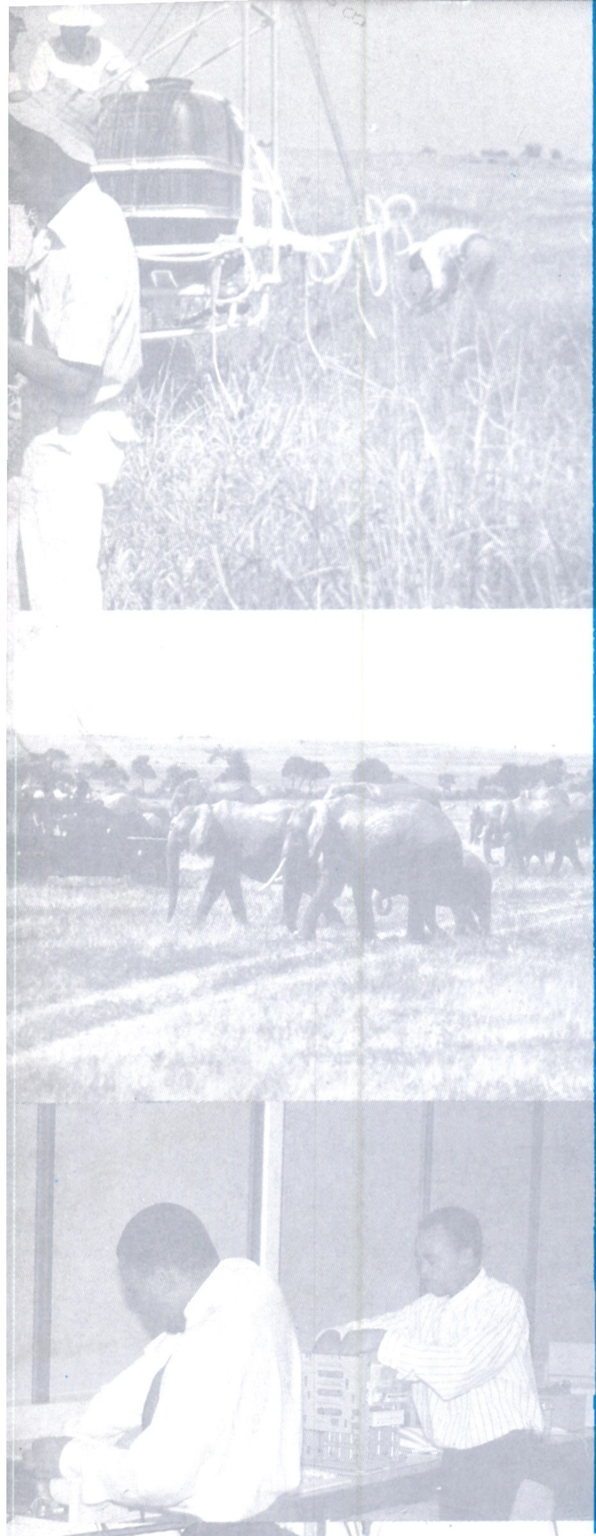

BANKI KUU YA KENYA

CENTRAL BANK OF KENYA

MONTHLY ECONOMIC REVIEW

MARCH 2002

OBJECTIVES OF THE CENTRAL BANK OF KENYA

The Central Bank of Kenya's objectives are laid down in the Central Bank of Kenya (Amendment) Act, 1996 as follows:

PRINCIPAL OBJECTIVES

1. The first principal objective shall be to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices

2. The second principal objective shall be to foster the liquidity, solvency and proper functioning of a stable market based financial system

SECONDARY OBJECTIVES

Without prejudice to the generality of the above two principal objectives, the Bank's secondary objectives shall be to:

1. Formulate and implement foreign exchange policy

2. Hold and manage its foreign exchange reserves

3. License and supervise authorised dealers in the money market

4. Promote the smooth operation of payments, clearing and settlement systems

5. Act as a banker and adviser to, and as fiscal agent of the Government; and

6. Issue currency notes and coins

KENYA MONTHLY ECONOMIC REVIEWS

The Monthly Economic Reviews, prepared by the Central Bank of Kenya, starting with the June 1997 edition, are available on the Internet at the address: http://www.centralbank.go.ke/
email: info@centralbank.go.ke

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Real GDP is estimated to have grown by 0.8% in the year 2001, largely reflecting recovery in agricultural production; increased investment in communications; and higher earnings from tourism. Although still low, **inflation** in February 2002 started to rise. The overall month-on-month inflation was negative 1.4%, up from negative 3.1% in January while underlying month-on-month remained unchanged at 1.5%.

Interest rate on the 91-day Treasury bill declined to an average of 10.6% in February 2002 from 10.9% in January 2001. The **money supply**, (M3X), stagnated, declining by 0.01% in the year to January 2002 compared with 3.8% increase in the year to January 2001. The stagnation in money supply in the year to January 2002 reflected a close match between a decline in net domestic assets and an increase in net foreign assets of the banking system.

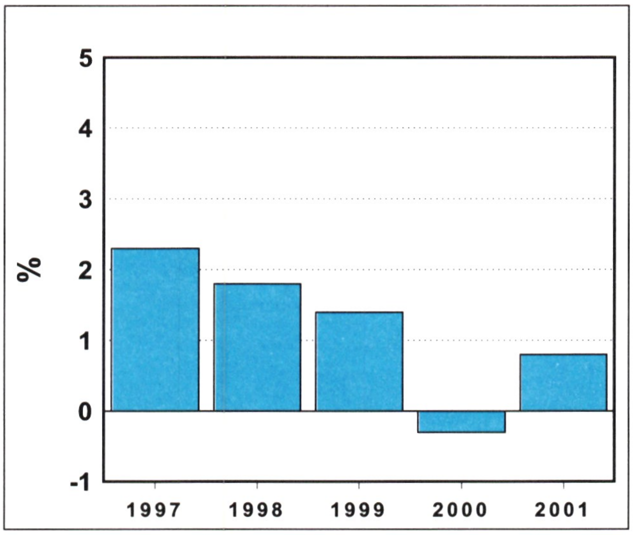
Assets of the **banking sector** decreased by 3.9% to Ksh 422.4bn in the year to January 2002. Non-performing loans were estimated at Ksh 110bn of total loans in January 2002, compared with Ksh 114.2bn in January 2001. Provisions for non-performing loans declined to Ksh 65.1bn in January 2002 from Ksh 68.0bn in January 2001. Consequently, net exposure decreased by Ksh 7.2 bn in January 2002,

Government fiscal operations resulted in a deficit of Ksh 11.9bn or 1.4% of GDP on a commitment basis in the first seven months of fiscal year 2001/02 compared with Ksh 5.0bn deficit in a similar period in the previous fiscal year. The stock of public debt decreased to Ksh 605.0bn in the first seven months of fiscal year 2001/02 from Ksh 605.8bn in June 2001. The decrease in public debt was entirely in the external debt as the domestic debt component increased.

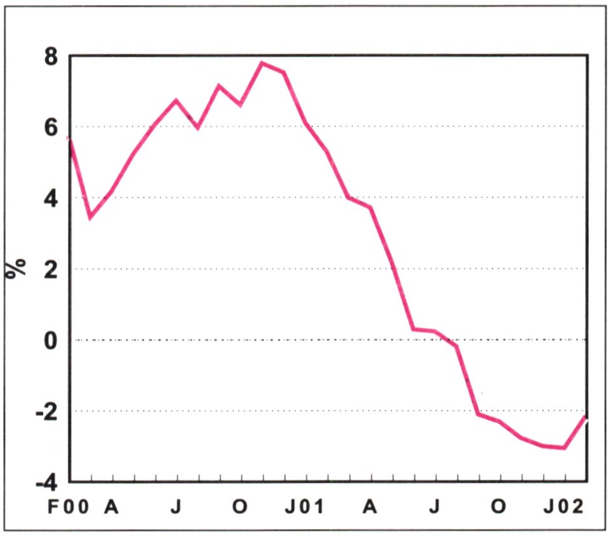
The **Kenya shilling** gained against the US dollar in February 2002 to exchange at Ksh 78.25 compared with Ksh 78.60 in January 2002. The overall **balance of payments** improved registering a surplus of US$ 72m in the year to January 2002 compared with a deficit of US$ 8m in the year to January 2001. The Central Bank foreign exchange reserves increased from US$ 897m at the end of January 2001 to US$ 1,035m or 3.4 months of imports cover of goods and non-factor services at the end of January 2002.

SELECTED PERFORMANCE INDICATORS

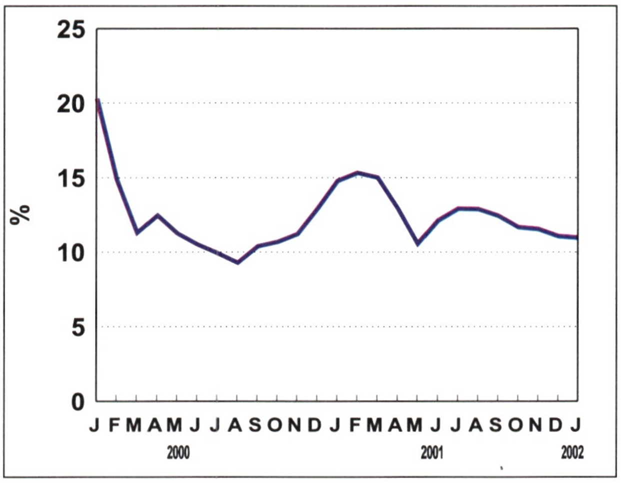
Economic Growth



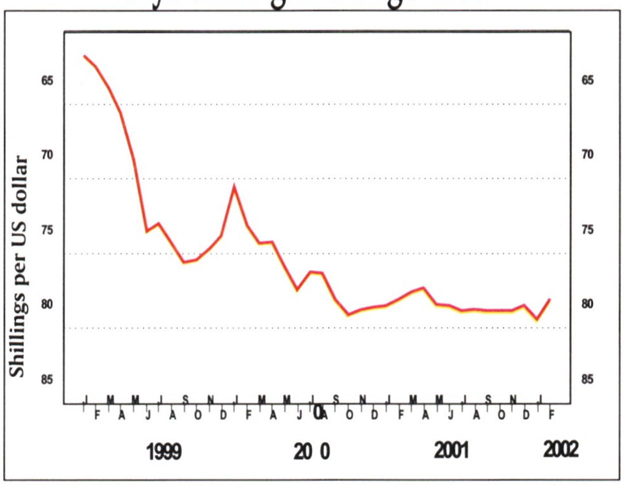
General Inflation



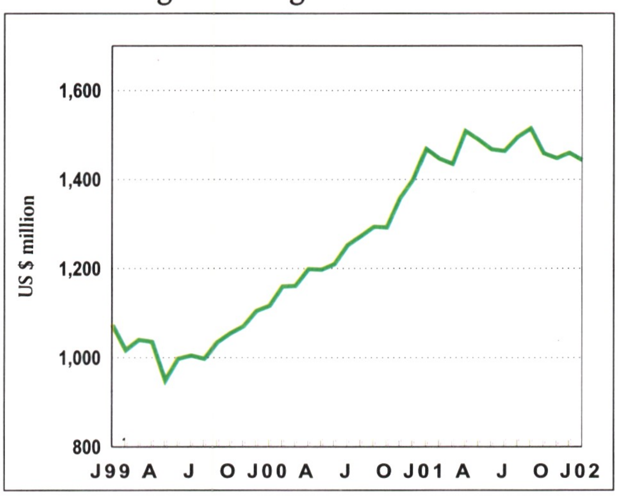
Interest Rates (91 - day T. Bill)



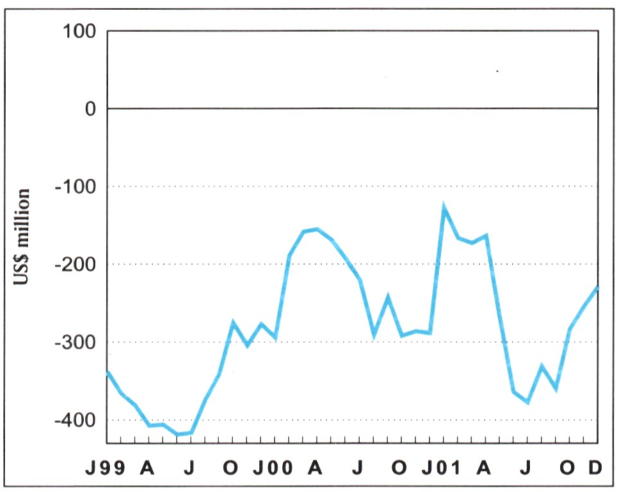
Kenya Shilling Exchange Rate



Foreign Exchange Reserves



Current Account Balance



Source: Central Bank of Kenya

SELECTED ANNUAL ECONOMIC INDICATORS, 1997 - 2001

INDICATOR	1997	1998	1999	2000	2001
1. POPULATION					
People in Millions	27.3	28.0	28.7	29.3	29.9
Growth (%)	2.5	2.4	2.2	2.1	2.1
2. NATIONAL ACCOUNTS					
GDP Market Prices (Ksh bn)	623	691	740	779	820
GDP at Factor Cost (US$M):					
At Current Prices	9120	9824	9066	8833	8620
At Constant 1982 Prices	9124	9285	9417	9386	9465
Real GDP Growth (%)	2.4	1.8	1.4	-0.3	0.8
Per Capita Income (US Dollars)	283	282	279	271	267
3. GROSS DOMESTIC SAVINGS (% of GDP at mkt prs)	**10.5**	**9.8**	**10.8**	**7.9**	..
4. GROSS DOMESTIC INVESTMENTS (% of GDP at mkt prs)	**18.5**	**17.4**	**16.2**	**15.6**	..
5. CONSUMER PRICE INFLATION					
Average Annual	11.2	6.6	3.5	6.2	0.8
Month-on-Month	8.3	2.5	8.0	7.5	-3.1
6. STOCK MARKET					
Nairobi Stock Exchange Price Index (1966=100)	3115.1	2962.1	2303.2	1913.4	1355.1
Trade Turnover (%)	0.3	0.4	0.2	0.2	0.2
7. GOVERNMENT BUDGET (Ksh bn)					
Budget Deficit (% of GDP)	-0.8	-1.6	0.5	1.0	-2.1
Revenue and Grants	155.0	184.9	201.2	182.7	216.4
Expenditure	159.8	195.0	197.3	175.2	232.9
Budget Deficit (-) / Surplus (+)	**-4.7**	**-10.1**	**3.8**	**7.6**	**-16.5**
8. MONEY AND CREDIT (Ksh bn)(END PERIOD)					
Money Supply (M3XT)	370.6	381.3	414.4	435.5	462.1
Money Supply (M3X)	321.8	333.6	345.7	360.0	368.4
Reserve Money	75.9	75.0	79.0	77.7	79.1
Total Domestic Credit	**327.4**	**350.6**	**358.5**	**362.1**	**369.1**
Government	82.7	91.1	84.1	76.4	89.1
Others	244.7	260.6	274.3	285.6	280.0
9. BALANCE OF PAYMENTS (US$ m)					
Overall Balance	**-33**	**66**	**-21**	**-8**	**147**
Current Account	**-450**	**-549**	**-214**	**-288**	**-229**
Capital and Financial Account	**417**	**615**	**193**	**279**	**376**
10. FOREIGN EXCHANGE RESERVES (US$ m)	**1,099**	**1,100**	**1,104**	**1,398**	**1,459**
Official*	788	783	791	897	1064
	(2.5)	*(2.5)*	*(2.9)*	*(2.9)*	*(3.5)*
Commercial banks & public	311	317	313	501	395
11. PUBLIC DEBT (US$ bn)					
External	5.8	5.7	5.4	5.2	4.9
As % of GDP	*64.0*	*57.7*	*50.6*	*47.0*	*45.1*
Domestic	2.7	3.0	2.6	2.5	2.8
As % of GDP	*29.2*	*30.2*	*24.5*	*22.4*	*25.8*
12. EXCHANGE RATE (Ksh/US$) (ANNUAL AVERAGE)	**58.8**	**60.4**	**70.3**	**76.2**	**78.6**

* Figures in parentheses refer to official reserves in terms of months of imports of goods and non-factor services.

