these staff are met by the Central Bank and fully reimbursed by the Corporation. In the year, salaries paid to the staff of Corporation by the Central Bank amounted to Shs. 270 million (2017: Shs. 308 million)

(vii) Kenya School of Monetary Studies (KSMS)

The Kenya School of Monetary Studies (the “School”) primarily owned and managed by CBK has been consolidated in these financial statements.

The permanent staff working at KSMS are employees of CBK. Fixed assets are also wholly owned by the Bank and a letter of support is issued annually to the external auditor of the School as part of the commitment of the Bank for going concern purposes.

During the year under review, the school's physical developments projects were significantly completed.

	2018 Shs' million	2017 Shs' million
CBK-KSMS related activities		
Grants from CBK	474	506
Buildings	2,317	3,223
Land	4,250	4,000
Receivable from KSMS	58	58
Accumulated deficit	62	62

(viii) Central Bank of Kenya Pension Fund and Banki Kuu Pension Scheme 2012

The pension schemes (that is, the defined benefit and defined contribution schemes) are managed and administered by the Secretariat appointed by the sponsor.

28 Financial risk management objectives and policies

The Group's activities expose it to a variety of financial risks, including credit risk and the effects of changes in debt and equity market prices, foreign currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance.

Risk management is carried out by the Banking department under policies approved by the Board of Directors. Other organs that monitor the assessment and management of risks within the Bank include: Board Audit Committee, Internal Audit Department and Risk Management Unit.

(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.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

28 Financial risk management objectives and policies (continued)

(a) Strategy in using financial instruments

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.

(b) Risks facing the Bank

The following are the main types of risks that the Bank is exposed to in the course of 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.) Credit risk

Credit risk arises from investment securities, balances due from banking institutions, funds held with IMF, loans and advances as well as other assets. The Bank has no significant concentrations of credit risk except for the lending to the Government of Kenya.

Management of the credit risk is through the choice of depository banks. The Bank's choice of depository banks is confined to top international banks that meet the set eligibility criteria of financial soundness on long-term credit rating (A), short-term credit rating (F1), composite rating and capital adequacy.

The amount that best represents the Group's maximum exposure to credit risk is per the statement of financial position.

The Bank assesses the credit quality of these assets. None of the balances have had their terms renegotiated as a result of non-performance. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors. Net write off/back of Shs.35 million (2016: Shs.24 million) have been recognised due to impaired balances to related parties.

FINANCIAL PERFORMANCE

Notes to the Financial Statements (continued)

28 Financial risk management objectives and policies (continued)

(i) Credit risk

The following amounts in loans and advances and other assets are neither past due nor impaired or individually impaired. All other financial instruments operate within their contractual terms.

	Neither past due nor impaired 2018 Shs' million	Individually impaired 2018 Shs' million	Neither past due nor impaired 2017 Shs' million	Individually impaired 2017 Shs' million
Balances due from banking Inst	522,987	-	735,548	-
Advances to banks	38,503	-	34,870	-
Investments securities – AFS	9	-	9	-
Funds held with (IMF)	2,012	-	1,877	-
Financial assets at FVPL	400,404	-	134,777	-
Due from Government of Kenya	80,188	-	24,449	-
Advances to employees	2,585	103	2,575	68
Due from banks under liquidation	-	3,400	-	3,400
Other assets	3,302	4,929	10,566	4,914
	1,049,990	8,432	944,671	8,382
Allowance for impairment				
- other assets (Note 16)	-	(4,929)	-	(4,914)
- loans and advances (Note 15)	-	(3,503)	-	(3,468)
	-	(8,432)	-	(8,382)
	1,049,990	-	944,671	-

There were no past due but not impaired balances as at 30 June 2018 - (2017: Nil).

(ii) Market risk

The Group takes on exposure to market risks, which is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios. Market risks arising from trading and non-trading activities are concentrated in Bank Treasury and are monitored by management with oversight from the Monetary Policy Committee.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with commercial banks or the market.

Non-trading portfolios primarily arise from the interest rate management of the Bank's investment and monetary policy assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's held-to-maturity and World Bank RAMP financial assets.

Interest rate risk

The Bank's interest rate risk arises from interest bearing investments, loans and advances to commercial banks and investments by banks. Borrowings issued at variable rates expose the Bank to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the Bank to fair value interest rate risk.

Notes to the Financial Statements (continued)

28 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

The tables below summarise the Bank's financial assets and liabilities and analyses them into the earlier of contractual maturity or re-pricing.

At 30 June 2018	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions	505,659	-	-	-	17,328	522,987
Securities & advances to banks	28,919	1,224	8,360	-	-	38,503
Financial assets at FVPL	25,421	100,066	274,846	-	71	400,404
Funds held with International Monetary Fund (IMF)	-	-	-	-	2,012	2,012
Investments securities – Available-for-sale	-	-	-	-	9	9
Loans and advances	151	454	1,569	411	-	2,585
Other assets	-	-	-	-	3,302	3,302
Due from Government of Kenya	-	57,959	4,440	17,789	-	80,188
Total financial assets	560,150	159,703	289,215	18,200	22,722	1,049,990
Liabilities						
Deposits from banks and government	-	-	-	-	584,287	584,287
Due to International Monetary Fund (IMF)	-	-	-	-	100,284	100,284
Other liabilities	-	-	-	-	7,119	7,119
Total financial liabilities	-	-	-	-	691,690	691,690
Interest sensitivity gap	560,150	159,703	289,215	18,200	(668,968)	358,300

As at 30 June 2018, increase of 10 basis points would have resulted in a decrease/increase in profit of Shs. 102,268 million (2017:Shs 91,096 million)