Sources: Central Bureau of Statistics, Central Bank of Kenya & Nairobi Stock Exchange

SELECTED MONTHLY ECONOMIC INDICATORS

INDICATOR	2001 Mar	Jun	Sep	Dec	2002 Jan	Feb*
1. INFLATION (%)						
Average Annual						
Overall	**6.0**	**5.2**	**3.3**	**0.8**	**0.1**	**-0.6**
Underlying	9.5	9.2	8.3	6.1	5.4	4.7
Month-on-Month						
Overall	**3.9**	**0.2**	**-2.2**	**-3.1**	**-3.1**	**-2.2**
Underlying	7.1	7.2	2.5	1.4	1.5	1.5
2. INTEREST RATES (%)						
91-day Treasury bill	15.0	12.1	12.4	11.0	10.9	10.6
Overdraft	20.1	19.7	19.6	20.0	19.3	..
3. STOCK MARKET						..
Nairobi Stock Exchange Price Index	1830.5	1657.1	1400.9	1355	1343	..
Trade Turnover (%)	0.35	0.45	0.15	0.17	0.15	..
4. GOVERNMENT BUDGET (Ksh bn.)**						
Budget Deficit (-) / Surplus (+)	**-9.9**	**-16.5**	**-3.7**	**-10.6**	**-11.9**	..
Revenue and Grants	153.4	216.4	46.0	94.2	110.3	..
Expenditure:	163.3	232.9	49.7	104.7	122.2	..
5. MONEY AND CREDIT (Ksh bn.)						
Money Supply (M3XT)	438.5	444.0	448.9	462.1	466.2	..
Money Supply (M3X)	356.1	352.2	355.0	368.4	360.6	..
Reserve Money	70.0	69.3	69.8	79.1	73.6	..
Total Domestic Credit	**361.6**	**356.9**	**356.7**	**369.1**	**355.7**	..
Government	75.9	68.7	69.6	89.1	78.3	..
Private Sector	285.6	288.2	287.0	280.0	277.4	..
6. MONEY AND CREDIT (Annual % Change)						
Money Supply (M3XT)	4.7	5.2	6.4	6.1	5.65	..
Money Supply (M3X)	3.5	1.7	1.7	2.3	-0.01	..
Reserve Money	-2.8	-8.5	0.2	1.8	3.4	..
Total Domestic Credit	**1.2**	**-0.7**	**-1.0**	**1.9**	**-1.3**	..
Government	-9.0	-17.5	-14.6	16.5	6.9	..
Private Sector	4.4	4.4	3.0	-2.0	-3.4	..
7. BALANCE OF PAYMENTS (US$ m)						
Overall Balance	**-10**	**0**	**78**	**65**	-34	..
Current Account Balance	**2**	**-27**	**-7**	**38**	14	..
Trade Balance	**-91**	**-135**	**-97**	**-15**	-64	..
Capital and Financial Account	**-12**	**28**	**86**	**27**	-48	..
8. FOREIGN EXCHANGE RESERVES (US $ m)	**1434**	**1467**	**1514**	**1459**	**1442**	..
Official***	928	955	1081	1064	1035	..
	(3.1)	*(3.1)*	*(3.4)*	*(3.5)*	*(3.4)*	
Commercial banks	506	512	433	395	406	..
9. PUBLIC DEBT (US$ bn)						..
External	5.2	5.0	5.0	4.9	4.9	..
As % of GDP	*46.8*	*48.7*	*46.0*	*45.1*	44.9	..
Domestic	2.6	2.7	2.8	2.8	2.8	..
As % of GDP	*23.3*	*26.2*	*25.7*	*25.8*	26.1	..
10. GROSS DOMESTIC DEBT (Ksh bn)******	**200.6**	**211.8**	**219.2**	**222.0**	**222.7**	..
11. AVERAGE EXCHANGE RATE						
Kshs/US$	**77.8**	**78.6**	**78.9**	**78.7**	**78.6**	**78.2**
Kshs/Sterling Pound	112.4	110.3	115.5	113.2	112.8	111.3
Kshs/ 100 Yen	64.2	64.4	66.5	61.9	59.3	58.6
Kshs/Euro	70.8	67.2	71.9	70.2	69.5	68.1

* Provisional.

** Cumulative fiscal year budget out-turn: deficit including grants and on commitment basis.

*** Figures in parentheses refer to official reserves in terms of months of imports of goods and non-factor services.

****Excludes Ksh 2,028m IMF disbursements onlent to the Govt. by the CBK, which is included in external public debt.

Source: Central Bureau of Statistics, Central Bank of Kenya and Nairobi Stock Exchange

Introduction

Inflation remained low through February 2002, with overall inflation remaining negative compared with the same month in 2001, while underlying inflation was slightly below the target of 5%.

However, analysis of changes in the consumer price index (CPI) in the month of February 2002 show that the downward trend in inflation had somewhat reversed. Overall and underlying inflation in the month of February was 0.3% and 0.2% compared to negative rates in the previous several months.

Overall Inflation

The overall inflation evolved (Table 1 and Chart 1) as follows in February 2002:

- The monthly overall inflation, that is, between January 2002 and February 2002 was 0.3% compared with 0.3% decline in January 2002. Following the increase in overall inflation between January and February 2002, the overall month-on-month inflation, that is, between February 2001 and February 2002, was negative 2.2% compared with negative 3.1% in January 2002.

- The overall average annual inflation, which is less sensitive to new emerging trends, however, declined to negative 0.6% from 0.1% in January 2002.

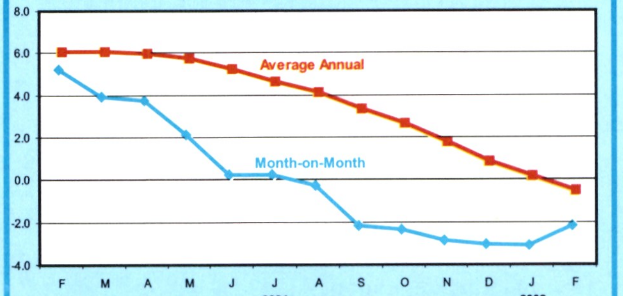
Underlying Inflation

Developments in the underlying inflation are indicated in Table 2 and Chart 2 as follows:

TABLE 1: OVERALL INFLATION (%)

	2001					2002	
	Feb	Mar	Jun	Sep	Dec	Jan	Feb
Month-on-month	5.2	3.9	0.2	-2.2	-3.1	-3.1	**-2.2**
Average annual	6.0	6.0	5.2	3.3	0.8	0.1	**-0.6**
Change over one month	-0.6	-0.6	-0.1	-0.1	-0.3	-0.3	**0.3**

CHART 1:

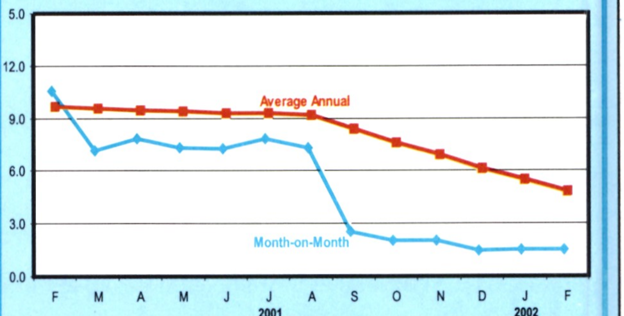


Sources: Central Bureau of Statistics & Central Bank of Kenya

TABLE 2: UNDERLYING INFLATION (%)

	2001					2002	
	Feb	Mar	Jun	Sep	Dec	Jan	Feb
Month-on-month	10.5	7.1	7.2	2.5	1.4	1.5	**1.5**
Average annual	9.6	9.5	9.2	8.3	6.1	5.4	**4.7**
Change over one month	0.2	-0.5	0.9	0.2	0.0	-0.2	**0.2**

CHART 2



Sources: Central Bureau of Statistics & Central Bank of Kenya

- The monthly underlying inflation, that is, the change in prices between January 2002 and February 2002 was 0.2% compared with negative 0.2% in January.

- However, the underlying month-on-month inflation, that is, the change in prices between February 2002 and the same month last year, was unchanged at 1.5% in February 2002 as in January.

- Underlying average annual inflation, however, declined to 4.7% in February 2002 from 5.4% in January 2002.

Inflation by Income Groups

Inflation in the basket of goods and services consumed by the three income groups was as follows (Table 3 and Chart 3):

- Inflation in goods and services purchased by the lower income group increased by 0.2% between January and February 2002 compared with a decline of negative 0.4% between December 2001 and January 2002. However, lower income group inflation was negative 3.2% in the year to February 2002, compared with 4.1% in the year to January 2001.

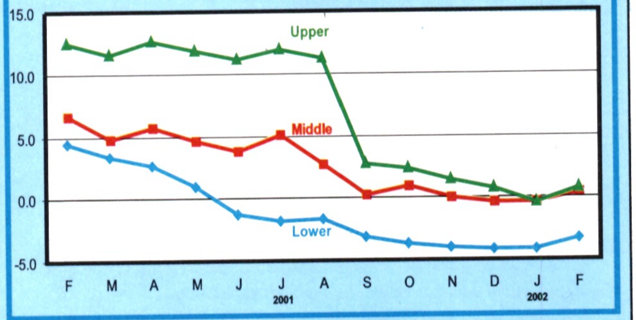
- Inflation in goods and services purchased by the middle income group increased to 0.6% between January and February 2002 compared with a decline of negative 0.1% between December 2001 and January 2002. The group's inflation also increased by 0.5% between February 2001 and February 2002 compared with a decline of 0.3% in the twelve months to January 2002.

- Inflation in goods and services purchased by the upper income group increased by 0.8% between January 2002 and February 2002. Similarly, inflation increased by 0.8% in the twelve months to February 2002 compared with negative 0.4% in the twelve months to January 2002.

TABLE 3: OVERALL MONTH-ON-MONTH INFLATION BY INCOME GROUPS(%)

INCOME GROUP	Changes over 12 months						
	2001					2002	
	Feb	Mar	Jun	Sep	Dec	Jan	Feb
Lower	4.5	3.4	-1.3	-3.1	-4.1	-4.1	-3.2
Middle	6.7	4.9	3.9	0.3	-0.3	-0.3	0.5
Upper	12.5	11.6	11.2	2.9	0.8	-0.4	0.8
All Groups	**5.2**	**3.9**	**0.2**	**-2.2**	**-3.1**	**-3.1**	**-2.2**
	Changes over one month						
Lower	-0.8	-0.6	-0.2	-0.3	-0.4	-0.4	0.2
Middle	-0.1	-0.8	0.4	0.3	-0.3	-0.1	0.6
Upper	-0.5	0.3	0.5	0.4	0.3	-0.9	0.8
All Groups	***-0.6***	***-0.6***	***-0.1***	***-0.1***	***-0.3***	***-0.3***	***0.3***

CHART 3



Sources: Central Bureau of Statistics & Central Bank of Kenya

Inflation by Basket Goods

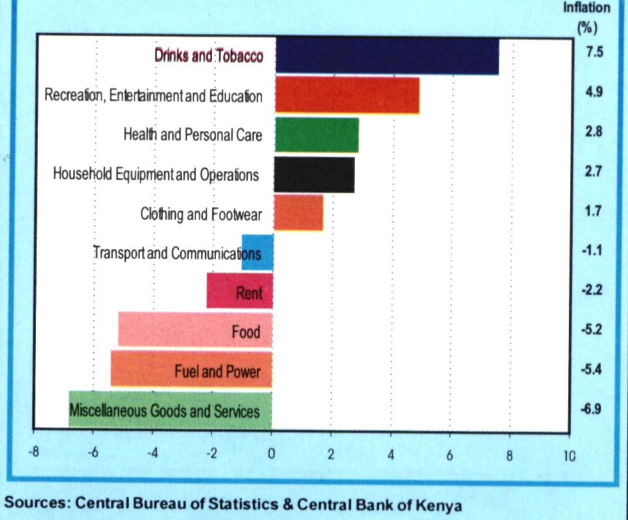
In February 2002, negative inflation continued to be recorded in food; fuel and power; transport and communications; and miscellaneous goods and services compared with the same month a year ago. However, looking at inflation in the month of February alone, that is, the change in CPI between January and February 2002, all baskets, except for the miscellaneous goods and services, had positive inflation. Inflation by basket of goods and services is shown in Table 4 and Chart 4 below.

TABLE 4: BASKET WEIGHTS & OVERALL MONTH-ON-MONTH INFLATION, JAN 2002 - FEB 2002

Goods and Services	Income Groups* (%) Lower (76.8)	Middle (20.9)	Upper (2.3)	Combined Weights for all items %	Changes Over One Year JAN 2002	FEB 2002	%Change Over one Month
Food	44.2	21.2	13.9	38.7	-6.9	-5.2	0.4
Rent	25.0	30.2	32.4	26.2	-3.1	-2.2	0.3
Recreation, Entertainment and Educatio	6.2	8.1	9.9	6.7	4.8	4.9	0.0
Household Equipment and Operations	5.3	9.9	10.7	6.4	2.6	2.7	0.2
Clothing and Footwear	5.0	5.2	4.1	5.0	1.7	1.7	0.0
Transport and Communications	4.1	6.2	7.9	4.6	-1.1	-1.1	0.0
Fuel and Power	3.1	8.1	9.7	4.3	-3.8	-5.4	0.4
Health and Personal Care	3.0	4.0	3.4	3.2	2.8	2.8	0.2
Miscellaneous Goods and Services	2.0	4.0	3.9	2.5	-7.5	-6.9	-0.1
Drinks and Tobacco	2.1	3.1	4.1	2.4	7.9	7.5	0.1
Totals & month-on-month inflation	**100**	**100**	**100**	**100**	**-3.1**	**-2.2**	**0.3**

* Numbers in parentheses are income group weights

CHART 4



Sources: Central Bureau of Statistics & Central Bank of Kenya

Outlook

It is emerging that the decline in inflation over the last six months is beginning to slowly reverse, partly as a result of the stabilisation of the agricultural food prices. The recent up turn in the international prices of crude oil from about US $ 20 per barrel in February 2002 to about US $ 24 per barrel in mid-March 2002 is also expected to exert pressure on domestic prices. Nonetheless, the underlying inflation is expected to remain within the 5% target as the Central Bank continues to implement prudent monetary policy. Equally key is the anticipated relative stability of the shilling exchange rate that will further check the inflationary pressures that would have emanated from this source.

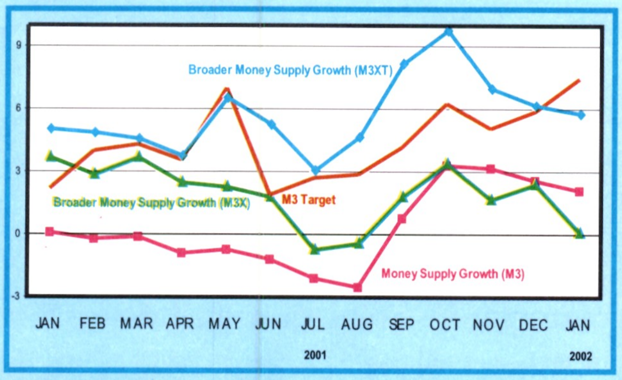
Money and Credit

Trends in the monetary aggregates were mixed in the year to January 2002 (Tables 5 and 6 and Charts 5 and 6). Narrow money, M3, which comprises both currency held by the public and private sector shilling deposits with commercial banks, increased by 2.0% compared with a 0.04% fall in the twelve months to January 2001. M3X, which is M3 plus resident private sector deposits denominated in foreign currency placed with local banks, stagnated, declining by 0.01% in the current period under review compared with 3.8% expansion in the year to January 2001. The stagnation in M3X reflected a reduction in resident private sector holdings of foreign currency denominated deposits which offset the increase in M3. This was attributed to the continued stability of the exchange rate, which reduced the need for the private sector to hedge against exchange rate fluctuations. As a result, the private sector increased investments in the relatively secure and high yielding government securities. Reflecting this development, broader money supply, M3XT, which is M3X plus non-bank holdings of government securities, increased by 5.7%, an acceleration over 5.2% increase in the year to January 2001.

TABLE 5: ANNUAL PERCENTAGE CHANGE IN MONEY SUPPLY

	2001		2001				2002
	Jan	Feb	Mar	Jun	Nov	Dec	Jan
M3X	3.8	2.8	3.5	1.9	1.6	2.3	-0.01
M3	0.0	-0.3	-0.2	-1.3	3.1	2.5	2.01
M3XT	5.2	4.8	4.5	5.2	6.9	6.1	5.65
M3X Target	3.5	3.5	5.5	5.5	4.2	4.7	4.70
M3XT Target	4.8	7.9	3.3	5.5	8.7	9.7	8.45

CHART 5



Source: Central Bank of Kenya

The stagnation of M3X in the year to January 2002 reflected a symmetrical match between a decline in net domestic assets (NDA) and an increase in the net foreign assets (NFA) of the banking system. The NDA declined by Ksh 2.3bn or 0.9%, largely reflecting a decline in domestic credit as other domestic assets increased. Developments in NDA components were as follows:

- Net credit to Government from the banking system increased by 6.9% in the year to January 2002 compared with 8.8% decline in the year to January 2001. During the period under review, Government increased its net borrowing from commercial banks by 27.9%. However, this borrowing was partly offset by the reduction in net government credit from the Central Bank of Ksh 9.7 billion or 46.8%.
- Credit to the private and other public sectors declined by 3.4% during the twelve months to January 2002 compared with 4.4%

TABLE 6: MONEY SUPPLY AND ITS SOURCES (ANNUAL BASIS), KSH BN.

	Jan 2001	Jan 2002	12 months Change Absolute	%	Target Jan '02	Dev.
1. Money supply, M3XT 1/	441.3	466.2	24.9	5.7	478.6	-12.3
2. Money supply, M3X (4+5) 2/	360.7	360.6	0.0	0.0	377.6	-17.0
3. Money supply, M3 3/	310.3	316.6	6.3	2.0	333.3	-16.7
Money supply, M2	291.2	302.1	10.9	3.7		
4. Net foreign assets 4/	90.3	92.6	2.3	2.5	90.3	2.2
Central Bank	59.3	74.7	15.4	25.9	73.1	1.6
Commercial banks & NBFIs	31.0	17.8	-13.1	-42.4	17.2	
5. Net domestic assets (5.1+5.2)	270.4	268.1	-2.3	-0.8	287.3	-19.2
5.1 Domestic credit (5.1.1+5.1.2)	360.3	355.7	-4.7	-1.3	381.9	-26.2
5.1.1 Government (net)	73.2	78.3	5.0	6.9	70.5	7.8
Central Bank(net)	20.6	10.9	-9.6	-46.8	7.9	3.0
Overdraft to Government	7.4	0.0	-7.4	-100.0	0.0	0.0
Cleared items awaiting posting to PMG	0.6	0.7	0.1	23.6	0.7	0.0
Rediscounted securities	0.0	0.1	0.1	137.8	2.0	-1.9
IMF Funds onlent to Governmnet	2.0	2.0	-0.1	-3.0	2.0	0.0
Treasury bills	16.9	27.0	10.1	59.7	9.9	17.1
Treasury Bonds	0.0	0.0	0.0	0.0	0.0	0.0
Non Interest Bearing Debt	20.0	9.9	-10.1	-50.5	27.0	-17.1
PMG deposits	-26.4	-28.8	-2.4	8.9	-33.7	4.9
Commercial Banks & NBFIs(net)	52.7	67.3	14.7	27.9	62.6	4.7
Banks	50.1	65.0	15.0	29.9		
NBFIs	2.6	2.3	-0.3	-11.4		
5.1.2 Private sector and other public sector:	287.1	277.4	-9.7	-3.4	311.4	-34.0
Central Bank	1.4	1.5	0.1	6.8		
Commercial banks	262.7	259.5	-3.2	-1.2		
NBFIs	23.0	16.4	-6.6	-28.6		
5.2 Other assets net (5-5.1)	-90.0	-87.6	2.4	2.6	-94.6	-7.0
6. Reserve money	71.2	73.6	2.4	3.4	76.4	-2.8
Cash in till	5.7	5.2	-0.5	-8.2	7.3	-2.0
Currency outside banks	42.0	44.8	2.8	6.6	43.6	1.3
Deposits with CBK	23.5	23.6	0.1	0.3	25.6	-2.0
Memorandum items						
Treasury bills outstanding	134.3	120.6	-13.7	-10.2		

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

1/ Broader money, M3XT, comprises M3X and non banking public holding of Government securities.

2/ Broader money, M3X, comprises M3 and residents foreign currency deposits with local banks.

3/ Broad money, M3, comprises currency outside banking institutions, and all private and other public sector holdings of demand savings and time deposits. It excludes central and local Government deposits with banking institutions.

4/ NFA at constant exchange rate of Ksh 78.95 to the US dollar (Sept. 30th, 2001).

Source: Central Bank of Kenya

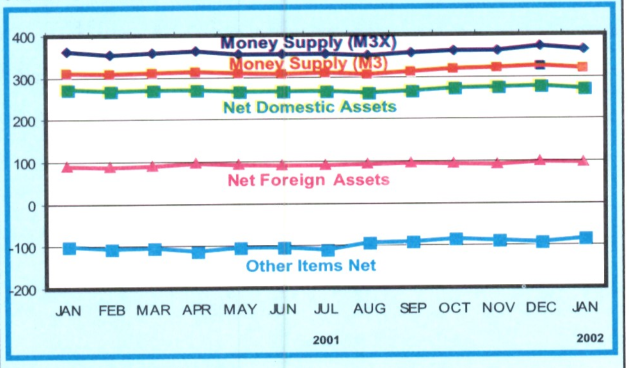
increase in the year to January 2001. The decline comprised reduction of 28.6% and 1.2% in credit from NBFIs and commercial banks, respectively.

- Other domestic assets of the banking system increased by 2.6% in the year to January 2002 compared with 38.5% decline in the twelve months to January 2001.

Reserve Money

Reserve money, which comprises currency in circulation and deposits of commercial banks and NBFIs at the

CHART 6: MONEY SUPPLY AND ITS SOURCES (KSH BN)



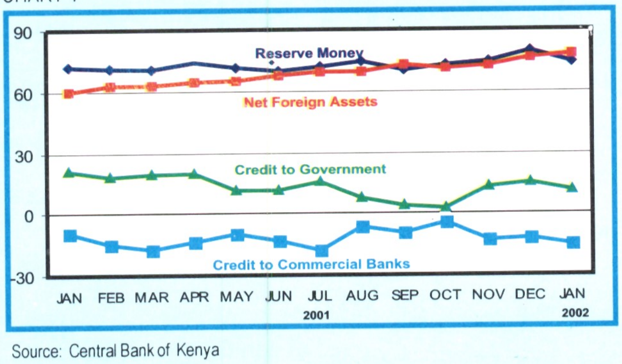
Source: Central Bank of Kenya

Central Bank, increased by 3.4% in the year to January 2002 compared with 7.1% decline in the year to January 2001 (Table 7 and Chart 7).

TABLE 7: RESERVE MONEY & ITS SOURCES (KSH BN)

	2000 Jan	2001 Jan	Change Absolute	%	Target Jan	Deviation
1 Net Foreign Assets	59.3	77.4	2.4	3.4	76.4	-2.8
2 Net Domestic Assets	11.9	-3.8	-15.7	-132.2	3.3	-7.1
2.1 Government Borrowing (net)	20.6	10.9	-9.6	-46.8	7.9	3.0
2.2 Advances & Discounts	-14.6	-15.4	-0.8	5.5	-9.0	-6.4
2.3 Other Domestic Assets (net)	5.9	2.0	-3.9	-66.5	4.4	-2.4
3 Reserve Money	71.2	73.6	2.4	3.4	76.4	-2.8
3.1 Banks Deposits at CBK	22.9	23.3	0.4	1.8	25.4	-2.0
3.2 NBFIs Deposits at CBK	0.5	0.2	-0.3	-62.5	0.2	0.0
3.3 Currency in Circulation	47.7	50.1	2.3	4.9	50.8	-0.8

CHART 7



Source: Central Bank of Kenya

The increase in the reserve money in the review period was mainly in currency in circulation that rose by 4.9%. The expansion in the reserve money was, however, within the set targets achieved through aggressive mop up of excess liquidity in the banking sector using open market operations.

Reserve money expansion in the year to January 2002 reflected the increase in net foreign assets (NFA) of the Central Bank, which more than offset the decline in the Bank's net domestic assets (NDA). NFA of the Central Bank increased by Ksh 2.4 bn with the build up arising from purchases from the interbank foreign exchange market.

Meanwhile, the NDA of the Central Bank declined by Ksh 15.7bn in the twelve months to January 2002 compared with Ksh 13.4bn decline in the year to January 2001. The decline in NDA during the period under review comprised the following:

- A decline of 46.8% in net credit to government due to repayment of Ksh 7.3bn gross borrowings and Ksh 2.4bn build up in deposits at the Bank.
- An increase of 5.5% in net indebtedness to commercial banks largely on account of 63.3% expansion in sterilized funds acquired through open market operations.
- A decline by 66.5% in other domestic assets of the Central Bank in the year to January 2002 compared with 56.2% increase in the year to January 2001.

Credit to the Private and Other Public Sectors

Banking system credit to both the private and other public sectors declined by 3.4% to Ksh 277.4bn in the twelve months to January 2002 compared with 4.4% increase in the year to January 2001 (Table 8 and Chart 8). The reduction reflected a persistent low demand for bank credit due to the subdued economic activities in year 2001, and the reluctance of banks to lend due to the uncertainty brought about by the debate on the Central Bank of Kenya (Amendment) Act, 2000 that reintroduces interest rate controls in the economy.

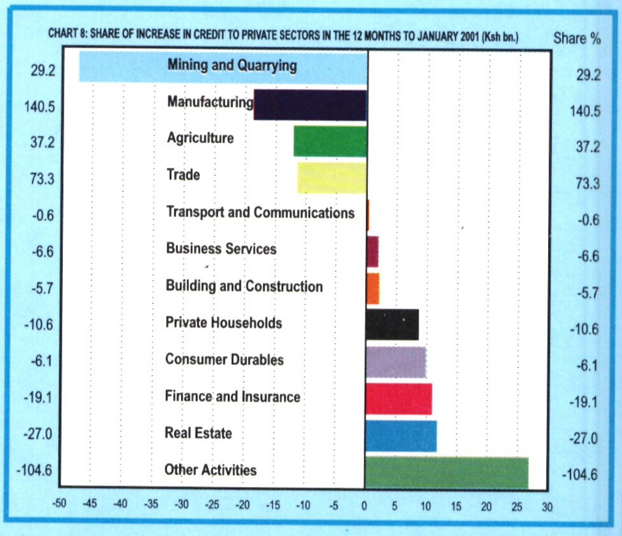
Analysis of bank credit to the various private sector activities shows that real estate, finance and insurance, private households, building and construction, business services and consumer durables and other activities took new loans amounting to Ksh 14.6bn during the 12-month period to January 2002. Meanwhile, the main private sector activities repaid a total of Ksh 22.7bn distributed as follows: manufacturing, Ksh 11.4 bn; trade, Ksh 5.9 bn; agriculture, Ksh 3bn, and mining and quarrying, Ksh 2.4bn.

TABLE 8: CREDIT TO PRIVATE & OTHER PUBLIC SECTORS (KSH. BN)

	2001 Jan		2002 Jan		Annual Change	
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)
1. Credit to other public sector	8.9	3.1	7.3	2.6	-1.6	-17.9
Local government	0.0	0.0	0.0	0.0	0.0	-89.7
Parastatals	8.9	3.1	7.3	2.6	-1.6	-18.2
2. Credit to private sector	278.2	96.9	270.1	97.4	-8.1	-2.9
Agriculture	25.2	8.8	22.2	8.0	-3.0	-12.0
Manufacturing	61.1	21.3	49.8	17.9	-11.4	-18.6
Trade	52.2	18.2	46.2	16.7	-5.9	-11.4
Building and construction	19.8	6.9	20.3	7.3	0.5	2.3
Transport & communications	10.6	3.7	10.7	3.8	0.0	0.5
Finance & insurance	13.9	4.9	15.5	5.6	1.5	11.1
Real estate	18.5	6.4	20.7	7.5	2.2	11.8
Mining and quarrying	5.0	1.7	2.6	0.9	-2.4	-47.3
Private households	9.8	3.4	10.7	3.8	0.9	8.7
Consumer durables	4.9	1.7	5.4	1.9	0.5	10.0
Business services	25.8	9.0	26.3	9.5	0.5	2.1
Other activities	31.4	10.9	39.9	14.4	8.5	26.9
3. TOTAL (1+2) *	287.1	100.0	277.4	100.0		

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

CHART 8: SHARE OF INCREASE IN CREDIT TO PRIVATE SECTORS IN THE 12 MONTHS TO JANUARY 2001 (Ksh bn.)



Source: Central Bank of Kenya

BANKING SECTOR DEVELOPMENTS

Structure of the Financial System

At the end of February 2002, the banking system comprised 46 commercial banks, 3 non-bank financial institutions (NBFIs), 2 mortgage finance companies, 4 building societies and 48 forex bureaus (Table 9). The decline in the total number of institutions from 60 in February 2001 to 55 in February 2002 was to due to mergers, liquidations and voluntary winding up of a few institutions.

TABLE 9 COMMERCIAL BANKS, NBFIS & FOREIGN EXCHANGE BUREAUS

Type of Institution/Bureau	Feb-2001	Feb-2002
Commercial Banks	48	46
(a) Operating	48	45
(b) Not operating	-	-
(c) Under Central Bank statutory management	-	1
Building Societies	4	4
Mortgage Finance Companies	2	2
Non-Bank Financial Institutions	6	3
(a) Operating	6	3
(b) Under Central Bank statutory management	-	-
Total	60	55
Foreign Exchange Bureaus	47	48

Source: Central Bank of Kenya

Asset Composition

The balance sheet structure of the banking sector changed substantially as major banks shifted to investment in government securities and reduced their lending activity following uncertainty regarding the implementation of the Central Bank of Kenya (Amendment) Act, 2000. Total assets of the banking system decreased by 3.9% to Ksh 422.4bn at the end of January 2002 from Ksh 439.6bn at the end of January 2001, mainly as a result of the placing under liquidation of one commercial bank. Consequently, loans and advances, which comprised 51% of banks' assets, decreased by Ksh 17.4bn to Ksh 215.1bn from Ksh 232.4.bn in January 2001. The decrease in loans and advances was also partly due to the exit of one bank which was placed under liquidation by the Deposit Protection Fund Board. Investment in government securities, which increased by 33.2% to Ksh 93.9bn in January 2002 from Ksh 70.5bn in January 2001, accounted for 22% of total assets compared with 16% in January 2001. Balances with the Central Bank remained unchanged and stood at Ksh 25.1bn, accounting for 6% of total assets.