Notes to the Financial Statements (continued)

28 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

At 30 June 2017	1 – 3 months Shs’ million	3-12 months Shs’ million	1 - 5 years Shs’ million	Over 5 years Shs’ million	Non-interest Bearing Shs’ million	Total Shs’ million
Assets						
Balances due from banking institutions	489,877	224,491	-	-	21,180	735,548
Securities & advances to banks	23,600	1,912	9,358	-	-	34,870
Financial assets at FVPL	1,998	40,984	91,722	-	73	134,777
Funds held with International Monetary Fund (IMF)	-	-	-	-	1,877	1,877
Investments securities – Available-for-sale	-	-	-	-	9	9
Loans and advances	111	342	1,100	1,022	-	2,575
Other assets	-	-	-	-	10,566	10,566
Due from Government of Kenya	-	1,110	4,440	18,899	-	24,449
Total financial assets	515,586	268,839	106,620	19,921	33,705	944,671
Liabilities						
Deposits from banks and government	-	-	-	-	470,109	470,109
Due to International Monetary Fund (IMF)	-	-	-	-	115,125	115,125
Other liabilities	-	-	-	-	2,559	2,559
Total financial liabilities	-	-	-	-	587,793	587,793
Interest sensitivity gap	515,586	268,839	106,620	19,921	(554,088)	356,878

As at 30 June 2017, increase of 10 basis points would have resulted in a decrease/increase in profit of Shs 91,096 million (2016: 92,361 million)

Notes to financial statements (continued)

28 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Monetary Policy Committee sets limits on the level of exposure by currency which is monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2018. Included in the table are the Bank's financial instruments categorised by currency:

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs 'million	Total Shs' million
At 30 June 2018						
Assets						
Balances due from banking institutions	299,812	66,175	5,228	-	151,772	522,987
Financial assets at fair value	400,404	-	-	-	-	400,404
Funds held with International Monetary Fund (IMF)	-	-	-	2,012	-	2,012
Total financial assets	700,216	66,175	5,228	2,012	151,772	925,403
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	100,284	-	100,284
Deposits from banks and government	16,422	2,654	2,573	-	238	21,887
Total financial liabilities	16,422	2,654	2,573	100,284	238	122,171
Net position	683,794	63,521	2,655	(98,272)	151,534	803,232

Notes to financial statements (continued)

28 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign exchange risk (continued)

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs 'million	Total Shs' million
At 30 June 2017						
Assets						
Balances due from banking institutions – Local	501,045	82,272	3,186	-	149,045	735,548
Financial assets at fair value through profit or loss	134,704	-	-	-	73	134,777
Funds held with International Monetary Fund (IMF)	-	-	-	1,877	-	1,877
Total financial assets	635,749	82,272	3,186	1,877	149,118	872,202
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	115,125	-	115,125
Deposits from banks and government	23,489	2,020	3,017	-	147	28,673
Total financial liabilities	23,489	2,020	3,017	115,125	147	143,798
Net position	612,260	80,252	169	(113,248)	148,971	728,404

As at 30 June 2018, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank's profit would have been:

- USD Shs 34,193 million (2017: Shs 31,072 million)
- Euro Shs 133, million (2017: Shs 8 million)
- British Pound Shs 3,176 million (2017: Shs 4,012 million)
- SDR Shs 4,911million (2017: Shs 5,662 million).

Notes to financial statements (continued)

28 Financial risk management objectives and policies (continued)

iii. Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, Treasury maintains flexibility in funding by maintaining availability under committed credit lines.

Management monitors rolling forecasts of the Bank's liquidity reserve on the basis of expected cash flow.

The table below analyses the Bank's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	On demand Shs' million	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Total Shs' million
At 30 June 2018						
Currency in circulation	-	-	-	-	262,439	262,439
Deposits from banks and government	555,588	-	28,698	-	-	584,286
Due to International Monetary Fund (IMF)	-	-	-	-	100,284	100,284
Other liabilities	-	-	7,119	-	-	7,119
Total financial liabilities	555,588	-	35,817	-	362,723	954,128
At 30 June 2017						
Currency in circulation	-	-	-	-	253,787	253,787
Deposits from banks and government	434,837	-	35,272	-	-	470,109
Due to International Monetary Fund (IMF)	-	-	-	-	115,125	115,125
Other liabilities	-	-	2,559	-	-	2,559
Repo sold to Banks	-	-		-	-	-
Total financial liabilities	434,837	-	37,831	-	368,912	841,580

FINANCIAL PERFORMANCE

Notes to the financial statements (continued)

28 Financial risk management objectives and policies (continued)

Fair value of financial instruments

IFRS 7 specifies a fair value hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Bloomberg).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

	Level 1 Shs' million	Level 2 Shs' million	Level 3 Shs' million	Total Shs' million
At 30 June 2018:				
Financial assets at fair value	400,333	71	-	400,404
Investment securities – Available-for-sale	-	-	9	9
Total assets	400,333	71	9	400,413
As at 30 June 2017:				
Financial assets at fair value	134,704	73	-	134,777
Investment securities – Available-for-sale	-	-	9	9
Total assets	134,704	73	9	134,786

There were no changes in level 3 instrument as disclosed in Note 12 of the financial statements.

29 Contingent liabilities and commitments

The Bank is party to various legal proceedings. Based on legal advice, the directors believe that no loss will arise from these legal proceedings. Appropriate provisions have been made where a liability is considered probable.

At 30 June 2018, the Bank had capital commitments of Shs.10,507 (2017: Shs10,684 million) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

	2018 Shs' million	2017 Shs' million
Not later than 1 year	188	164
Later than 1 year and not later than 5 years	95	483
	283	647

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