Asset Quality

The level of non-performing loans (NPLs) declined to Ksh 110.4bn at end of January 2002 from Ksh 114.2bn in January 2001 (Table 10). However, as a proportion of gross loans, NPLs rose to 39.4% in January 2002 from 38.1% in January 2001. The increase in the ratio reflects the sharp drop in total gross advances by Ksh 19.5bn that more than

TABLE 10: NON-PERFORMING LOANS* (NPLs) (PROVISIONS) (Ksh bn)

		Jan-01	Jan-02
1.	Total Advances (Gross)	299.6	280.1
2.	Non Performing loans (NPLs)	114.2	110.4
3.	Provisions made for the NPLs	67.2	65.1
4.	Net NPLs (2-3)	47.0	45.3
5.	Value of securities (estimated)	33.2	38.7
6.	Net Exposure (2-3-5)	13.8	6.6
7.	NPLs as % of total Advances (2/1)	38.1%	39.4%
8.	Net NPLs as % of total Advances (4/1)	15.7%	16.2%
9.	Exposure as % of total Advances (6/1)	4.6%	2.4%
10.	Provisions as % of NPLs (3/2)	58.9%	59.0%

* Non-performing loans are those that are not being serviced as per loan contracts and expose the financial institutions to potential losses

Source: Central Bank of Kenya

off set the decrease in non-performing loans. Total provisions for bad and doubtful loans fell to Ksh 65.1bn from Ksh 67.2bn in January 2001. The industry was holding securities worth about Ksh 38.7bn, thus giving an uncovered exposure of Ksh 6.6bn for which additional provisions may be necessary.

Deposit Liabilities

Deposits, including accrued interest, held by the banking institutions decreased by 1.3% to Ksh 328.0bn in January 2002 from Ksh 332.4bn in January 2001. The top eight commercial banks accounted for 72.7% of the total deposit liabilities.

Capital and Reserves

Capital and reserves of the banking system increased by 5.1% to Ksh 56.6bn in January 2002 from Ksh 53.8bn in January 2001 (Table 11). The increase was due to profits made for the year to date. Largely as a result of the increase in capital and decrease in deposits, the level of capitalisation as measured by the ratio of capital and reserves to total deposits increased to 17.3% at the end of January 2002, from 16.2 % at the end of January 2001. Similarly, the ratio of total capital to risk-weighted assets increased to 18.9% at the end of January 2002 from 17.6% at the end of January 2001 and was above the legal minimum requirement of 12%.

TABLE 11: SELECTED ASSETS & LIABILITIES OF THE BANKING SYSTEM (Ksh bn)

	Jan. 2001	Jan. 2002	Change* Absolute	%
ASSETS	**439.6**	**422.4**	**17.3**	**-3.9**
Commercial Banks	414.5	404.5	10.0	-2.4
NBFIs	25.1	17.8	7.3	-29.1
Loans and Advances	232.4	215.0	17.4	-7.5
Government Securities	70.5	93.9	23.4	33.2
Balances at Central Bank	24.5	25.1	0.6	2.5
Fixed Assets	18.5	18.1	0.5	-2.6
Other Assets	29.3	23.1	6.3	-21.3
LIABILITIES	**385.8**	**365.8**	**20.0**	**-5.2**
Deposits**	332.4	328.0	4.4	-1.3
Capital and Reserves	53.8	56.6	2.7	5.1
Foreign Liabilities	11.1	9.3	-1.8	-16.4
Other Liabilities	42.2	28.4	-13.8	-32.7

*Absolute and percentage changes may not necessarily add up due to rounding.
**Includes interbank balances.

Source: Central Bank of Kenya

Profitability of the Sector

The unaudited pre-tax profits increased by 12.6% to Ksh 1,301m for the month ending January 2002 from Ksh 1,156m at the end of January 2001. The improvement in performance is mainly attributed to reduced expenses, which declined by 23.7% from Ksh 5,092m to Ksh 3,885m while incomes declined by 17.0% from Ksh 6,248m to Ksh 5,185m. The drop in expenses was largely caused by the decline in interest expense on deposits, bad debt charges and salaries and wages.

Institutions Under Statutory Management

Delphis Bank Ltd., which was placed under statutory management in June 2001, has not been re-opened since the stakeholders had not met the minimum conditions set for re-opening.

Source: Central Bank of Kenya

Cash and Liquidity Ratios of Commercial Banks and NBFIs

Deposit taking financial institutions operated above the 20% minimum liquidity and 10% cash ratio requirements in the months of January 2002 and February 2002 (Table 12 and Chart 9)

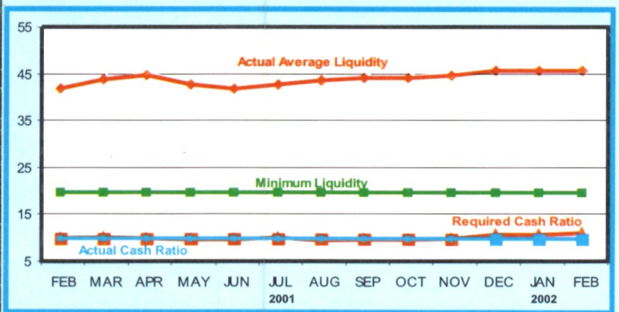
TABLE 12: CASH AND LIQUIDITY RATIOS (%)

	2000	2001				2002	
	Dec	Jan	Mar	Jun	Dec	Jan	Feb
Commercial Banks							
Average Liquidity	43	43	44	42	46	46	46
Minimum Liquidity	20	20	20	20	20	20	20
Cash Ratio - All Banks	9.9	9.4	10.2	10.0	10.0	10.0	10.0
Minimum Cash Ratio**	10	10	10	10	10	10	10
NBFIs							
Average Liquidity	42	45	48	60	57	59	56
Minimum Liquidity	20	20	20	20	20	20	20
Cash Ratio	11.8	11.3	11.5	10.1	10.9	11.0	11.3
Minimum Cash Ratio**	10	10	10	10	10	10	10

* Monthly average liquidity and cash ratios

** Commercial banks and NBFIs must observe fortnightly an average of 10% cash ratio and a daily minimum of 8%. The requirement became effective from 1st October 2000.

CHART 9



Source: Central Bank of Kenya

Liquidity Ratios

Liquidity position of deposit taking institutions in January and February 2002 was as follows:

- Average liquidity ratio for commercial banks was maintained at 46% for the third consecutive month in February 2002, while that for NBFIs fell to 56% from 59% in January 2002.
- The average liquidity ratio for mortgage finance companies remained unchanged at 29% for the third consecutive month in February 2002 while that for building societies declined to 51% in February 2002 from 54% in January 2002.

Cash Ratios

Commercial banks and NBFIs maintained the minimum monthly cash ratio of 10% in January and February 2002. Average cash ratio for commercial banks remained unchanged at 10% in February 2002 while that of NBFIs was 11.3% in February 2002 from 11% in January 2002.

Interest Rates

Principal money market interest rates declined marginally in January 2002 and February 2002 in response to the decline in the 91-day Treasury bill rate (Table 13 and Chart 10).

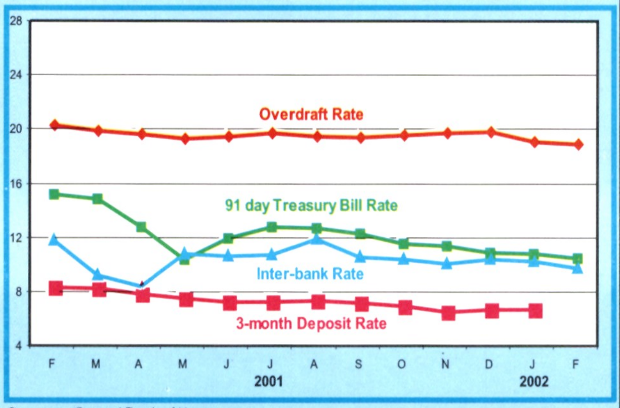
TABLE 13: INTEREST RATES (%)

	2001									2002	
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Average Lending Rate (1)	19.6	19.2	19.3	19.7	19.5	19.4	19.8	19.4	19.5	19.3	..
Overdraft	19.9	19.5	19.7	20.0	19.7	19.6	19.8	19.9	20.0	19.3	..
Treasury bill**	12.9	10.5	12.1	12.9	12.8	12.4	11.6	11.5	11.0	10.9	10.6
Interbank	8.5	10.9	10.7	10.8	12.0	10.7	10.5	10.1	10.4	10.3	9.8
Average Deposit rate (2)	6.6	6.4	6.4	6.2	6.2	6.3	6.2	5.9	5.7	5.7	..
3 - month deposit	8.1	7.7	7.5	7.5	7.6	7.4	7.2	6.8	6.9	6.9	..
Spread (1-2)	13.0	12.8	12.9	13.5	13.3	13.2	13.6	13.6	13.8	13.6	..

* Provisional

** 91-Days Treasury Bill

CHART 10



Sources: Central Bank of Kenya

The 91-day Treasury bill rate has been declining since February 2001 due to excess liquidity in the domestic market. The excess liquidity was attributed to low demand for commercial bank credit as a result of the slow pace of economic recovery and the adverse effects of the Central Bank of Kenya (Amendment) Act, 2000 on bank lending operations. Banks invested the apparent excess liquidity in government securities in the absence of alternative investment options.

Trends in the respective interest rates were as follows:

- 91 days Treasury bill rate declined to 10.6% in February 2002 from 10.9% in January 2002.
- Average interbank rate declined to 9.8% in February 2002 from 10.3% in January 2002.
- The interest rate charged by commercial banks for the overdraft facility declined to 19.3% in January 2002 from 20.0% in December 2001.
- Meanwhile, the interest rate on three months' deposit rate in January 2002 stabilised at 6.9% as in December 2001, while the interest rate paid on savings deposits remained unchanged at 4.4% for the fourth consecutive month.
- In the month of January 2002, the average lending rate eased to 19.3% from 19.5% in December 2001, while the average rate paid on deposits remained unchanged at 5.7%, resulting in an interest rate spread of 13.6%.

Shilling Exchange Rate

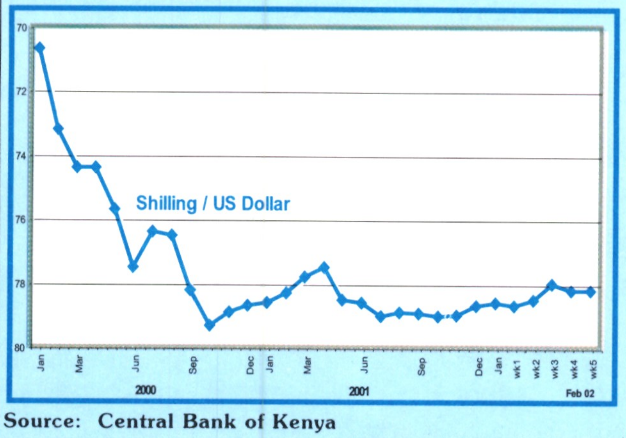
The Kenya shilling appreciated in February 2002 against all major trading partner currencies, except the South African Rand (Table 14 and Chart 11).

TABLE 14: SHILLING EXCHANGE RATE

	2001					2002	2002 February					
	Jan	Mar	Jun	Sep	Dec	Jan	wk 1	wk 2	wk 3	wk 4	wk 5	Avg
US Dollar	78.6	77.8	78.6	78.9	78.7	78.6	78.7	78.5	78.0	78.2	78.2	78.3
Pound Sterling	116.3	112.4	110.3	115.5	113.2	112.8	111.0	111.1	111.3	111.8	111.3	111.4
100 Japanese Yen	67.3	64.2	64.4	66.5	61.9	59.3	58.7	58.8	58.6	58.6	58.3	58.6
Uganda Shilling*	23.2	22.5	22.6	22.2	21.9	22.2	22.0	22.2	22.3	22.4	22.6	22.4
Tanzania Shilling*	10.2	10.7	11.3	11.3	11.6	11.8	11.9	12.0	12.2	12.3	12.3	12.2
Euro	73.8	70.8	67.2	71.9	70.2	69.3	67.6	68.1	68.2	68.2	67.9	68.1
Nominal Effective Exchange Rate	78.6	80.3	80.5	81.2	83.1	83.6						
Real Effective Exchange Rate	95.0	95.1	95.1	94.5	96.8	97.2						

* Units of currency per Kenya shilling

CHART 11



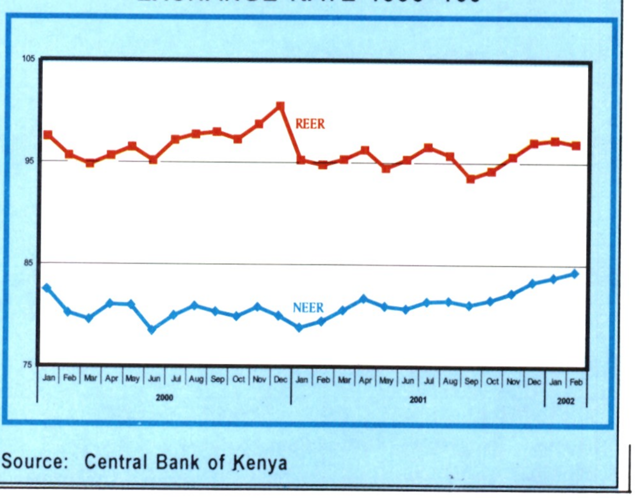
Source: Central Bank of Kenya

The shilling continued to remain stable appreciating against the US dollar only marginally by 0.4% to trade at an average of Ksh 78.3 in February 2002 from Ksh 78.6 in January 2002. This reflected weak demand for foreign currency as a result of persistent low economic activity. Against the Euro, the Japanese Yen, and the Pound Sterling, the shilling strengthened by 2.1%, 1.2% and 1.2%, respectively. The three currencies also lost against the US dollar in the international market by 1.7%, 0.8% and 0.8%, respectively. The shilling however weakened marginally against the South African Rand to exchange at Ksh 6.83 in February 2002 from Ksh 6.76 in January 2002. The Rand gained against the US dollar by 1.4% in the period under review.

With respect to regional currencies, the Kenya shilling, in February 2002, gained against the Tanzanian shilling to trade at an average of Tsh 12.2 from Tsh 11.8 in January but remained stable at Ush 22.4 against the Uganda shilling, the same level as in January 2002.

The trade-weighted nominal shilling exchange rate appreciated by about 4.6% in the year to February 2002 compared with an appreciation of 0.8% in the year to February 2001. In real terms, however, the shilling appreciated by 0.5% compared with 1.1% depreciation in 2001, mainly on account of appreciation of the trade weighted nominal shilling exchange rate which more than offset the decline in domestic inflation.

CHART 12: NOMINAL & REAL EFFECTIVE EXCHANGE RATE 1995=100



Source: Central Bank of Kenya

Budgetary Developments

Government budgetary operations in the first seven months of financial year 2001/2002 resulted in a deficit of Ksh 11.9bn or 1.4% of GDP on a commitment basis compared with Ksh 5.0bn deficit or 0.6% of GDP in a similar period in financial year 2000/2001 (Table 15 and Chart 13). On a cash basis, the outturn deteriorated to a deficit of Ksh 13.7bn or 1.6% of GDP from Ksh 0.5bn deficit in the same period of the previous year.

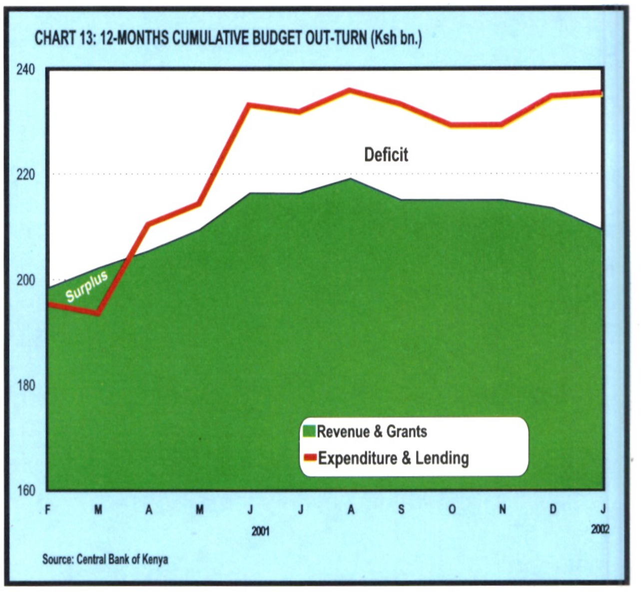


TABLE 15: BUDGET OUT-TURN (KSH BN.)

TABLE 15: BUDGET OUT-TURN (Ksh bn.)

	FY 2000/2001 January Actual	FY 2000/2001 January Share (%)	FY 2001/2002 January* Actual*	FY 2001/2002 January* Share (%)	Jan Target	2001/02 Over(+)/ Below (-)
1. TOTAL REVENUE & GRANTS	**117.4**		**110.3**		**131.1**	**-20.8**
Revenue	107.3	91.4	106.9	96.9	127.5	-20.6
Ordinary Revenue	99.4	84.6	98.1	89.0	115.5	-17.3
Tax Revenue	90.3	76.9	92.1	83.5	104.4	-12.3
Income Tax	28.9	24.6	31.6	28.7	35.0	-3.4
Value Added Tax	27.9	23.8	29.7	26.9	32.8	-3.0
Import Duty	17.3	14.7	13.3	12.1	18.5	-5.2
Excise Duty	16.2	13.8	17.5	15.8	18.2	-0.8
Non Tax Revenue	9.1	7.8	6.0	5.5	11.0	-5.0
Investment Income	2.3	1.9	0.4	0.4	2.0	-1.5
Others	6.9	5.8	5.6	5.1	9.1	-3.5
Appropriations-in-Aid	7.9	6.7	8.8	7.9	12.1	-3.3
External Grants	10.1	8.6	3.4	3.1	3.5	-0.1
2. TOTAL EXPENDITURE AND LENDING	**122.5**		**122.2**		**135.8**	**-13.6**
Recurrent Expenditure	109.7	89.6	111.5	91.3	116.8	-5.2
Domestic Interest	13.6	11.1	14.1	11.6	15.5	-1.4
Foreign Interest	2.9	2.4	5.0	4.1	4.6	0.4
Wages and Salaries	41.1	33.5	44.8	36.6	44.2	0.6
Others	52.1	42.6	47.6	39.0	52.5	4.8
Development Expenditure	12.5	10.2	10.7	8.7	19.1	-8.4
Civil Contingency Fund	0.2	0.2	0.0	0.0		
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-5.0**		**-11.9**		**-4.8**	**-7.1**
as a ratio of GDP (%)	-0.6		-1.4		-0.6	
4. ADJUSTMENT TO CASH BASIS	**5.0**		**-4.1**		**-3.8**	**-0.3**
5. DEFICIT ON A CASH BASIS	**0.0**		**-16.0**		**-8.6**	**-7.4**
as a ratio of GDP (%)	0.0		**-1.9**		-1.0	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**0.5**		**-2.4**		**0.0**	**-2.4**
7. FINANCING	**0.5**		**13.7**		**8.6**	**5.1**
Domestic (Net)	**-6.1**		**23.1**		**13.5**	**9.6**
Central Bank	-0.4		0.1			
Commercial banks	-10.3		15.9			
Other domestic sources	4.6		7.1			
Non banks	4.6		7.1			
Capital Receipts (privatisation)	0.0		0.0			
External (Net)	**6.6**		**-9.5**		**-8.0**	**-4.6**
Loan Disbursements	13.1		3.6			
Less Loan Repayments	-6.5		-13.1			

* Provisional

Sources: Treasury and Central Bank of Kenya

Revenue and Grants

Government receipts amounted to Ksh 110.3bn in the first seven months of financial year 2001/2002 (Table 16). The receipts, which were Ksh 7.1bn lower than in a similar period in financial year 2000/2001, comprised Ksh 106.9bn ordinary revenue and Ksh 3.4bn external grants. The decline in receipts was mainly in external grants.

TABLE 16: COMPOSITION OF GOVERNMENT REVENUE (KSH BN)

	Jan '01 Ksh bn	Share %	Jan '02 Ksh bn	Share %
1. Revenue (2+3+4)	**107.3**	**91.4**	**106.9**	**96.9**
2. Tax Revenue	90.3	76.9	92.1	83.5
Income Tax	28.9	24.6	31.6	28.7
Value Added Tax	27.9	23.8	29.7	26.9
Import Duty	17.3	14.7	13.3	12.1
ExciseDuty	16.2	13.8	17.5	15.8
3. Appropriations-in-Aid	7.9	6.7	8.8	7.9
4. Other Revenue	9.1	7.8	6.0	5.5
5. External Grants	**10.1**	**8.6**	**3.4**	**3.1**
TOTAL RECEIPTS (1+5)	**117.4**	**100.0**	**110.3**	**100.0**

Source: Treasury

The government revenue comprised the following:

- Tax revenue amounting to Ksh 92.1bn or Ksh 1.8bn higher than in the comparable period of the previous financial year. Income tax and Value Added Tax (VAT) combined increased by Ksh 4.5 bn whilst import and excise duties collections declined by Ksh 2.7bn.
- Other revenue comprising investment income, license fees, fines and other levies amounting to Ksh 6.0bn, Ksh 3.1bn lower than revenue received in a similar period in the previous fiscal year.
- Appropriations-in-Aid amounting to Ksh 8.8bn, which was Ksh 0.9bn higher than in a similar period in the previous fiscal year.
- External grants dropped to Ksh 3.4bn compared with Ksh 10.1bn in the same period last fiscal year. The high level in the previous fiscal year reflected a grant of Ksh 5.8bn received from the World Food Programme for drought relief.

Expenditure and Net Lending

Government expenditure and net lending amounted to Ksh 122.2bn in the first seven months of financial year 2001/2002 compared with Ksh 122.5bn in a similar period in financial year 2000/2001 (Table 17).

TABLE 17: COMPOSITION OF GOVERNMENT EXPENDITURE (KSH BN)

	Jan '01 Ksh bn	Share %	Jan '02 Ksh bn	Share %
Salaries & Wages	**41.1**	33.5	**44.8**	36.6
Total Interest	**16.5**	13.5	**19.1**	15.7
Domestic*	**13.6**	11.1	**14.1**	11.6
Foreign	**2.9**	2.4	**5.0**	4.1
Development	**12.5**	10.2	**10.7**	8.7
Others	**52.4**	42.8	**47.6**	39.0
TOTAL EXPENDITURE	**122.5**	**100.0**	**122.2**	**100.0**

*Includes commission and other charges paid to CBK

Source: Treasury

The major components of the expenditure were as follows:

- Recurrent expenditure at Ksh 111.5bn or 91.3% of total expenditure was Ksh 1.8bn higher than in a similar period in financial year 2000/2001. The expenditure comprised the following:

- Wages and salaries of Ksh 44.8bn, accounting for 36.6% of total government expenditure. At this level, expenditure on wages and salaries was Ksh 3.7bn higher than in a comparable period in the previous fiscal year.
- Ksh 19.1bn interest payment on government debt. The payments were Ksh 2.6bn higher than in a comparable period in financial year 2000/2001, following increased domestic borrowing that offset the benefit of reduced interest rates. Interest paid on domestic debt amounted to Ksh 14.1bn or 73.8% of the total interest paid on government debt while that on foreign debt was Ksh 5.0bn.
- Other recurrent expenditures, mainly on operations and maintenance at Ksh 47.6bn was Ksh 4.5bn lower than in the corresponding period in financial year 2000/2001.

• Development expenditure amounted to Ksh 10.7bn or 8.7% of total government expenditure. At this level, development expenditure was Ksh 1.8bn lower than in a similar period in financial year 2000/2001.

Financing

Government fiscal operations in the first seven months of the financial year 2001/02 resulted in a financing gap of Ksh 32.6bn. The gap necessitated the following borrowing by Government (Table 18):

TABLE 18: GOVERNMENT BORROWING REQUIREMENTS & SOURCES (KSH BN)

FINANCING REQUIREMENTS	Jan '01 Ksh bn	Share %	Jan '02 Ksh bn	Share %
1. Fiscal deficit	**0.5**	3.3	**13.7**	41.9
2. External debt reduction	**0.0**	0.0	**9.5**	29.1
3. Domestic debt reduction	**14.3**	96.7	**9.5**	29.0
3.1 Central Bank (incl. items in transit)	**4.0**	27.2	**9.5**	29.0
3.2 Commercial banks (net of deposits)	**10.3**	69.6	**0.0**	0.0
3.3 Non-bank sources	**0.0**	0.0	**0.0**	0.0
4. Increase in GoK deposits at CBK	**0.0**	0.0	**0.0**	0.0
Total	**14.8**	100.0	**32.6**	100.0

FINANCING SOURCES	Jan '01 Ksh bn	Share %	Jan '02 Ksh bn	Share %
1. Fiscal surplus	**0.0**	0.0	**0.0**	0.0
2. External debt increase	**6.6**	44.4	**0.0**	0.0
3. Increase in domestic debt	**4.6**	31.0	**23.0**	70.5
3.1 Central Bank	**0.0**	0.0	**0.0**	0.0
3.2 Commercial banks	**0.0**	0.0	**15.9**	48.9
3.3 Non-bank sources	**4.6**	31.0	**7.1**	21.7
4. Reduction in GoK deposits at CBK	**3.6**	24.6	**9.6**	29.5
Total	**14.8**	100.0	**32.6**	100.0

Sources: Treasury & Central Bank of Kenya

- Ksh 15.9bn from commercial banks,
- Ksh 7.1bn from non-bank sources,
- Ksh 9.6bn draw down of Government deposits held at the Central Bank.

The funds were utilized in making payments as follows:

- Net external repayment of Ksh

9.5bn;

- Net repayment of Ksh 9.5bn to Central Bank; and
- Financing a budget deficit of Ksh 13.7bn

Government Borrowing from the Central Bank

Government indebtedness to the Central Bank declined by Ksh 9.5bn to Ksh 39.7bn during the first seven months of financial year 2001/02 from Ksh 49.2bn in June 2001 (Table 19). The decline in net indebtedness to the Bank of Ksh 9.5bn was due to the following transactions:

- Ksh 2.9bn pay off of government overdraft at the Bank; during the period July – October 2002, and
- Ksh 6.6bn decline in cleared items awaiting transfer to the Paymaster General Account.

TABLE 19: GOVERNMENT GROSS BORROWING FROM THE CENTRAL BANK, FY 2001/2002 (KSH BN)

		2001 June	2002 Jan	Movement
Total Government Credit (1+2+3+4+5)		**49.2**	**39.7**	**-9.5**
1.	Overdraft	2.9	0.0	-2.9
2.	Rediscounted securities	0.1	0.1	0.0
	Treasury bills	0.1	0.1	0.0
	Treasury bonds	0.0	0.0	0.0
3.	Non-interest bearing T/bills & bonds	36.9	36.9	0.0
4.	IMF funds onlent to Government	2.0	2.0	0.0
5.	Cleared items in transit	7.4	0.7	-6.6
Memorandum				
	Authorised overdraft limit	**8.8**	**8.8**	**0.0**
	Amount utilised to date	**2.9**	**0.0**	**-2.9**
	Amount available	5.9	8.8	2.9

Source: Central Bank of Kenya

Source: Central Bank of Kenya

Public Debt

Public debt decreased by Ksh 0.8bn to Ksh 605.0bn in January 2002 from Ksh 605.8bn in June 2001. At that level, the debt was 70.2% of GDP. The decrease in the debt stock followed a decline of Ksh 11.7bn in external debt that offset a Ksh 10.9bn increase in domestic debt (Table 20). Domestic debt amounted to Ksh 222.7bn or 36.8% of total public debt at the end of January 2002, while external debt was Ksh 382.3bn or 63.2% of the debt stock.

TABLE 20: KENYA'S PUBLIC DEBT (KSH BN)

	Jun-00*	Jun-01**	Jan-02**	Change 2001/02
EXTERNAL* **				
Bilateral	128.7	122.4	117.7	-4.8
Multilateral	234.1	231.8	225.0	-6.8
Commercial Banks	31.5	36.0	35.9	-0.1
Export Credit	1.5	3.8	3.8	0.0
SUB-TOTAL	**395.7**	**394.0**	**382.3**	**-11.7**
(as a % of GDP)	50.9	45.7	44.4	-1.4
DOMESTIC				
Banks	**120.1**	**109.2**	**113.5**	**4.3**
Central Bank	51.0	47.2	37.7	-9.5
Commercial Banks	69.1	62.0	75.8	13.8
Non-banks	**77.0**	**93.4**	**102.9**	**9.5**
Non-Bank Financial Inst.	2.7	3.9	2.1	-1.8
Other Non-Bank Sources	74.4	89.6	100.8	11.2
Non-residents	**9.0**	**9.2**	**6.3**	**-2.9**
SUB-TOTAL	**206.1**	**211.8**	**222.7**	**10.9**
(as a % of GDP)	26.5	24.6	25.8	1.3
GRAND TOTAL	**601.8**	**605.8**	**605.0**	**-0.8**
(as a % of GDP)	77.4	70.3	70.2	-0.1

* Revised.
** Provisional.
***Includes IMF Loans.
From January 2001 internal debt is reported on a gross basis, that is, without netting out government deposits and Treasury advances to parastatals. The debt is net of shs 2,028m. IMF disbursements onlent to the Govt by CBK and which are considered as part of external debt

Source: Treasury & Central Bank of Kenya

Domestic Debt

Government domestic debt increased to Ksh 222.7bn at the end of January 2002 from Ksh 211.8bn in June 2001 (Tables 21 and 22). The Ksh 10.9bn increase in domestic debt in January 2002 was explained by Ksh 20.1bn increase in government securities, which was partly offset by Ksh 9.2bn decrease in non-securitised debt.

TABLE 21: GOVERNMENT DOMESTIC DEBT (KSH BN)

	2001				2002
	Jan	Jun	Sep	Dec	Jan
Total stock of Domestic Debt (A+B)	**193.3**	**211.8**	**219.2**	**222.0**	**222.7**
A. Government Securities	**183.0**	**199.3**	**215.7**	**215.5**	**219.5**
1. Treasury Bills (excluding Repo Bills)	**112.3**	**116.4**	**116.9**	**96.8**	**93.1**
Banking institutions	48.3	50.7	55.7	45.3	38.4
Others	64.0	65.8	61.2	51.5	54.7
2. Treasury Bonds	**32.4**	**44.5**	**60.5**	**80.3**	**88.0**
Banking institutions	10.3	13.1	22.0	32.8	37.7
Others	22.1	31.4	38.5	47.5	50.3
3. Long term Stocks	**1.5**	**1.5**	**1.5**	**1.5**	**1.5**
Banking institutions	0.0	0.0	0.0	0.0	0.0
Others	1.5	1.5	1.5	1.5	1.5
4. Non-interest bearing T/Bills and Bonds	**36.9**	**36.9**	**36.9**	**36.9**	**36.9**
Of which: Repo T/Bills	22.0	21.1	27.0	27.0	27.0
B. Others:	**10.3**	**12.5**	**3.5**	**6.5**	**3.2**
Of which CBK overdraft to Government	7.4	2.9	0.5	0.0	0.0

From Janaary 2001 domestic debt is reported on a gross basis i.e. without netting out government deposits and Treasury advances to parastatals.

Sources: Central Bank of Kenya

TABLE 22: ANALYSIS OF DOMESTIC DEBT (KSH BN)

	Jun-01	Jan-02	Change
Government securities	**199.3**	**219.5**	**20.1**
Treasury Bills*	116.4	93.1	-23.3
Treasury Bonds	44.5	88.0	43.5
Of which: special bonds	6.3	8.3	1.9
Government Stock	1.5	1.5	0.0
Non-interest bearing debt	**36.9**	**36.9**	**0.0**
Others**	**12.5**	**3.2**	**-9.2**
Of which: Overdraft at the Central Bank	2.9	0.0	-2.9
Total Stock of Domestic Debt	**211.8**	**222.7**	**10.9**

*** Excludes REPO Treasury bills**
**** Includes overdraft, items in transit, commercial banks advances and tax reserve certificates**

Source: Central Bank of Kenya

Treasury Bills

The stock of Treasury bills declined significantly to Ksh 93.1bn in January 2002 from Ksh 116.4bn in June 2001 (Table 23 and Chart 14). The outstanding Treasury bills accounted for 42.4% of the stock of Government securities. The distribution of Treasury bills holdings by investors in January 2002 was as follows:

- Banking institutions held bills worth Ksh 38.4bn or 41.3% of the stock, out of which the commercial banks and non-bank financial

TABLE 23: OUTSTANDING TREASURY BILLS BY HOLDER (KSH BN.)

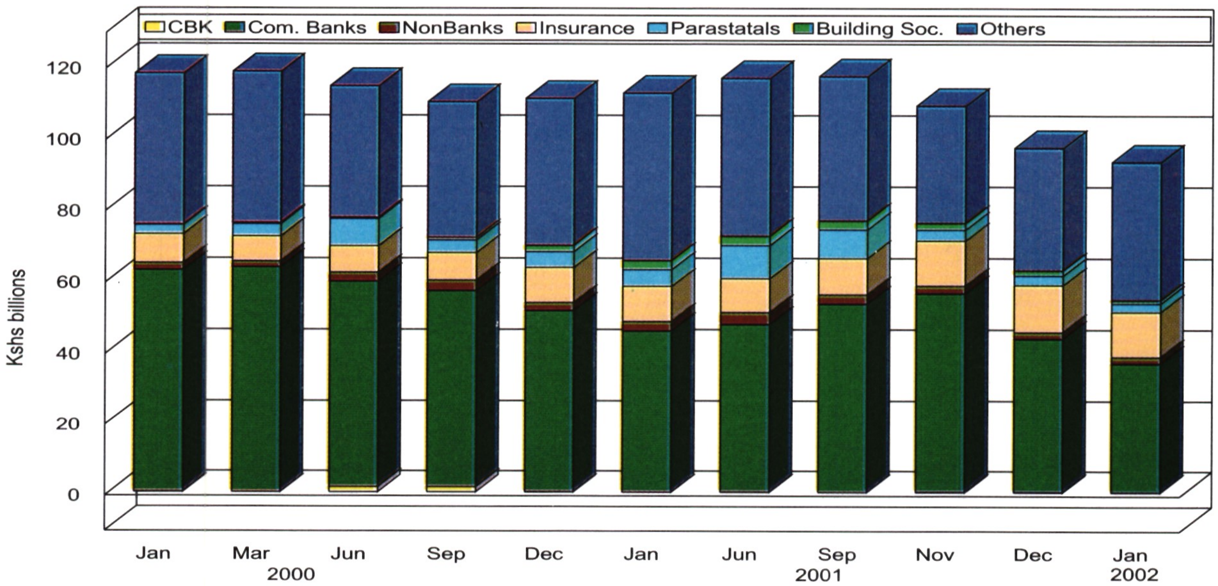
	2001						2002	
Holders	Jan	%	Jun	%	Dec	%	Jan*	%
Banking Institutions	48.3	43.0	50.7	43.5	45.3	46.8	38.4	41.3
Central Bank	0.0	0.0	0.1	0.1	0.2	0.2	0.1	0.1
Comm. Banks	45.6	40.6	47.3	40.6	43.3	44.7	36.5	39.2
NBFIs	2.6	2.3	3.3	2.8	1.8	1.8	1.8	1.9
Insurance Companies	9.8	8.7	9.5	8.2	13.1	13.5	12.5	13.5
Parastatals	4.7	4.2	9.3	8.0	2.7	2.7	2.4	2.6
Of which: NSSF	0.8	0.7	0.2	0.2	0.5	0.5	0.8	0.9
Building Societies	2.6	2.3	2.6	2.2	1.5	1.6	1.0	1.1
Others	46.9	41.8	44.3	38.1	34.3	35.4	38.7	41.6
Total**	**112.3**	**100.0**	**116.4**	**100.0**	**96.8**	**100.0**	**93.1**	**100.0**

* Provisional

** Excludes Repurchase Order bills

Source: Central Bank of Kenya

CHART 14: OUTSTANDING TREASURY BILLS BY HOLDER (Ksh bn.)



Source: Central Bank of Kenya

institutions held bills worth 36.5bn and Ksh 1.8bn, respectively while the Central Bank held bills worth Ksh 0.1bn.

- Other corporate investors and individuals held Ksh 54.7bn or 58.7% of the bills.

Treasury Bonds

The stock of Treasury bonds increased to Ksh 88.0bn as at end January 2002 from Ksh 44.5bn in June 2001. In January 2002, the Government issued a 1 year fixed rate bond and 3 year fixed rate bond from which Ksh 7.0bn and Ksh 3.0bn respectively were realised. A further Ksh 1.0bn Treasury bonds were issued in the month to secure pending bills. During the period under review, bonds of Ksh 57.3bn were issued, but this was partially offset by Treasury bond redemptions of Ksh 13.8bn. The stock of outstanding Treasury bonds in January 2002 was held by various investors as follows:

- Commercial banks held bonds of Ksh 36.9bn;
- Non-bank financial institutions held bonds of Ksh 0.8bn; and
- Other investors including insurance companies, other corporate investors and individuals held bonds of Ksh 50.2bn.

Government Long-term Stocks

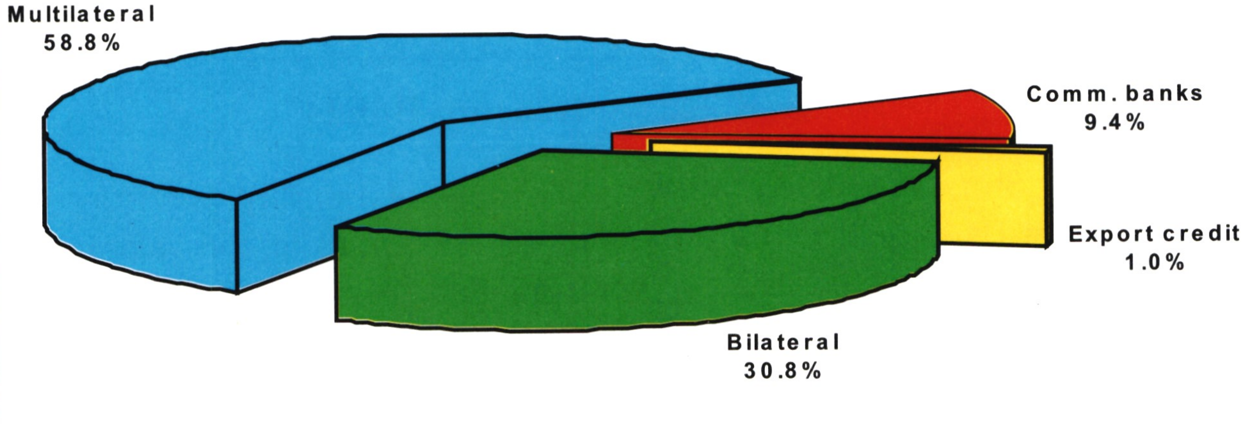
The government long-term stocks remained unchanged at Ksh 1.5bn at the end of January 2002. The Ksh 1.5bn outstanding government stocks were held entirely by the non-bank sector, of which the National Social Security Fund held Ksh 0.8bn.

External Debt

External debt stood at Ksh 382.3bn, or the equivalent of US$ 4.9bn, at the end of January 2002, a decrease of Ksh 11.7bn in the debt stock from the June 2001 level. At this level, the stock of external debt was equivalent to 44.4% of GDP. The fall in external debt during the period under review reflected a repayment of Ksh 15.2bn, which was partly offset by loan disbursements amounting to Ksh 3.6 bn.

Multilateral creditors accounted for 58.8% of the total external debt while bilateral creditors accounted for 30.8%. Commercial creditors share of external debt was 10.4% (Chart 15).

CHART 15: EXTERNAL DEBT DISTRIBUTION



Source: Treasury

Balance Of Payments

The overall balance of payments position improved to a surplus of US$ 72m in the year to January 2002 compared to a deficit of US$ 8m in the year to January 2001. The improvement in the balance of payments was due to an increase in the capital account surplus, which more than offset the increase in the external current account deficit (Table 24 and Charts 16 and 17).

The Current Account

The current account deficit, comprising the balances on trade in goods and services, income, and net current transfers, increased to $266 million (about 3.2% of GDP) in the year to January 2002 from $249 million (about 2.2% of GDP) in the year to January 2001. Although the surplus on services increased, it was more than offset by an

TABLE 24: BALANCE OF PAYMENTS (US$ m)

ITEM	Year to Jan-01	Q1 Feb-Apr	Q2 May-Jul	Q3 Aug-Oct	Q4 Nov01-Jan-02**	Year to Jan 2002**
OVERALL BALANCE	-8	14	12	83	-2	72
I. CURRENT ACCOUNT	-249	46	-179	-113	-20	-266
Goods	-1504	-346	-578	-450	-257	-1630
Exports (fob)	1816	510	524	439	421	1895
Coffee	153	27	30	20	12	88
Tea	464	123	123	90	98	433
Horticulture	221	73	57	48	65	242
Oil products	143	50	34	43	27	153
Other	836	239	279	240	220	978
Imports (cif)	3319	856	1102	889	678	3525
Oil	804	248	188	176	177	788
Chemicals	437	121	122	120	118	481
Manufactured goods	370	109	118	113	180	519
Machinery & transport equipment	769	192	512	253	116	1074
Other	938	185	162	228	88	662
Services	1255	392	399	337	236	1364
Non-factor services (net)	625	208	250	203	130	791
of which tourism	259	75	76	66	36	252
Income (net)	-133	-40	-41	-37	-41	-159
of which official interest	-121	-39	-31	-29	-29	-128
Current Transfers	763	224	190	170	148	732
Private (net)	91	160	167	171	148	645
Public (net)	672	64	23	-1	0	87
II. CAPITAL & FINANCIAL ACCOUNT	241	-31	190	196	19	339
Capital Tranfers (net)	63	17	15	17	18	68
Financial Account	178	-48	175	179	1	306
Official, medium- & long-term	-170	-79	-48	-102	-10	-238
Inflows	304	64	44	41	46	194
Outflows	-474	-142	-91	-142	-56	-432
Private, medium- & long-term (net)	140	13	47	-1	10	69
Commercial Banks (net)***	-232	-1	109	36	17	161
Short Term and Errors & Ommissions (net)	439	18	66	245	-16	313
Memo:	-91	12	156	35	27	231
Gross Reserves	1398	1508	1463	1431	1442	1442
Official****	897	949	981	1021	1035	1035
	2.9	3.1	3.2	3.4	3.4	3
Commercial Banks	501	559	482	410	406	406

* Provisional

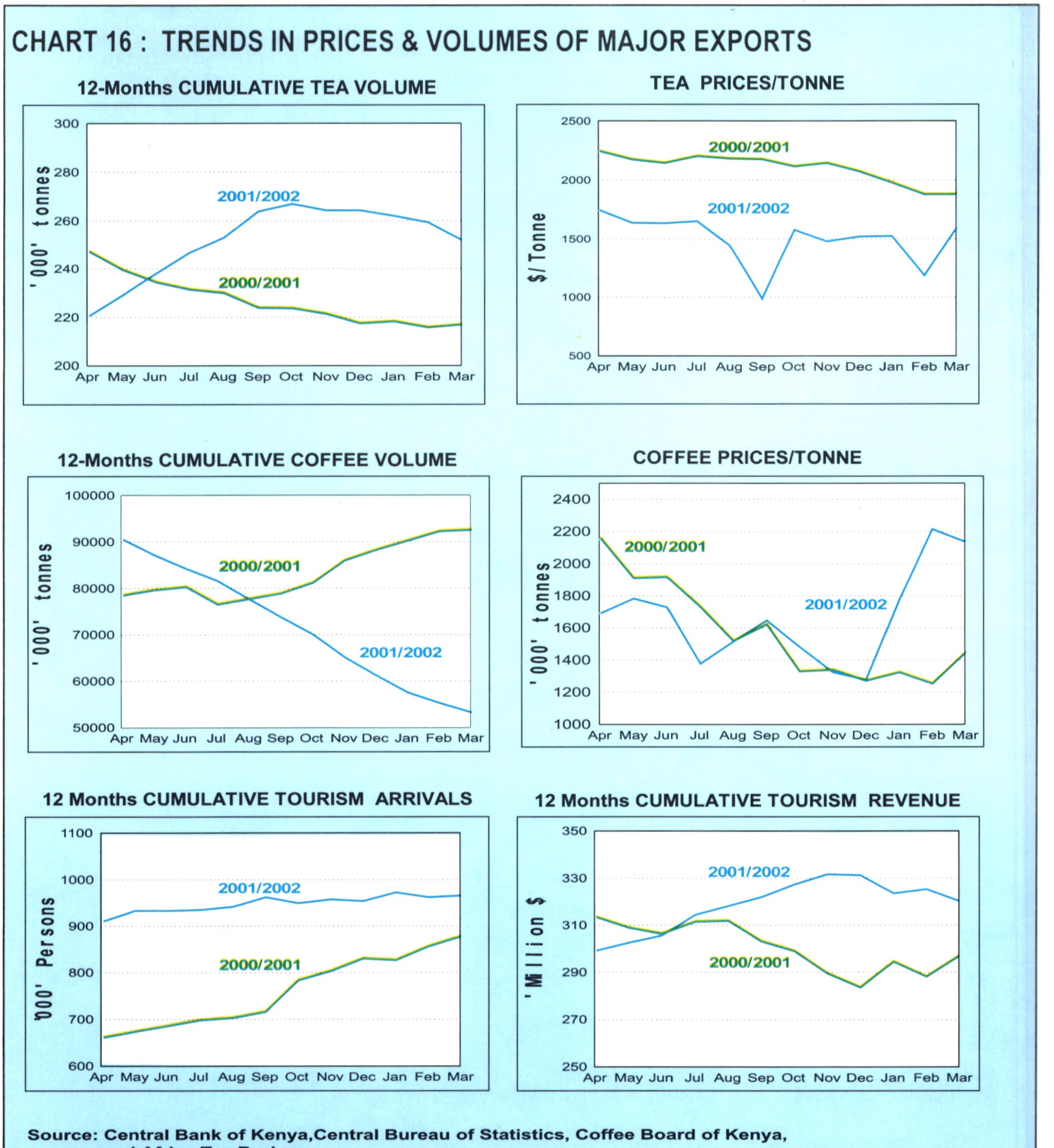
** An increase in an asset is denoted by a negative sign

Source: Central Bank of Kenya

increase in trade deficit, a reduction in the current transfers surplus and an increase in income deficit. The worsening of the net current account deficit occurred mainly in the second and third quarters of the period under review .

Merchandise Goods

The merchandise account deficit widened to US$1,630 million (about 15.6% of GDP) in the period under review. The



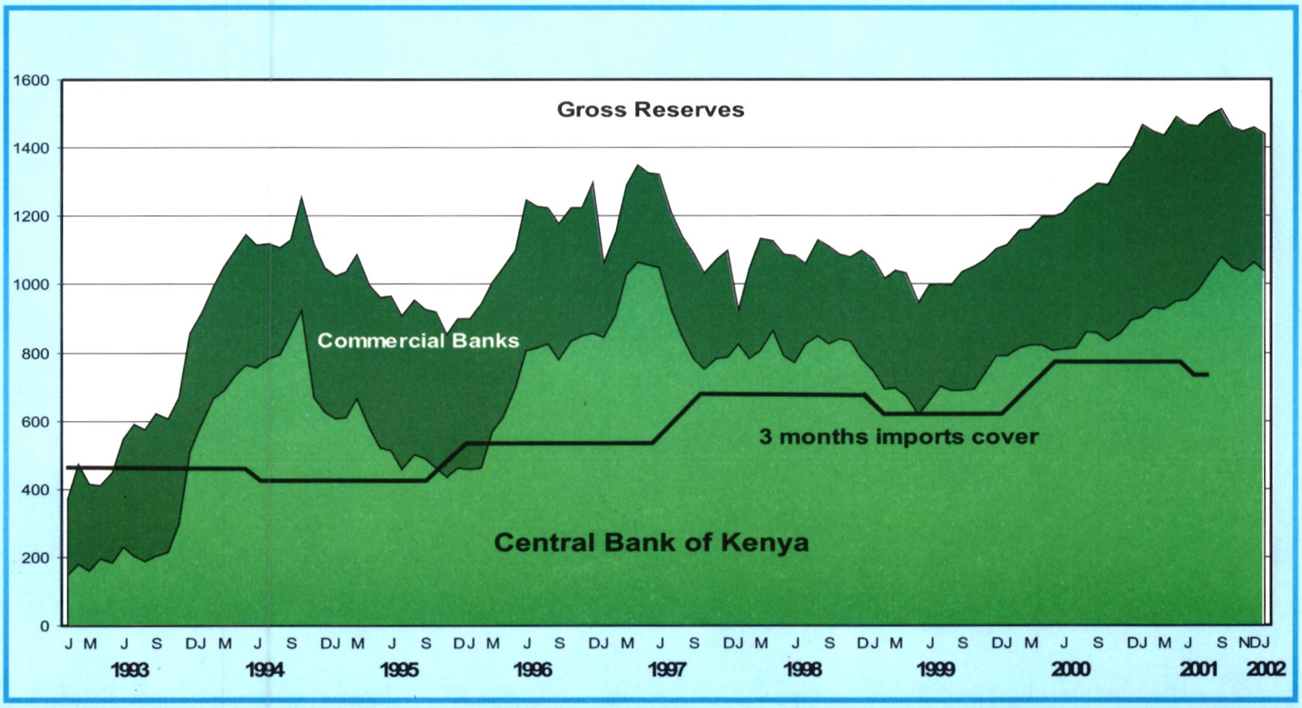
Source: Central Bank of Kenya, Central Bureau of Statistics, Coffee Board of Kenya, and Africa Tea Brokers widening was on account of a 6.2% growth in imports of goods, which more than offset a 4.3% increase in exports. Machinery and transport equipment, manufactured goods and chemicals accounted for the increase in imports of goods. Oil imports, however, declined. Except coffee and tea, all other major categories of exports of goods increased in the period under review. The decline in coffee export earning reflected the effects of low international prices as well as lower export volumes. The decline in tea exports was also due to low international prices.

Services

The services account surplus improved during the period under review, reflecting increases in net receipts from non-factor services, which more than offset the decline in both the net current transfers and net investment income. Non-factor services rose to US$ 791m compared to US$ 625m in the year to January 2001. The improvement in net non-factor services was on account of the increase in tourism, transportation services as well as 'other' private services.

Net investment income, defined as income payments on foreign-owned assets in Kenya less income receipts on Kenyan owned assets abroad, however, registered a higher deficit of $159 million (about 1.5% of GDP) compared with a deficit of US$ 130 million in the year to January 2001. Net current transfers also declined, albeit marginally, to record a surplus of US$ 732 million compared with a surplus of US$ 737 million in the

CHART 17: FOREIGN EXCHANGE RESERVES (US$ m)



Source: Central Bank of Kenya

year to January 2001

Capital and Financial Account

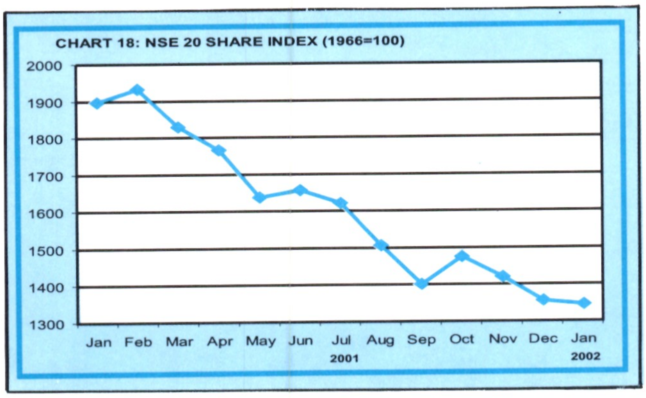
Net recorded capital and financial inflows, that is, net acquisitions by foreign residents of assets in Kenya less net acquisitions by Kenyan residents of assets abroad, improved by US$ 98m (about 0.9% of GDP) to a surplus of US$ 339m during the period under review. The improvement was due to an increase in net capital transfers from US$ 63m to US$ 68m and increase in net private medium and long-term capital flows from a net outflow of US$ 91m to a net inflow of US$ 231m. These developments more than offset the decline of US$ 170m in net long-term official capital inflows to a net outflow of US $ 238m and decline in short term capital inflows from US$ 439m to US$ 313m. The short-term capital inflows includes statistical discrepancy, that is, errors and omissions.

Foreign Exchange Reserves

Following the improvement in the balance of payments, official foreign exchange reserves increased to US $ 1,035m, equivalent to 3.4 months of imports of goods and non-factor services at end of January 2002 compared to US $ 897m a year earlier (Chart17). Commercial banks on their part held foreign exchange reserves amounting to US$ 406m at end of January 2001, US$ 95m lower than the level in January 2001. Foreign exchange reserves held by the entire banking system stood at US$ 1,442m at the end of January 2002 compared to US$ 1,398m at end of January 2001.

Stock Market

Trading at the Nairobi Stock Exchange in the month of January 2002 was fairly stable compared to December 2001, following improvements in turnover at the bonds market and market capitalization at the equities market. Trading in the Government bonds increased sharply, reflecting improved yields and sluggish returns to investment in equities.



Equities Market

Trading at the equities market was fairly stable in January 2002 compared to December 2001 with the market indicators evolving as follows:

- Market capitalization increased by 3.5% to Ksh 89.1bn in January 2002 compared with a decline of 4.5% in December 2001.
- The NSE 20 Share price index declined by 0.9% to close at 1343.41 compared with a 4.6% decline in December 2001.
- The volume of shares traded out of total shares issued declined by 1.8% to 5.1m in January 2002 compared with a 17.3% decline in December 2001.
- The volume of shares traded in January 2002 increased by 50.3% to 2,415 while the average value per transaction declined by 39.6% to Ksh 56,503, thereby resulting in a decline of 9.3% in the value of shares traded compared with 10.3% decline in December 2001. Consequently, the value turnover, expressed as the ratio of Kenya shilling worth of shares traded to market capitalization declined by 11.8% to 0.15% in January 2002, compared with a decline of 10.5% in December 2001.

Foreign Investors Board

Trading at the Foreign Investors Board recorded a 93.5% decline in turnover, to Ksh 3.5m in January 2002 compared with 160.6% increase in December 2001. The counter recorded minimal sales to foreigners amounting to Ksh 170,779.

The Bond Market

Turnover at the bond market increased by 429% in January 2002 to Ksh 3.7bn, from Ksh 701m in December 2001, largely accounting for the improvement in turnover from Government bonds by 464% to Ksh 3.6bn. The average yield on traded bonds in January 2002 remained relatively stable for the third consecutive month, increasing by 1.6% in January 2002 to 11.32% from 11.14% in December 2001. The trend in the yield on bonds reflects that of the 91-day Treasury bill rate that averaged 10.6% in January 2002 from 10.9% in December 2001.

Economic Growth & Real Sector Activities

Introduction

Real GDP is estimated to have expanded by 0.8% in 2001 compared with 0.3% decline in 2000 (Table 25 and Chart 19). The improved economic activity was mainly due to favourable agricultural production, following good weather conditions. The increased earnings from the tourism sector, investment in telecommunications services and improved power supply during the year also contributed to the modest improvement in economic performance in 2001.

Agriculture

The agricultural sector is estimated to have recovered in real terms by an estimated 2.3% in 2001 as a result of

TABLE 25: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES

MAIN SECTORS	Share in Real GDP in 2000 (%)	Output in Ksh m 2000/[1]	Est. for 2001/[2]
Agriculture	**24.0**	24,813	25,372
Manufacturing	**13.1**	13,527	13,563
Building & Construction	**2.4**	2,492	2,453
Trade, Restaurants & Hotels	**12.7**	13,077	13,301
Transport, Storage & Comm.	**6.1**	6,326	6,512
Financial Services	**10.6**	10,945	11,127
Government Services	**14.7**	15,182	15,267
Others of which	**16.4**	16,995	16,635
Non-monetary Sector	*5.6*	*5,826*	*5,680*
Domestic Services	*2.9*	*2,990*	*2,942*
Ownership of Dwellings	*5.7*	*5,878*	*5,912*
Other	*2.2*	*2,301*	*2,171*
Est. Real GDP (1982 Prices)	100.0	**103,357**	**104,230**
Nominal GDP (at Factor cost)		**672,219**	
Overall GDP Deflator		**6.5**	
GDP at Mkt Prices		**788,917**	
MAIN SECTORS		**Annual Percentage Change**	
Agriculture		-2.4	2.3
Manufacturing		-1.5	0.3
Building & Construction		-1.5	-1.6
Trade, Restaurants & Hotels		1.0	1.7
Transport Storage & Comm.		2.0	2.9
Financial Services		0.4	1.7
Government Services		0.7	0.6
Others of which/[3]		0.7	-2.1
Non-monetary Sector		*1.2*	*-2.5*
Domestic Services		*2.4*	*-1.6*
Ownership of Dwellings		*1.4*	*0.6*
Other		*-4.5*	*-5.6*
Est. Growth Rate of Real GDP		**-0.3**	**0.8**
Growth of Nominal GDP		**5.5**	
Changes in GDP Deflator (inflation)		**5.6**	
Growth of GDP at Mkt Prices		**6.6**	

Notes

1 From the Economic Survey, 2001.

2 Estimates based on selected economic activities.

3 Includes forestry and fishing, mining and quarrying, electricity and water, and sectors less imputed bank charges

Sources: Central Bureau of Statistics and Central Bank of Kenya

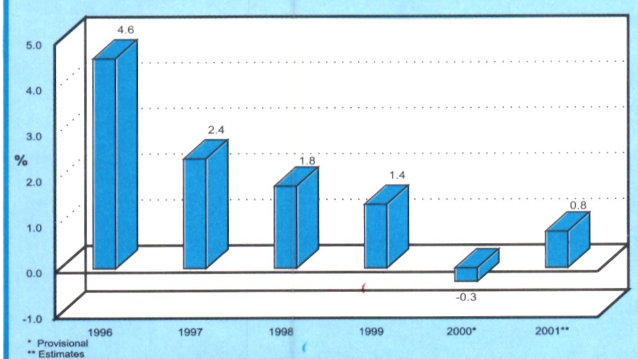


CHART 19: REAL GDP GROWTH RATES, 1996 - 2001

* Provisional
** Estimates
Sources: Economic Survey and Central Bank of Kenya

good weather conditions. Output of tea, horticulture, pyrethrum and sisal increased by 24.7%, 5.6%, 8.6% and 8.2% during the year compared with declines of 5.0%, 0.7%, 14.7% and 2.2%, respectively, in 2000. Food crop production also increased, leading to substantial declines in prices, with retail price of dry maize and beans declining by 38.6% and 0.6% respectively in November 2001 compared with the price in November 2000. However, in addition to declining international prices of major export crops, namely: tea and coffee, output of coffee and sugar cane declined by 43.5% and 29.3% in 2001 (Table 26).

TABLE 26: PRODUCTION OF MAJOR CROPS (TONNES)

Crop	2000	2001
Tea	236,286	294,633
Horticulture (exports)	98,210	103,667
Pyrethrum	4,509	4,899
Sisal	21,429	23,180
Coffee	98,030	54,553
Sugar cane	4,660,970	3,161,610
	% Changes	
Tea	-5.0	24.7
Horticulture (exports)	-0.7	5.6
Pyrethrum	-14.7	8.6
Sisal	-2.2	8.2
Coffee	52.5	-44.4
Sugar cane	4.2	-24.6

Sources: Central Bureau of Statistics, Pyrethrum Board of Kenya, Kenya Sugar Authority, Sisal Board of Kenya and HCDA

Manufacturing

Manufacturing activity improved in 2001 as indicated by the increased use of raw materials. Electricity consumption, the bulk of which is by industrial plants, increased by 10.9% in 2001 compared with a decline of 12.0% in 2000 (Table 27).

TABLE 27: CONSUMPTION OF ELECTRICITY AND FUELS

	2000	2001	% Changes
Total Fuels (mt)*	2,233	1,981	-11.3
Electricity Generation (kwh)	3,868	4,339	12.2
Electricity sales (kwh)	3,147	3,490	10.9

*January to November

Source: Central Bureau Statistics

Similarly, the value of imports of key intermediate products namely: chemicals and related products; crude materials; and machinery and transport equipment increased in dollar terms by 10.3%, 15.7% and 9.9%, respectively in the first ten months of 2001 (Table 28).

TABLE 28: IMPORTS OF INTERMEDIATE GOODS (US $ M)

	Jan-Oct 2000	Jan-Oct 2001	% Change
Chemicals Related Products	368	406	10.3
Crude Materials	70	81	15.7
Machinery & transport equip. *	585	643	9.9
Mineral fuels and lubricants	702	649	-7.5

*Excluding purchase of planes by Kenya Airways

Source: Customs Department

The low price of crude oil products also helped reduce the operating costs of many firms within the manufacturing sector. Activity was further enhanced in agro-based industries following increased supply of raw materials from agriculture. Recovery in industrial activity, however, continues to be constrained by reduced credit to the private sector, insecurity and the poor state of infrastructure, particularly roads. The production of selected manufactures is as shown in Table 29.

TABLE 29: PRODUCTION OF SELECTED MANUFACTURES (TONNES)

Item	2000 (Actual)	January - November 2001 (Provisional)
Galvanized sheets	128,256	135,242
Soft Drinks ('000 litres)	145,482	162,560
Soda Ash	215,990	269,320
Cement production	1,046,871	881,747
Assembled Vehicles (Units)	2,418	1,802
	% Changes	
Galvanized sheets	14.8	5.4
Soft Drinks	5.8	11.7
Soda Ash	-3.3	24.8
Cement production	-13.1	-15.8
Assembled Vehicles	-31.2	-25.5

Source: Central Bureau of Statistics

Trade, restaurants & hotels

Activity in the trade, restaurant and hotels picked up in the period under review. During the year, tourism earnings increased by 17.7% compared with a decline of 25.7% in 2000. In the same period, tourist arrivals increased by 14.4% compared with an increase of 15.3% in 2000.

Transport, storage and communications

Transport, storage and communications are estimated to have expanded by 2.9% in 2001 compared with a growth of 2% in 2000. The improvement in the sector is reflected by the 16.2% increase in non-container freight through the Mombasa port in 2001 compared with 11.5% increase in 2000. Similarly, mobile phone subscribers increased from 20,000 in June 2000 to 720,000 in February 2002. Cargo handled by the Kenya Railways, however, declined by 7.9% in 2001 compared with an increase of 7.2% in 2000.

Building and Construction

The building and construction sector remained weak for the second consecutive year, partly as a result of the high cost of credit and partly due to the persistent low level economic activity. As a result, the use of cement, a major input in the sector, declined by a further 9.6% in 2001 compared with a decline of 16.5% in 2000. Similarly, total plans approved by selected urban authorities declined by 3.9% during the same period.

Financial Services

The performance of the financial sector improved in 2001. Banking institutions posted pre-tax profits of Ksh 9.9bn in 2001 or 67.0% higher than Ksh 5.9bn earned in 2000. The increased profitability of the sector reflected the positive effects of the restructuring and provisioning for bad and doubtful debts undertaken since 1999. Provisions that had to be made for bad and doubtful debts in 2001 were 37.8% lower than the level made in 2000. Efficiency in the banking sector in 2001 was also demonstrated by 18.7% decline in expenses.

Outlook

Economic recovery is expected to continue into 2002, but at a much slower pace than earlier envisaged. Real GDP in 2002 is projected to grow by 1.4%, against 3.2% original expectation. The downward revision on real GDP growth for the year was necessitated by the continued high cost of production, the general slowdown in the global economy and the persistent low investor confidence on account of delayed restoration of external financial support and uncertainties characterising the run-up to the general elections.

REMARKS BY NAHASHON N. NYAGAH, GOVERNOR OF THE CENTRAL BANK OF KENYA, DURING THE LAW SOCIETY OF KENYA MONTHLY LUNCHEON HELD AT THE HOTEL INTERCONTINENTAL ON THURSDAY, FEBRUARY 28, 2002

1. It is indeed a pleasure and honour for me to be with you this afternoon to participate in this notable monthly event. I consider this a particularly important occasion as it affords me the opportunity to share with a distinguished gathering of the learned friends, my thoughts on a topical issue like ***'The Liberalization of the Banking Sector: Problems and Prospects'***.

2. **Ladies and Gentlemen,** I intend to present my remarks in four parts. **First,** I will focus on a brief review of Kenya's banking sector during the period prior to adopting the current reforms; **Second**, I will discuss the objectives and the key financial sector reforms that have been undertaken by the Kenya Government; **Third**, I shall try to make a fair assessment of how we have performed in achieving these objectives; and, **Finally**, I will outline some emerging issues and problems that we still have to address and thereafter, the way forward.

3. Let me start by briefly outlining the evolution of the banking sector in Kenya. At independence, Kenya inherited a relatively simple banking system comprising seven commercial banks and two non-bank financial institutions. These institutions were foreign owned and largely focused their attention on foreign trade financing and offered, if any, limited service to business enterprises owned by indigenous Kenyans. To channel bank credit to the neglected African businesses and thereby bring indigenous Kenyans into the economic mainstream, the Government adopted various interventionist measures, including the establishment of government-owned/controlled commercial banks, imposition of interest rate controls, introduction of mandatory lending to agriculture, and policies to promote establishment of privately owned local financial institutions.

4. It is in this context that the Government set up the National Bank of Kenya (1968), and the Kenya Commercial Bank (1970) after acquiring the business interest of Gridlays International Ltd. With regard to interest rates, the Government required the Central Bank to fix the minimum interest payable on savings deposits and maximum interest chargeable on bank loans. The

control of interest rates was justified, in the prevailing circumstances, in terms of promoting savings, encouraging investment by making credit affordable, and protecting small-scale businesses. In addition, banking institutions were directed to lend at least 17% of their deposits to the agricultural sector. This directive was intended to ensure that farmers, given the importance of agriculture in the Kenyan economy, accessed adequate credit from the banking sector.

5. Moreover, the Government adopted various policies that were intended to encourage the establishment of private locally-owned banking institutions, and, in particular, the type of financial institutions that have come to be known as non-bank financial institutions (NBFIs). **First**, the statutory minimum capital for non-bank financial institutions was set at a much lower level than that for commercial banks. **Second**, non-bank financial institutions were subject to less stringent prudential regulations than commercial banks. Moreover, unlike commercial banks, NBFIs were not required to maintain any minimum cash balances with the Central Bank. And they were allowed to freely determine their operational interest rates. Consequently, there was a proliferation of locally owned non-bank financial institutions in the 1980s.

6. **Ladies and Gentlemen,** the question we should ask ourselves is: How effective were those intervention and control measures in achieving their intended objectives? Yes, it is a fact that the two government-owned banks expanded and assumed a dominant place in the country's banking sector. However, even with this branch network expansion all over the country, empirical evidence indicates that the establishment of the state-owned banks only helped in mobilizing deposits from the rural areas whilst rural credit did not increase commensurately. Indeed, the banks were simply channeling funds from the rural to the urban areas.

7. With regard to control of interest rates, it became increasingly clear that the measure was adversely affecting savings and investment. **First**, deposit rates remained lower than inflation, thereby discouraging saving in form of financial instruments. **Second**, lending rates also remained below inflation thus making it less attractive for banks to lend. Indeed, because the direct control of interest rates made it difficult for banks to price risk, banks were reluctant to extend credit to the small-scale businesses because of the higher risk involved in lending to such enterprises. As a matter of fact, some commercial banks were circumventing the controls by levying other indirect charges and fees.

8. As concerns agricultural credit guidelines, they not only proved difficult to implement, but were also ineffective in promoting economic development. Banks appeared to achieve their target lending to agriculture on paper as many of them misreported their credit operations, either deliberately or through the influence of borrowers whose intention was not any way to use the loan proceeds for financing agriculture. Compounding the problem was the absence of penalties for non-compliance and the difficulties of having a watertight operational definition of agricultural credit. It is, therefore, doubtful that the mandatory lending to agriculture led to any improvement in credit availability to the farmers.

9. Let me say a few words on the policy of encouraging locally owned private financial institutions. Yes, there was a proliferation of such institutions in the late 1970s and early 1980s, but the problems associated with this growth came to the fore in mid-1980s when the banking system suffered its first crisis triggered by the collapse of one non-bank financial institution in 1984. The situation worsened in 1986 when another two locally- owned non-bank financial institutions and one commercial bank collapsed. Towards the end of the 1980s, it was clear that the system was plagued with a large number of insolvent institutions, many of which were locally owned. Inevitably, the general public lost confidence in the locally - owned financial institutions, thereby triggering a flight of savings back to the older and more established banks. It was obvious that the strategy of encouraging local interest in the banking sector was misguided and it did not, contrary to what would have been expected, improve access to banking facilities for the majority of the population.

10. **Ladies and Gentlemen,** it was against this background that the Kenya Government in the late 1980s adopted a comprehensive economic reform programme, of which one important element was the liberalization of the banking sector. The reform of the banking sector was aimed at strengthening the intermediation function of the banking institutions so that funds could be channeled efficiently from the savers to productive users of these financial resources. The financial reforms gathered momentum in the 1990s and targeted the following areas:

- Abolition of credit controls;
- Freeing up of interest rates (July 1991);
- Strengthening the legal supervisory framework and banking supervision

capacity;

- Restructuring of insolvent institutions — nine insolvent institutions were merged to form the Consolidated Bank of Kenya in 1989;

- Establishment of a deposit insurance fund to protect small savers;

- Government divestiture from the banking sector (GoK shares in KCB limited to 35% while in NBK to 22.5%);

- Strengthening of prudential regulations:

  - Raising of the minimum capital required to establish a bank;

  - Restriction of the amount any one person can borrow to 20% of core capital; for insider borrowers, and in particular Directors, their loans are now required to be approved by a full board and must be reported to the Central Bank;

  - Adoption of computer data system to enhance off-site surveillance and increased frequency of on-site inspections;

  - Institution of monetary penalties for non-compliance;

    - Adoption of universal banking in 1995; and,

    - Granting some limited autonomy to the Central Bank in 1996.

11. **Ladies and Gentlemen,** let me now say a few words on how we have faired so far particularly in the context of our financial stability objective. After going through a rough patch in the late 1980s and the first half of 1990s, we have seen the banking sector enjoy some degree of stability, particularly in the last three years — thanks to the reforms undertaken by the Government and the strict enforcement of prudential regulations by the Central Bank.

12. I would not like to give the impression that all has been well since the advent of the liberalization process in the banking sector. There still exist many difficult challenges in the sector that require to be addressed if the sector is to make any meaningful impact in the economy. The first problem, which is a major threat to the stability of the banking industry and which requires immediate attention in terms of both thought and action, is to resolve issues

pertaining to the escalating level of non-performing loans. A major factor that continues to make it difficult to resolve this problem pertains to the growing number of court injunctions that lead to delays in resolving commercial-related cases within a reasonable timeframe. On this particular aspect, may I take the liberty to appeal to you as the **learned men and women of the land** to come up with appropriate legal reforms that can help us to tidy up the enforcement of commercial contracts.

13. The second problem is lack of effective competition in the sector, in spite of the large number of banking institutions we have in the country. This problem is partly a result of the banking crisis that we experienced in the past that has eroded public confidence in small and fragile locally - owned banks. Also contributing to this problem is the persistently large Government borrowing requirement and the relatively higher return offered on government paper.

14. The third, and perhaps the most serious one, relates to the persistence of high real lending rates even when deposit rates are coming down with the rate of inflation. The consequence of this development has been the high interest spreads. This has led commentators on the performance of the Kenyan economy to rightly or wrongly, point their accusing finger to interest rates as one of the most significant contributory factors to the country's dismal economic performance. They hold the view that interest rates in Kenya are 'too high' to allow any meaningful investment to take place. This situation is, in their view, the reason why investment and growth have dropped to historically low levels. They, therefore, have welcomed the passage of the Central Bank of Kenya (Amendment) Act, 2000, arguing that regulating interest rates will provide the miracle we need to spur the urgently needed investment and growth. They contend that fixing interest rates at low levels will encourage the business community to expand its business undertakings as cheap credit becomes available.

15. This conclusion begs the question: Will the Central Bank (Amendment) Act, 2000 deliver to the Kenyan public what appears literally speaking, as a free lunch? Will the Act alone liberate Kenyans from the bondage of poverty? My considered answer to these questions is 'Not at all' and that what proponents of this Act say is pure conjecture. Why do I say this?

16. **Madam Chairperson**, while we share the concerns raised in respect to the 'high interest rate problem' and the likely adverse effect on the performance of our economy, we in the Central Bank do not consider, from both empirical

and theoretical basis, the regulation of interest rates as the right prescription to deal with the issue. I am surprised **Madam Chairperson** that some professionals have been supporting this approach. They fail to appreciate that the approach may precipitate passage of similar legislations aimed at controlling other sectors, including the legal sector. More importantly, they fail to appreciate that regulating interest rates contradicts the market-based policies that we have been implementing for some years now. Moreover, control of interest rates only addresses itself to the symptoms and not the causes of the interest rate problem.

17. What are the consequences of controlling interest rates? If we go ahead to implement control on interest rates, it will have the following serious adverse consequences on the economy:

- It will send out the wrong signals that the country is going back to the days of economic controls, and thereby **destroy investor confidence**. This will undermine the flow of investment particularly from the rest of the world.

- Banks will **discriminate against small-scale savers** because controls will force them to resort to increasing the minimum amounts that can earn interest or even increase other fees and charges.

- Controls will not allow for the pricing of risk by banks. Banks will, therefore, concentrate their attention on the relatively big businesses and **shut out small borrowers** whose loans involve higher risks and higher administrative costs, and indeed whose contributions to bank revenues is only 20% of the total revenue.

- The controls will restrict financial institutions from charging fees except those stipulated in the Act. The weaker institutions will most likely collapse and the stronger ones will consider other alternatives that may include **retrenchments and withdrawals from the rural areas** in a bid to cut down costs.

- The Act will **hinder the development of micro finance institutions** that provide support to small scale and informal enterprises because such institutions have to charge relatively higher interest rates due to the nature of their business.

- Controlled rates will **trigger capital flight** as banks and businesses with surplus funds seek alternative investments outside the country where they can earn a better return on their funds. The capital flight triggered by the controls will lead to **instability in the shilling exchange rate**. In turn, this will make Kenya less attractive as an investment destination – at a time that we are unable to attract adequate flows of foreign direct investments.

- Control of interest rates **will stifle medium and long term financing**. The restriction that interest earned on a loan should not exceed the principal amount will render mortgage finance companies and building societies inoperable.

18. As I indicated earlier, we in the Bank are equally concerned with the high **'interest rate problem'** in the country and are taking steps to address the issue. However, there are no quick fixes or instant prescriptions. Our strategy focuses on:

- Enhancing our supervision and surveillance of the industry to ensure that our banking institutions are sound so that Kenyans will feel confident to bank with any of the existing institutions. This way, we hope to promote effective competition that should lead banks to reduce their interest margins significantly.

- Pursuing in place other alternatives such as private–sector-based debt buy-back initiatives to help clean the balance sheets of banking institutions. Of course, this will require to be accompanied by appropriate legal reforms to strengthen, as I said earlier, enforcement of commercial contracts.

- Encourage the private sector, and particularly the Kenya Bankers Association, to establish credit reference bureaus, which, when fully operational, should help in reducing the size of bad loans.

- Continue to encourage banks to adopt appropriate Information Technology and Communication systems that facilitate the reduction of their operational costs.

- Continue to encourage the Government itself to balance its books. It is encouraging that the Government has indeed shown its commitment in the recent past months to reduce its domestic borrowing requirements.

19. **Ladies and Gentlemen,** in concluding my remarks, I would like to ask Kenyans to appreciate one thing: that the world today has become a global village and the era of government controls is over. Kenya is not an island on its own, and we cannot, therefore, expect to succeed by adopting policies that have been discarded the world-over. If we take just one wrong turn, the consequences are likely to be disastrous, as potential investors will not know how far we intend to go in the wrong direction. We have been forewarned. The choice is ours!!

20. With these remarks, I rest my case for a liberalized banking sector.

Balance Sheet of the Central Bank of Kenya

(Amounts in Ksh Millions)

	Jan 2001	Jan 2002	Movement
ASSETS	**145,636**	**147,100**	**1,464**
Foreign Exchange	71,396	81,334	9,938
Advances and Discounts to Banks	519	2,093	1,574
Investment in Government Securities	1,245	1,437	192
Government Accounts	46,920	39,600	-7,320
Overdraft to Government of Kenya	7,397	-	-7,397
Clearing Account	578	715	137
IMF funds onlent to Government	2,028	1,968	-60
Non-interest Bearing Government Debt	36,917	36,917	0
Debtors	2,557	1,881	-676
Retirement Benefit Asset	-	289	289
Property and Equipment	703	606	-97
Other Assets	22,296	19,860	-2,436
Revaluation Account	19,642	18,642	-1,000
Times Tower	2,654	1,218	-1,436
LIABILITIES	**145,636**	**147,100**	**1,464**
Currency in Circulation	47,731	50,055	2,324
Repo Bills	11,705	19,100	7,395
Deposits	72,338	70,439	-1,899
Government of Kenya	26,391	28,753	2,362
Commercial Banks			
Kenya	22,687	23,142	455
External	103	28	-75
Non -banks Financial Institutions	794	409	-385
IMF	12,054	9,757	-2,297
Other Public Entities and Project A/Cs	10,309	8,350	-1,959
Other Liabilities and Provisions	4,911	407	-4,504
Capital and Reserves	8,951	7,099	-1,852
Capital	1,500	1,500	0
General Reserve Fund	3,841	4,248	407
Period's Surplus	3,610	1,351	-2,259

Source: Central Bank of Kenya

Notes on the Balance Sheet

The following changes occurred in items of the balance sheet of the Central Bank between January 2001 and January 2002:

Assets

Foreign exchange increased by Ksh 9,938m to Ksh 81,334m from Ksh 71,396m mainly due to revaluation associated with the depreciation in the shilling exchange rate and purchase of foreign exchange from the interbank market.

Advances and discounts to commercial banks increased by Ksh 1,574m to Ksh 2,093m.

Government accounts decreased by Ksh 7,320m to Ksh 39,600m in January 2002 mainly on account of Ksh 7,397m repayment of overdraft facility.

Other assets, comprising Revaluation account and Times Tower, decreased by Ksh 2,436m to Ksh 19,860m.

Liabilities

Currency in circulation increased by Ksh 2,324m to Ksh 50,055m from Ksh 47,731m.

The stock of **repo bills** increased by Ksh 7,395m.

Deposits decreased by Ksh 1,899m to Ksh 70,439m due to a decrease in liabilities to IMF by Ksh 2,297m and projects accounts by Ksh 1,959m. Deposits of the Government of Kenya and commercial banks, however, increased by Ksh 2,362m and Ksh 455m, respectively.

Other liabilities and provisions decreased by Ksh 4,504m to Ksh 407m.

Capital and Reserves decreased by Ksh 1,852m to Ksh 7,099m in the year to January 2002, mainly due to Ksh 2,259m decrease in the period's surplus, which offset Ksh 407m increase in General Reserve Fund.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